
WHEN CHURCHES FAIL: THE DIOCESAN DEBTOR DILEMMAS*

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*“[T]he First Amendment does not provide a shield behind which a church may avoid liability for harm . . . arising from the alleged sexual assault or battery by one of its clergy”*¹

*“The Bankruptcy Act simply does not authorize a trustee to distribute other people’s property among a bankrupt’s creditors.”*²

I. INTRODUCTION

The road from defendant to debtor is often short, and the cases of the Catholic dioceses would appear to be no exceptions. Facing hundreds of millions of dollars in liability for priests’ sexual misconduct, dioceses in Washington, Arizona, and Oregon recently filed cases under Chapter 11 of the U.S. Bankruptcy Code.³ Other dioceses may soon follow

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1. Malicki v. Doe, 814 So. 2d 347, 351 (Fla. 2002).

2. Pearlman v. Reliance Ins. Co., 371 U.S. 132, 135–36 (1962).

3. Voluntary Petition, Comm. of Tort Litigants v. Catholic Diocese of Spokane (*In re Catholic Bishop*), No. 04-08822-PCW11 (Bankr. E.D. Wash. Dec. 6, 2004) [hereinafter Voluntary Petition, Spokane]; Voluntary Petition, *In re Roman Catholic Church of the Diocese of Tucson*, No. 04-04721

suit.⁴ Like the Dow Corning Corporation,⁵ the A.H. Robins Company,⁶ countless asbestos manufacturers,⁷ and other tortfeasors of recent memory,⁸ the dioceses seek to discharge—to reduce or eliminate—the claims against them.

(Bankr. D. Ariz. Sept. 20, 2004) [hereinafter, Voluntary Petition, Tucson]; Voluntary Petition, *In re Roman Catholic Archbishop*, No. 04-37154 (Bankr. D. Or. July 6, 2004) [hereinafter Voluntary Petition, Portland]. Information about all three cases, including links to the diocesan webpages, can be found at Bankruptcy Protection and the Sexual Abuse Crisis, <http://www.bishop-accountability.org/bankrupt/> (last visited Feb. 5, 2006). Several other dioceses, including those in Boston, Los Angeles, and Davenport, Iowa, have also indicated that bankruptcy may be in the offing. *See id.*

4. Dioceses and parishes continue to litigate and settle claims of sexual abuse. *See* Colleen Robledo, 2005 Catholic Church Sex Abuse Settlements (May 18, 2005), http://www.snapnetwork.org/legal_courts/2005_settlements.htm.

5. *See* Lindsey v. O'Brien, Tanski, Tanzer & Young Health Care Providers (*In re Dow Corning Corp.*), 86 F.3d 482, 485–87 (6th Cir. 1996) (providing the factual and procedural background of the breast implant litigation); *In re Dow Corning Corp.*, No. 95-20512, 1995 Bankr. LEXIS 1123 (E.D. Mich. Aug. 9, 1995) (discussing the Dow Corning bankruptcy, which resulted from litigation over breast implants). *See also* Marcus Cole, *Limiting Liability Through Bankruptcy*, 70 U. CIN. L. REV. 1245, 1271–74 (2002) (describing the *In re Dow Corning* case).

6. *Menard-Sanford v. Mabey (In re A.H. Robins Co.)*, 880 F.2d 694 (4th Cir. 1989); *A.H. Robins Co. v. Piccinin*, 788 F.2d 994 (4th Cir. 1986); Kenneth R. Feinberg, *The Dalkon Shield Claimants Trust*, 53 LAW & CONTEMP. PROBS. (AUTUMN) 79, 103–04 (1990); Georgene M. Vairo, *The Dalkon Shield Claimants Trust, and the Rhetoric of Mass Tort Claims Resolution*, 31 LOY. L.A. L. REV. 79, 129 (1997); Georgene M. Vairo, *The Dalkon Shield Claimants Trust: Paradigm Lost (or Found)?*, 61 FORDHAM L. REV. 617 (1992). *See generally* S. ELIZABETH GIBSON, CASE STUDIES OF MASS TORT LIMITED FUND CLASS ACTION SETTLEMENTS & BANKRUPTCY REORGANIZATIONS 187–217 (2000); RICHARD B. SOBOL, BENDING THE LAW: THE STORY OF THE DALKON SHIELD BANKRUPTCY (1991).

7. Scores, if not hundreds, of companies are affected by potential liability for asbestos exposure, and many have commenced bankruptcy cases to manage that liability. *See* STEPHEN J. CARROLL ET AL., RAND INST. FOR SOC. JUSTICE, ASBESTOS LITIGATION COSTS AND COMPENSATION: AN INTERIM REPORT, at vi–vii (2002) (estimating that by the end of 2000, 600,000 people had filed claims naming over 6000 companies as defendants, and \$54 billion had been spent on litigation); Richard L. Cupp, Jr., *Asbestos Litigation and Bankruptcy: A Case Study for Ad Hoc Public Policy Limitations on Joint and Several Liability*, 31 PEPP. L. REV. 203, 205 (2003); Michelle J. White, *Why the Asbestos Genie Won't Stay in the Bankruptcy Bottle*, 70 U. CIN. L. REV. 1319, 1322 (2002). *See also, e.g.,* Findley v. Blinken (*In re Joint E. & S. Dist. Asbestos Litig.*), 982 F.2d 721, 753 (2d Cir. 1992); *Kane v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 843 F.2d 636, 639 (2d Cir. 1988); *In re Armstrong World Indus. Inc.*, 320 B.R. 523 (D. Del. 2005).

8. Whether and to what extent bankruptcy should be the ultimate repository for mass tort liability is a subject of some debate. *See, e.g.,* Alan N. Resnick, *Bankruptcy as a Vehicle for Resolving Enterprise-Threatening Mass Tort Liability*, 148 U. PA. L. REV. 2045, 2048–49 (2000); Georgene Vairo, *Mass Torts Bankruptcies: The Who, the Why and the How*, 78 AM. BANKR. L.J. 93, 93–95 (2004) (describing the increased use of bankruptcy to resolve mass tort litigation and noting that “the courts have had mixed results in handling mass tort litigation”). *See generally* G. Marcus Cole, *A Calculus Without Consent: Mass Tort Bankruptcies, Future Claimants, and the Problem of Third Party Non-debtor “Discharge,”* 84 IOWA L. REV. 753 (1999); Edith H. Jones, *Rough Justice in Mass Future Claims: Should Bankruptcy Courts Direct Tort Reform?*, 76 TEX. L. REV. 1695, 1722 (1998) (urging Congress to enact “substantive or procedural tort reform” to govern the use of bankruptcy in mass tort cases).

As with most mass tort bankruptcies, these cases present a struggle between two sets of comparatively innocent parties: tort claimants (the victims of the sexual abuse) and other creditors, on the one hand, versus the parishioners, or church members, on the other. Unlike most bankruptcies, however, these cases present two dilemmas: one doctrinal and the other constitutional.

The doctrinal dilemma will force bankruptcy courts to choose between the bankruptcy rules that would ordinarily apply in a Chapter 11 case and exceptions imposed by religious liberty principles. The choice will be difficult, for at least three reasons. First, if a diocese were effectively shut down (because all assets were sold) over the objection of the diocese and parishioners, those parishioners, and perhaps the bishop, may credibly claim that this use of the Bankruptcy Code⁹ “substantially burdens” their exercise of religion under both the Religion Clauses of the First Amendment¹⁰ and statutory protections for religious actors.¹¹ Second, for a variety of complex reasons, the internal rules of the churches themselves (that is, canon law) may displace or modify state law rules on property and governance that would ordinarily apply in bankruptcy.¹² Third, use of some

9. 11 U.S.C. §§ 101–1330 (2000 & Supp. 2005). The Bankruptcy Code recently underwent a significant revision. Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11, 18 & 28 U.S.C.). By and large, the revision should not affect the issues discussed in this Article, with two related exceptions: Section 363(d) of the Bankruptcy Code has been amended to provide that the bankruptcy trustee may use, sell, or lease property out of the ordinary course only if “in accordance with applicable nonbankruptcy law that governs the transfer of property by a corporation or trust that is not a moneyed, business, or commercial corporation or trust.” 11 U.S.C. § 363(d) (Supp. 2005). Section 1129(a)(16) of the Bankruptcy Code has been added to provide a substantially similar rule where property is transferred in connection with confirmation of a plan of reorganization under Chapter 11. *Id.* § 1129(a)(16) (Supp. 2005). Unlikely as it may seem, if religious liberty rules are “applicable nonbankruptcy law” in the diocesan cases, they may condition or prevent sales of diocesan property.

These awkwardly drafted provisions would appear to be a response to the case *In re Bankruptcy Appeal of Allegheny Health, Education & Research Foundation*, 252 B.R. 309, 315 (W.D. Pa. 1999), where a nonprofit hospital chain used Chapter 11 to circumvent Pennsylvania law on asset sales. See Richard Levin & Alesia Ranney-Marinelli, *The Creeping Repeal of Chapter 11: The Significant Business Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 603, 643 (2005) (discussing the *Allegheny* case and noting that “[d]espite its obvious purpose, [revised] § 363(d)(1) is poorly drafted and could be read as applying to all debtors, although this would lead to absurd results”). If applicable, these amendments would apply to the pending diocesan cases, as they are effective as to all cases pending on or filed on or after April 20, 2005. 11 U.S.C. § 1221(d) (Supp. 2005).

10. The First Amendment provides that “Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof.” U.S. CONST. amend. I.

11. See, e.g., Religious Freedom Restoration Act (RFRA) of 1993, 42 U.S.C. §§ 2000bb–2000bb-4, held unconstitutional as to state law by *City of Boerne v. Flores*, 521 U.S. 507 (1997). See also *infra* Part IV.A.3.

12. See *infra* Parts III.B and IV.B.

of the more intrusive powers ordinarily available in bankruptcy cases, such as appointment of a Chapter 11 trustee, might violate the Establishment Clause by “entangling” state actors in church affairs.

But solving the doctrinal dilemma may create a second, constitutional dilemma. If bankruptcy courts do limit application of the Bankruptcy Code in favor of religious (for example, canon) law, creditors, including victims of sexual abuse, may argue that the Establishment Clause has been violated. Canon or other religious law should not, they would argue, give religious actors economic benefits not available to others that are similarly situated.¹³

So far, we have seen courts follow both horns of the dilemma. The bankruptcy court in the Spokane, Washington case, for example, recently dismissed the religious liberty concerns of parishioners, and declared that all parish assets were property of the bankruptcy estate.¹⁴ Although somewhat more solicitous of the religious liberty concerns of parishioners, the bankruptcy court in Portland also recently came to a similar decision.¹⁵ These decisions could be the first step toward forced sales of diocesan properties, including churches, cemeteries, schools, and hospitals.¹⁶ These decisions may not survive on appeal.¹⁷

The bankruptcy court in Tucson, Arizona, by contrast, recently confirmed a plan of reorganization for the diocese based, in part, on canon law.¹⁸ The plan treats the parishes as separate legal entities and “their”

13. See *infra* Part IV.C.

14. See *Comm. of Tort Litigants v. Catholic Diocese of Spokane (In re Catholic Bishop)*, 329 B.R. 304 (Bankr. E.D. Wash. 2005).

15. *Tort Claimants Comm. v. Roman Catholic Archbishop (In re Roman Catholic Archbishop) (Portland Property Decision)*, 335 B.R. 842 (Bankr. D. Or. 2005).

16. This has already occurred in Canada. The Diocese of St. George, Newfoundland, recently sought bankruptcy protection from more than \$40 million in claims. See Associated Press, *Diocese Seeks Protection; It's the First Canadian One to Make the Move in the Abuse Scandal*, RICH. TIMES DISPATCH, Mar. 20, 2005, at A19, available at 2005 WLNR 4470007. Thereafter, the Canadian Supreme Court held that parish property was part of the diocesan estate and could be sold over parishioners' objections. See Doug Struck, *Rising Anger over Church Sales*, HAMILTON SPECTATOR (Ont., Can.), June 29, 2005, at A13, available at 2005 WLNR 10197862.

17. The Spokane diocese has already appealed, see *Motion for Leave to Appeal and Notice of Appeal Transmittal to U.S. District Court, In re Catholic Bishop*, No. 04-08822-PCW11 (Bankr. E.D. Wash. Sept. 6, 2005), and the Portland Archdiocese may do so, as well. See News Release, Archdiocese of Portland in Or., Statement of the Archdiocese of Portland (Dec. 30, 2005), <http://www.archdpdx.org/newsrel/property-issues.html>.

18. Third Amended & Restated Disclosure Statement Regarding Plan of Reorganization Dated May 25, 2005 at 24–29, *In re Roman Catholic Church of the Diocese of Tucson*, No. 04-bk-04-04721-JMM (Bankr. D. Ariz. May 25, 2005) [hereinafter, Reorganization Plan, Tucson].

property as outside the reach of the bankruptcy estate.¹⁹ Although the court's confirmation of the plan might be construed as an "endorsement" of canon law, the Establishment Clause problem is tempered considerably by the consensual nature of the plan: creditors overwhelmingly chose the result, even if it ended up conferring on the church a benefit that bankruptcy law, alone, might not.²⁰ Although not a perfect result, it is probably about as good as these cases are likely to get.

These cases, and any others in which a religious entity goes into bankruptcy, present both an extraordinary challenge to the bankruptcy system, and a strong form of the tension embedded in the Religion Clauses generally.²¹ The latter problem, as many have observed, is that every free exercise accommodation potentially offends the Establishment Clause, at least as it has frequently been construed.²² Here, unlimited application of the Bankruptcy Code may violate the religious liberty rights of parishioners, but material accommodation of these rights may violate the Establishment Clause.

Fortunately, the Supreme Court has recognized that there are ways to ease this tension and the dilemmas it creates. As the Court observed in *Locke v. Davey*, there must be "play in the joints" between the two

19. *See id.*

20. I note that the Tucson plan was confirmed shortly before the bankruptcy court in the Spokane case announced its decision on property of the estate. Creditors who voted for the Tucson plan thus could not have known that another court was about to hold that unincorporated parishes could not hold property outside of the bankruptcy estate. Whether the timing mattered—that is, whether knowing that another court rejected canon law on the property question—will never be known.

21. *See Locke v. Davey*, 540 U.S. 712, 718 (2004) (asserting that "the Establishment Clause and the Free Exercise Clause[] are frequently in tension"); *Tilton v. Richardson*, 403 U.S. 672, 677 (1971) (noting the "internal tension in the First Amendment between the Establishment Clause and the Free Exercise Clause"); Sylvia Sohn Penneys, Casenote, *And Now for a Moment of Silence: Wallace v. Jaffree*, 39 U. MIAMI L. REV. 935, 940–41 (1985) (recognizing the potential tension between the two clauses if both were to be interpreted broadly). *See generally* Katie Hosford, Note, *The Search for a Distinct Religious-liberty Jurisprudence Under the Washington State Constitution*, 75 WASH. L. REV. 643, 644 (2000) (claiming that "free exercise and separation of church and state have the potential to lead to contradictory results").

22. *See, e.g.*, DANIEL A. FARBER, *THE FIRST AMENDMENT* 281 (1998) ("Just as the Free Exercise Clause seems to be saying to avoid burdening religion, the Establishment Clause seems to be telling us not to make any special deals for religious groups."); Michele Estrin Gilman, "Charitable Choice" and the Accountability Challenge: Reconciling the Need for Regulation with the First Amendment Religion Clauses, 55 VAND. L. REV. 799, 863 (2002) (discussing the tension between the Free Exercise and Establishment Clauses); Gregory P. Magarian, *How to Apply the Religious Freedom Restoration Act to Federal Law Without Violating the Constitution*, 99 MICH. L. REV. 1903, 1967–68, 1989 (2001) ("In the past, the jurisprudence of religious accommodation has been complicated by the often unstated imperative to balance free exercise against establishment concerns.").

clauses.²³ In this context, courts may find flexibility in at least two places they might not otherwise look.

First, the doctrinal dilemma created by the presence of meaningful religious liberty claims can, as Perry Dane has observed, be viewed and analyzed as a conflict-of-laws problem.²⁴ If we view the diocesan cases through a conflict-of-laws lens, the choice becomes more clear. For a variety of reasons, “forum law,” what I will call “ordinary bankruptcy law”—the Bankruptcy Code and state law unaltered by canon law or religious liberty principles—should presumptively apply. Few of the choice-influencing factors suggested by the *Restatement (Second) of Conflict of Laws* would be advanced by choosing anything other than generally applicable bankruptcy law.²⁵ It would be difficult, for example, to ensure uniformity if each religious debtor’s own religious rules governed its bankruptcy case. Moreover, since the dioceses—not the tort creditors—choose the fora, they presumably understand and accept the results that will flow from that choice.²⁶

But conflict-of-laws analysis also suggests ways to minimize the harms to religious actors likely to result from unrestrained use of bankruptcy law. Most important, a forum court, here the bankruptcy court, generally applies its own procedural rules, including rules on presumptions and burdens of proof. In these cases, courts would presumptively apply bankruptcy law, but parishioners, or the dioceses, could rebut that presumption as to particular matters by showing that subjecting core religious assets to the bankruptcy process substantially burdens the exercise

23. *Davey*, 540 U.S. at 718 (quoting *Walz v. Tax Comm’n*, 397 U.S. 664, 669 (1970)) (discussing First Amendment protections and pointing out that the two guarantees are often in conflict). See also *Walz*, 397 U.S. at 669 (“[W]e will not tolerate either governmentally established religion or governmental interference with religion. . . . [T]here is room for play in the joints . . . which will permit religious exercise to exist without sponsorship . . .”). In *Davey*, the Court upheld a Washington state tuition assistance program that excluded religious studies. *Davey*, 540 U.S. at 714–18, 725. See *infra* Part III.C.

24. Perry Dane, Note, *Religious Exemptions Under the Free Exercise Clause: A Model of Competing Authorities*, 90 YALE L.J. 350 (1980).

25. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6 (1971). See also *infra* Part V.A.

26. Indeed, an undercurrent in these cases is frustration with church attempts to argue “out of both sides of its mouth.” *Comm. of Tort Litigants v. Catholic Diocese of Spokane (In re Catholic Bishop)*, 329 B.R. 304, 319 (Bankr. E.D. Wash. 2005). Here, as discussed *infra* in notes 125–34 and accompanying text, the court was criticizing the apparent inconsistency of diocesan positions on church property. In prior litigation, the Spokane diocese had successfully argued that the parishes had no interest in diocesan property. See *id.* at 319–20 (noting that in *Munns v. Martin*, the diocese claimed, and the Supreme Court of Washington held, that the bishop owned the school). Now, of course, the diocese argues that they do. A response might be that this assumes the critical fact: was “forum law” the Bankruptcy Code, standing by itself, or as modified by religious liberty principles? I argue *infra* in Part V.A that the latter is an unlikely interpretation.

of their religion. The burden of proof could be increased or decreased, depending on the nature of the assets and the particular bankruptcy procedure in question. Conflict-of-laws principles give courts flexibility absent from the current doctrinal choices.

Conflict-of-laws doctrine and theory would not solve all problems, however. What, for example, should courts do with disputed “religion-marginal” assets, such as a portfolio of securities, the income from which supports core assets such as houses of worship? Here, a second body of doctrine and norms, arising from equity jurisprudence, might help. In prior work, I argued that equity can help to solve difficult religious liberty problems that pit religious actors against “third parties.”²⁷ Here, I develop the concept of “purposive equity”—equity designed to accomplish the policy goals of the bankruptcy system—which, I argue, can help courts balance the economic and noneconomic concerns in play in these cases.²⁸ Purposive equity may also help courts to craft specific remedies, such as liens and trusts, to protect the core religious rights of parishioners while also maximizing the bankruptcy estate and, therefore, the tort creditors’ recoveries.²⁹

I do not suggest that choice-of-law or equity doctrines in themselves will solve all of the problems presented by the diocesan (or other, similar) cases. Indeed, I offer them largely for instrumental—not adjudicative—purposes. I think they can produce a result that the parties themselves might consider second best, but which the settlement-inclined bankruptcy system might consider quite good: consensual resolutions negotiated by the parties.

27. See Jonathan C. Lipson, *On Balance: Religious Liberty and Third-party Harms*, 84 MINN. L. REV. 589, 665–70 (2000) [hereinafter Lipson, *On Balance*]. See also Jonathan C. Lipson, *First Principles and Fair Consideration: The Developing Clash Between the First Amendment and the Constructive Fraudulent Conveyance Laws*, 52 U. MIAMI L. REV. 247 (1997) [hereinafter Lipson, *First Principles*] (discussing application of the First Amendment to fraudulent conveyance law).

28. I use the term “purposive” in the sense Max Weber intended: as application of instrumental reasons, the orientation of social action toward a particular end. See, e.g., MAX WEBER, *THE THEORY OF SOCIAL AND ECONOMIC ORGANIZATION* 151 (Talcott Parsons ed., 1947) (defining “organization” as “a system of continuous purposive activity of a specified kind”). Cf. MAX WEBER ON LAW IN ECONOMY AND SOCIETY 74–75 (M. Rheinstein ed., E. Shils trans., Harvard Univ. Press 1954) (1925) (“New legal norms thus have two primary sources, viz., first, the standardization of certain consensual understandings, especially purposive agreements, which are made with increasing deliberateness by individuals who, aided by professional ‘counsel,’ thereby demarcate their respective spheres of interest . . .”). For a critical discussion of Weberian rationality in the religious liberty context, see Steven G. Gey, *Why Is Religion Special?: Reconsidering the Accommodation of Religion Under the Religion Clauses of the First Amendment*, 52 U. PITT. L. REV. 75, 175 (1990).

29. As discussed below, I am mindful of cases such as *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308 (1999), where the Supreme Court held that federal courts, a group which in this context may or may not include bankruptcy courts, are limited to the equitable powers that existed in 1789. I discuss *Grupo Mexicano* and its limits in Part V.B, *infra*.

This is because, if properly used, these doctrines can make the parties' more extreme positions prohibitively expensive to litigate. Conflict of laws and equity may not "solve" the diocesan debtor dilemmas, but may make fighting more costly than settlement.

I should also note what this Article is *not* about. This is not an attempt to exonerate the dioceses, to impugn the parishioners, or to minimize the harms suffered by the victims of priests' sexual abuse. The problem of sexual abuse in the Catholic Church is truly staggering. It is, as the recent Report of the Grand Jury on the Archdiocese of Philadelphia observed, "hard to comprehend or absorb the full extent of the malevolence and suffering visited on this community, under cover of the clerical collar, by powerful, respected, and rapacious priests."³⁰ It may be that other mechanisms of reconciliation and resolution would produce better results than those generated by our system. Indeed, a subsidiary theme developed in this Article is that our current thinking about bankruptcy fails to account for cases like those involving diocesan debtors.³¹

Nevertheless, we have the system we have. It has created extremely large monetary obligations and, in some cases, those obligations have become the problem of the bankruptcy courts. If the litigation positions of the parties are pushed to their extremes, as seems to be happening in some of these cases, courts will be forced to make untenable choices: to shutter the dioceses or to leave the victims with less, perhaps far less, than they would otherwise be entitled to. This Article is not a brief in favor of either extreme, but rather an attempt to generate a third way, a path out of the dilemmas these cases create.

This Article is also not strictly about the diocesan cases. Although unusual, they are not unique. The form and force of the problems they create will occur with increasing frequency in the future. There are other Catholic dioceses, and, for that matter, other religious institutions³² that have suffered from similar scandals and may therefore incur massive debts. Moreover, and more generally, as religious entities become increasingly enmeshed in everyday life, engaging in activities ranging from providing

30. Report of the Grand Jury at 12, *In re* County Investigating Grand Jury, No. 03-00-239 (C.P. Pa. Sept. 15, 2005). This report, along with supporting materials is available at Philadelphia District Attorney's Office, Grand Jury Report on the Sexual Abuse of Minors by Clergy, <http://www.philadelphiadistrictattorney.com/pages/1/index.htm> (last visited Feb. 6, 2006).

31. See *infra* Part III.A.

32. Examples are collected in Ira C. Lupu & Robert W. Tuttle, *Sexual Misconduct and Ecclesiastical Immunity*, 2004 BYU L. REV. 1789, 1793 n.13.

social services to running restaurants, they will inevitably incur debts.³³ When these debts exceed the debtors' abilities to pay, they will commence bankruptcy cases which will, in greater or lesser degrees, create the problems addressed here.

This Article proceeds in four major parts. Part II discusses the background of the diocesan cases as they have developed to date, highlighting the religious liberty disputes they have already presented. Part III surveys some of the major bankruptcy issues in these cases and distinguishes the potential results under bankruptcy and canon law. Part IV considers limitations on bankruptcy law that might be imposed by principles of religious liberty. It also develops the constitutional dilemma that would appear to flow from following either of the options presented by the doctrinal dilemma. Part V explores alternatives to these options—the “play in the joints”—including the application of conflict-of-laws doctrine and purposive equity.

II. THE DIOCESAN BANKRUPTCY CASES

The diocesan sex abuse cases have already received an extraordinary amount of coverage and warrant only a brief review here. The general focus thus far has been on the question of liability: should the dioceses be liable for the misconduct of their priests, and if so, on what theory?³⁴

Today, however, we know that many dioceses have become liable for the harms caused, whether by agreement or judgment.³⁵ This leaves only

33. As to the role that religious institutions play in social services, see IRA C. LUPU & ROBERT W. TUTTLE, *ROUNDTABLE ON RELIGION & SOC. WELFARE POLICY, THE STATE OF THE LAW 2004: PARTNERSHIPS BETWEEN GOVERNMENT AND FAITH-BASED ORGANIZATIONS* (2004). As to their commercial activities, see Lipson, *On Balance*, *supra* note 27, at 615–17.

34. Symposium issues of the *Brigham Young University Law Review* and the *Boston College Law Review* consider these questions in detail. See Conference, *Church Autonomy Conference*, 2004 *BYU L. REV.* 1093; Symposium, *The Impact of Clergy Sexual Misconduct Litigation on Religious Liberty*, 44 *B.C. L. REV.* 947 (2003). The factual background to the scandal can be found in archives maintained by The Poynter Institute and the National Catholic Reporter. See Abuse Tracker 2005B, <http://www.ncrnews.org/abuse> (last visited Feb. 6, 2006); Poynter Online—Abuse Tracker, *The Death of a Pope: Headlines from Around the World* (July 15, 2005), <http://poynter.org/column.asp?id=46>. A recent symposium issue of the *Seton Hall Legislative Journal* considers some of the bankruptcy issues raised by these cases. Symposium, *Bankruptcy in the Religious Non-profit Context*, 29 *SETON HALL LEGIS. J.* 341 (2005).

35. In addition to those discussed here, the Archdiocese of Boston settled its lawsuits for a total of \$85 million, which it is funding in part with proceeds from selling real estate. See, e.g., Michael Paulson & Steve Bailey, *BC Eyes Archdiocese Land; Loans for Church Seen*, *BOSTON GLOBE*, Dec. 5, 2003, at A1. Other settlements include dioceses in Connecticut and Illinois. See Associated Press, *Diocese to Pay \$21 Million for Sex Abuse*, *NEW HAVEN REG.*, Oct. 17, 2003 (reporting on the Connecticut Diocese settlement); Cathleen Falsani, *Chicago Archdiocese Settles 15 Sex Abuse Claims*

the question of remedy. Like many debtors, not all dioceses have, or believe they have, the assets to pay these obligations in full. Thus, some have gone into bankruptcy. Although they have developed in different ways and exhibit different dynamics, all three cases filed thus far illustrate the basic doctrinal and constitutional dilemmas about which laws should govern and what courts should do when the doctrinal alternatives are unacceptable.

A. PORTLAND, OREGON

The Diocese of Portland commenced its Chapter 11 case on July 6, 2004.³⁶ Facing claims of more than \$500 million for alleged sex abuse by priests and other employees, the archdiocese became the first in the country to seek bankruptcy protection.³⁷ At the time the diocese filed for bankruptcy, it had settled more than 130 sex abuse claims for over \$53 million.³⁸ The diocese also faced two jury trials where the plaintiffs sought more than \$155 million in damages.³⁹

The diocese's bankruptcy filings claimed nearly \$20 million in assets and \$373 million in liabilities.⁴⁰ The diocese did not, however, list parish assets worth nearly \$500 million as property of the estate.⁴¹ These assets included churches and schools, cemeteries, a priests' retirement fund, retreat centers, and a seminary education fund.⁴² Nor did the diocese include a money market account, a short-term cash account, an equity

for \$8 Million, CHI. SUN-TIMES, Oct. 3, 2003, at 8; Nancy Meersman, *Diocese Agrees to Pay \$6.5m to Settle Sex-abuse Cases*, UNION LEADER (Manchester, N.H.), May 23, 2003, at A1 (mentioning the Iowa Diocese settlement while reporting on a settlement in Manchester, New Hampshire); Todd Ruger, *Diocese Settlement Totals \$9M*, QUAD-CITY TIMES (Davenport, Iowa), Oct. 29, 2004 (reporting on the Iowa Diocese settlement).

36. See Voluntary Petition, Portland, *supra* note 3, at 4.

37. Jeff Wright, *Asset Fight Has Florence Church in a Fix*, REG.-GUARD (Eugene, Or.), Feb. 1, 2005, at A1.

38. Steve Woodward, *Church Sex-abuse Claims Rise*, OREGONIAN, May 9, 2005, at B1, available at 2005 WLNR 7337467.

39. Steve Woodward, *Portland Archdiocese Sex-abuse Claim Strategy Still in Limbo*, OREGONIAN, July 12, 2005, at A1, available at 2005 WLNR 10950025.

40. See Debtor's Bankruptcy Schedules & Statement of Financial Affairs, *In re Roman Catholic Archbishop*, No. 04-37154-elp11 (Bank. D. Or. July 30, 2004) (listing the assets the diocese claims as property of the estate).

41. See *id.* at Exhibit 14B (listing real property that the diocese claims to hold for use by other entities).

42. *Id.*

account, or a fixed income account as property of the estate.⁴³ The diocese claimed it merely held bare legal title to this real and personal property.⁴⁴

On August 11, 2004, a committee of tort claimants in the Portland case filed a complaint asking the bankruptcy court to declare that the disputed parish property is property of the estate.⁴⁵ The diocese responded that it holds the property for parishes and parishioners under the law of trusts, canon law, and other nonbankruptcy laws.⁴⁶ Moreover, the diocese argued, by adjudicating the complaint, the court would violate the First Amendment by, among other things, becoming “entangled” in interpreting religious law.⁴⁷

A committee of parishioners filed a motion to intervene in the property litigation, arguing that they had an interest because they used the property at issue on a daily basis.⁴⁸ The parishioners claimed that intervention should be granted because the tort claimants’ committee’s complaint sought to divest the parishioners and parishes of their interests in the disputed property.⁴⁹ Additionally, the court agreed with the committee of parishioners and granted their motion to intervene.⁵⁰ The court certified a reverse class of defendants that included all 390,000 parishioners, the parishes themselves, and anyone who had contributed to a parish or parish trust.⁵¹

On December 30, 2005, in a complex pair of rulings, Judge Perris ruled that the unincorporated parishes are not legally distinct from the archdiocese, that the archdiocese owns all parish property outright, and that any unrecorded interests in such property (that is, in favor of the parishes)

43. Complaint (Declaratory Judgment Re Property of the Estate) at 3, Tort Claimants Comm. v. Roman Catholic Archbishop (*In re Roman Catholic Archbishop*), No. 04-03292-elp (Bankr. D. Or. Aug. 11, 2004).

44. See Debtor’s Bankruptcy Schedules & Statement of Financial Affairs, *supra* note 40.

45. See Complaint, *supra* note 43, at 4.

46. Defendant’s Answer & Affirmative Defenses at 5, Tort Claimants Comm. v. Roman Catholic Archbishop (*In re Roman Catholic Archbishop*), No. 04-37154-elp11 (Bankr. D. Or. Sept. 27, 2004).

47. *Id.*

48. Comm. of Parishioners’ Reply to Responses to Motion to Intervene at 3, *In re Roman Catholic Archbishop*, No. 04-37154-elp11 (Bankr. D. Or. Mar. 7, 2005).

49. *Id.*

50. Order Granting Motion to Intervene at 2, Tort Claimants Comm. v. Roman Catholic Archbishop (*In re Roman Catholic Archbishop*), No. 04-37154-elp11 (Bankr. D. Or. Mar. 22, 2005).

51. Steve Woodward, *Archdiocese of Portland Parishes Will Join Dispute*, OREGONIAN, July 1, 2005, at E10, available at 2005 WLNR 10441678. See *Lay Catholics Included in Archdiocesan Bankruptcy Case*, CATH. WORLD NEWS, Aug. 2, 2005, <http://www.cwnews.com/news/viewstory.cfm?recnum=38762>.

are void in bankruptcy.⁵² Judge Perris indicated in dicta, however, that sales of some of this property may “substantially burden” the religious liberty rights of parishioners.⁵³

On November 15, 2005, even before resolution of the property-of-the-estate question, the debtor filed a plan of reorganization and disclosure statement.⁵⁴ According to news reports, the plan would pay tort claimants around \$42 million—double the \$21 million that would (according to the archdiocese) be available if parish property were excluded from the estate.⁵⁵ According to the disclosure statement, the plan would pay all current and future tort claimants in full, although the source of funds and some estimate of the amount of tort claims are not disclosed.⁵⁶ The plan had been filed shortly before the bankruptcy court had heard argument on the disposition of the parish property. The disclosure statement intimated that if the archdiocese ultimately loses the parish property litigation, the plan would offer only the lower amount, \$21 million.⁵⁷ As of this writing, neither the plan nor disclosure statement in the Portland case have received judicial approval.

B. SPOKANE, WASHINGTON

The Spokane diocese commenced its case on December 6, 2004,⁵⁸ after settlement talks with victims failed.⁵⁹ At the time it filed for bankruptcy, the diocese had spent approximately \$300,000 to settle six

52. Tort Claimants Comm. v. Roman Catholic Archbishop (*In re Roman Catholic Archbishop*) (*Portland Property Decision*), 335 B.R. 842, 867 (Bankr. D. Or. 2005); Tort Claimants Comm. v. Roman Catholic Archbishop (*In re Roman Catholic Archbishop*) (*Portland Avoidance Decision*), 335 B.R. 868, 889 (Bankr. D. Or. 2005).

53. See *Portland Property Decision*, 335 B.R. at 860–61.

54. Debtor’s Plan of Reorganization, *In re Roman Catholic Archbishop*, No. 04-37154-elp11 (Bankr. D. Or. Nov. 15, 2005); Disclosure Statement Regarding Debtor’s Plan of Reorganization, *In re Roman Catholic Archbishop*, No. 04-37154-elp11 (Bankr. D. Or. Nov. 15, 2005).

55. See *Victims Slam Archdiocese Bankruptcy Reorganization Plan*, E. OREGONIAN, Nov. 17, 2005.

56. See Disclosure Statement Regarding Debtor’s Plan of Reorganization, *supra* note 54, at 11–12 (providing that present and future tort claims will be paid one hundred percent, even though the amount of such claims is “To Be Determined by the Court”).

57. See *id.* at 13 (stating that “if the Court were to rule that the Parish property was not available to pay Claims, the Archdiocese would have little incentive to offer an amount that would be sufficient to pay all Claims in full as it has offered to do under the Plan”).

58. See Voluntary Petition, Spokane, *supra* note 3, at 2.

59. Virginia de Leon, *Bankruptcy for Diocese: Filing to Stop Sex Abuse Suits Won’t Close Schools*, SPOKESMAN-REVIEW.COM, Nov. 11, 2004, http://www.spokesmanreview.com/tools/story_pf.asp?ID=37129.

claims and faced nineteen pending lawsuits from fifty-eight plaintiffs.⁶⁰ The diocese listed an estimated \$11 million in assets as property of the estate.⁶¹ If, however, it had included property that it characterized as belonging to parishes, the estate would allegedly have totaled approximately \$80 million.⁶² The disputed parish property included churches, schools, and endowment and custodial funds.⁶³

Tort creditors filed two adversary proceedings, claiming that the disputed property should have been included as property of the estate.⁶⁴ They sought both a declaration that the disputed property was part of the bankruptcy estate⁶⁵ and substantive consolidation of the diocesan bankruptcy estate with the parishes that allegedly held the disputed property.⁶⁶

In late August 2005, the bankruptcy court ruled in favor of the tort claimants.⁶⁷ The diocese has appealed.⁶⁸ Among other arguments, the diocese claims that parish property should not be part of the estate, and that the bankruptcy court infringed the diocese's rights under the state and

60. *Id.*

61. See Nicholas K. Geranios, *Can Spokane Diocese Survive Bankruptcy?; Ruling May Expose More Assets to Abuse Settlements*, COLUMBIAN (Vancouver, Wash.), July 11, 2005, at C2, available at 2005 WLNR 10856379.

62. *See id.*

63. Complaint for Declaratory Relief & Substantive Consolidation at 6–13, Comm. of Tort Litigants v. Catholic Diocese of Spokane (*In re Catholic Diocese of Spokane*), No. 04-08822-PCW11 (Bankr. E.D. Wash. Feb. 4, 2005).

64. *See id.*; Complaint for Declaratory Judgment to Determine Property of the Estate, Shea v. Catholic Bishop (*In re Catholic Bishop*), No. 04-08822-PCW11 (Bankr. E.D. Wash. Dec. 22, 2004).

65. Complaint for Declaratory Relief & Substantive Consolidation, *supra* note 63, at 15; Complaint for Declaratory Judgment to Determine Property of the Estate, *supra* note 64, at 6–7.

66. Complaint for Declaratory Relief & Substantive Consolidation, *supra* note 63, at 14–15. Substantive consolidation would treat the separate legal entities of the parish and diocese as one for the purpose of determining assets and liabilities. The doctrine is described in detail *infra* in notes 154–68 and accompanying text.

67. *See* Comm. of Tort Litigants v. Catholic Diocese of Spokane (*In re Catholic Bishop*), 329 B.R. 304 (Bankr. E.D. Wash. 2005) (granting the claimants' motion for a determination that the disputed real property was part of the estate).

68. Notice of Appeal, Comm. of Tort Litigants v. Catholic Diocese of Spokane (*In re Catholic Bishop*), No. 04-08822-PCW-11 (Bankr. E.D. Wash. Sept. 6, 2005). At least part of the problem in the Spokane case may be the contentious relations among the parties. Among other things, the parties have attacked one another and their respective counsel, alleging duplication of efforts and, more seriously, that the bishop has breached his fiduciary duties to the bankruptcy estate by siding with parishioners on the property-of-the estate question. *See* Motion by Tort Claimants' Comm. to Restrict Use of Estate Property at 6–7, *In re Catholic Bishop*, No. 04-08822 (Bankr. E.D. Wash. Dec. 2, 2005).

federal constitutions, as well as the Religious Freedom Restoration Act (“RFRA”).⁶⁹

Like the Portland archdiocese, the Spokane diocese filed a plan of reorganization and disclosure statement without having resolved the property-of-the-estate question.⁷⁰ And, like the Portland plan, the Spokane plan met with little enthusiasm from tort claimants.⁷¹ Among other things, the plan—which was predicated on canon law, and apparently ignored the effect of the bankruptcy court’s ruling on the property of the estate—failed to indicate how much creditors would receive, or how the plan would be funded. As of this writing, neither the plan nor the disclosure statement in the Spokane case have received judicial approval.

C. TUCSON, ARIZONA

Even the most seemingly amicable of the cases, that of the Tucson diocese, wrestled with the dilemmas created by the conflict between bankruptcy and constitutional law. The Tucson diocese commenced its bankruptcy case on September 20, 2004, and was the first to confirm a reorganization plan.⁷² In 2002, the diocese settled eleven lawsuits involving sixteen plaintiffs.⁷³ Following the 2002 settlement, an additional thirty-four plaintiffs filed twenty-two lawsuits against the diocese.⁷⁴ When the diocese filed for bankruptcy, these twenty-two actions were pending,⁷⁵ and the Tucson diocese had spent approximately \$17 million on settlements and related costs.⁷⁶

In July 2005, the court approved the reorganization plan proposed by the diocese.⁷⁷ The claimants will receive from \$15,000 to \$600,000 each.⁷⁸ Parish assets were not included in the \$22.2 million that the diocese allotted

69. See Statement of Issues to Be Presented on Appeal ¶¶ 2, 9, 10, *In re Catholic Bishop*, No. 04-08822-PCW-11 (Bankr. E.D. Wash. Sept. 16, 2005).

70. Debtor’s Plan of Reorganization, *In re Catholic Bishop*, No. 04-08822-PCW-11 (Bankr. E.D. Wash. Oct. 10, 2005); Disclosure Statement Regarding Plan of Reorganization Dated October 10, 2005, *In re Catholic Bishop*, No. 04-08822-PCW-11 (Bankr. E.D. Wash. Oct. 10, 2005).

71. See *Spokane Diocese’s Plan No Cause for Rejoice*, 45 BCD NEWS & COMMENT (Oct. 25, 2005).

72. Voluntary Petition, Tucson, *supra* note 3; Reorganization Plan, Tucson, *supra* note 18, at 1.

73. Reorganization Plan, Tucson, *supra* note 18, at 44.

74. *Id.*

75. Stephanie Innes, *Diocese Claimants Handily OK Plan*, ARIZ. DAILY STAR, July 9, 2005, at B1, available at 2005 WLNR 11288111.

76. de Leon, *supra* note 59.

77. Sheryl Kornman, *Diocese to Pay \$10M Upfront as Plan OK’d*, TUCSON CITIZEN, July 12, 2005, at 1A.

78. Editorial, *Settlement in Diocese Case Bodes Well*, TUCSON CITIZEN, July 13, 2005, at 4B.

to pay sex abuse claims.⁷⁹ However, the plan required the parishes to contribute \$2 million to the settlement fund.⁸⁰ In addition, the plan required each parish to incorporate as an Arizona nonprofit corporation in order to take legal title to parish property.⁸¹

The Tucson plan and disclosure statement attempted to deal with the property of the estate question in two ways. First, the disclosure statement explicitly acknowledged that the plan was based in part on canon law:

[T]he Diocese [of Tucson] is a juridic person under Canon Law. Similarly, each Parish is a juridic person separate from the Diocese. A juridic person is an artificial person, distinct from all natural persons or material goods, constituted by competent ecclesiastical authority for an apostolic purpose, with a capacity for continuous existence and with canonical rights and duties like those of a natural person (*e.g.*, to own property, enter into contracts, sue or be sued).

As decreed by Canon Law, every diocese (which is itself a juridic person) is to be divided into distinct parts or Parishes. The establishment of Parishes is obligatory, not optional. A Parish is a certain community of the church members whose pastoral care is entrusted to a pastor under the authority of the diocesan bishop. Once a Parish has been established, it becomes a juridic person separate and distinct from the Diocese.⁸²

Second, and perhaps more instrumentally, the disclosure statement observed that it could take more than nine years to litigate these questions.⁸³ Thus, the diocese argued, and creditors apparently agreed,⁸⁴ that the plan was probably the best deal that the creditors could get. Because the Tucson plan was confirmed before the Spokane and Portland property decisions were issued, we do not know whether those decisions would have led the Tucson creditors to view the plan differently.

III. BANKRUPTCY POLICY AND PROCESS

Except to the extent that religious liberty rules and norms apply, the diocesan cases would, like most other bankruptcies, be governed by the

79. See Kornman, *supra* note 77, at 1A.

80. *Id.*

81. Reorganization Plan, Tucson, *supra* note 18, at 69. The bishop retained some control over the parishes. See *id.* at 70 (noting that the separately incorporated parishes will be governed by canon law).

82. *Id.* at 24 (internal citations omitted).

83. *Id.* at 30–31.

84. Eighty-four percent of seventy-six tort creditors, representing all but \$230,000 of the \$15.7 million owed, voted to accept the plan, with twelve percent voting to reject it. Innes, *supra* note 75, at B1.

U.S. Bankruptcy Code,⁸⁵ the paramount framework for resolving claims against a financially distressed debtor.⁸⁶ It is therefore useful to start by assessing the motives and mechanics of the bankruptcy system.

A. BANKRUPTCY POLICY

Bankruptcy is a subject unusually amenable to vigorous discussions about policy, process, and intellectual methodology.⁸⁷ Whether we should even have Chapter 11—the reorganization provisions invoked by the dioceses—has itself been debated with great heat, if not light.⁸⁸ From a doctrinal perspective, reorganization under Chapter 11 of the Bankruptcy Code is thought to embrace two sometimes competing goals: “preserving going concerns and maximizing property available to satisfy creditors.”⁸⁹

85. 11 U.S.C. §§ 101–1330 (2000 & Supp. 2005).

86. See NAT'L BANKR. REVIEW COMM'N, *BANKRUPTCY: THE NEXT TWENTY YEARS* 898–99 (1997) (explaining that a single forum and set of procedural rules ensures uniform treatment of every type of claimant).

87. The modern form of the debate was encapsulated in a dialogue between Elizabeth Warren and Douglas Baird. Compare Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775 (1987) (arguing that bankruptcy policy reflects normative and political judgments about the distribution of losses), with Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815 (1987) (arguing that bankruptcy reflects no inherent policy other than choices made by underlying laws on property, contract, and so forth).

88. Compare, e.g., Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1078 (1992) (“Chapter 11 should be repealed, abolishing court-supervised corporate reorganizations and, in effect, precluding residual claimants from participating in any reorganization of the firm.”), and Charles W. Mooney, Jr., *A Normative Theory of Bankruptcy Law: Bankruptcy as (Is) Civil Procedure*, 61 WASH. & LEE L. REV. 931, 934 (2004) (noting that “the core role of bankruptcy law [i]s the maximization of recoveries for those with nonbankruptcy legal entitlements relating to financially distressed debtors”), with, e.g., Elizabeth Warren, *Essay, Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 355 (1993) (“[T]he [Bankruptcy] Code carries out a deliberate distributional policy in favor of all those whom a business failure would have hurt. The choice to make bankruptcy ‘rehabilitative’ represents a desire to protect these parties along with the debtor and creditors who are more directly affected.”). Cf. Robert K. Rasmussen, *An Essay on Optimal Bankruptcy Rules and Social Justice*, 1994 U. ILL. L. REV. 1, 2 (“The debate over Chapter 11 reflects a division over which policies bankruptcy law should embrace.”).

Some already conclude that Chapter 11 as it has been understood is dead. See Douglas G. Baird & Robert K. Rasmussen, *Reply, Chapter 11 at Twilight*, 56 STAN. L. REV. 673 (2003); Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 753 (2002) [hereinafter Baird & Rasmussen, *The End*] (“To the extent we understand the law of corporate reorganizations as providing a collective forum in which creditors and their common debtor fashion a future for a firm that would otherwise be torn apart by financial distress, we may safely conclude that its era has come to an end.”). Cf. Elizabeth Warren & Jay Lawrence Westbrook, *Contracting Out of Bankruptcy: An Empirical Intervention*, 118 HARV. L. REV. 1197 (2005) (noting that in recent years, scholars have increasingly advocated replacing the current mandatory bankruptcy system with one based on contractual principles, and assessing the merits of such a system empirically).

89. *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 435 (1999). See also *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984) (“The fundamental purpose of

The problem here is that accomplishing the former may or may not be consistent with the latter.

From a more theoretical standpoint, bankruptcy policy discussions have been dominated by two general camps, and it is not clear that either can solve the diocesan debtor dilemmas.⁹⁰ On the one hand, there are the traditionalists or pragmatists, a loose collection of academics and practitioners who argue that bankruptcy embraces complex, “competing—and sometimes conflicting—values” and aspirations.⁹¹ Under this view, bankruptcy policy involves many different approaches to the basic question of how losses should be distributed. Losses may be distributed by agreement of the parties (for example, as in secured credit), by state law (for example, as in exemptions and lien laws), or by positive bankruptcy law (for example, as in special priorities built into the Bankruptcy Code protecting, *inter alia*, grain farmers and fisherman⁹²). Any number of competing values may lead Congress to enact a national bankruptcy law that distributes these losses. Courts should, according to traditionalists, have great flexibility in crafting bankruptcy rules and standards to address these values.

On the other hand, there are proceduralists who argue, in essence, that bankruptcy law should have little or no policy other than respecting nonbankruptcy entitlements.⁹³ This position derives from Thomas Jackson’s 1982 article on the “creditor’s bargain,” in which he argued that the proper way to view the bankruptcy system was from the perspective of the deal that creditors would have chosen for themselves had they been in a position to do so before the debtor’s bankruptcy.⁹⁴ Thus, “[t]he cornerstone of the creditor’s bargain is the normative claim that prebankruptcy entitlements should be impaired in bankruptcy only when necessary to

reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources.”)

90. See, e.g., Douglas G. Baird, Essay, *Bankruptcy’s Uncontested Axioms*, 108 YALE L.J. 573, 576 (1998) (“[T]here are two distinct camps. In the first are traditional bankruptcy lawyers and scholars . . .”).

91. See Warren, *supra* note 87, at 777.

92. See 11 U.S.C. § 507(a)(6) (2000 & Supp. 2005).

93. See Baird, *supra* note 90, at 576–77 (“The second group [in the bankruptcy policy debates] consists almost entirely of academics The group’s distinctive characteristic is its focus on procedure and its belief that a coherent bankruptcy law must recognize how it fits into both the rest of the legal system and a vibrant market economy.” (internal footnotes omitted)).

94. Thomas H. Jackson, *Bankruptcy, Non-bankruptcy Entitlements, and the Creditors’ Bargain*, 91 YALE L.J. 857 (1982).

maximize net asset distributions to the creditors as a group.”⁹⁵ Bankruptcy law should be viewed as nothing more than a procedural mechanism for solving the collective action problem that arises upon insolvency. It should not, therefore, import distributional goals and values that deviate from this model.

A central character in the creditors’ bargain is the “residual claimant.”⁹⁶ “[T]he optimal solution” to financial distress would, in the creditors’ bargain model, “vest decision making authority with the residual claimants, who gain or lose at the margin from the actions of the firm.”⁹⁷ Under a standard theory of priority, and assuming a solvent corporation, the residual claimants would be the holders of shares of the corporate debtor’s common stock, who are generally viewed as the most junior class of claimants. When the firm is in financial distress, however, the generalized theory of priority dictates that some higher, prior claimant—for example, the unsecured creditor—assumes this status.⁹⁸ This claimant, having the most at stake economically, should, under the creditors’ bargain model, control the bankruptcy process.⁹⁹ Thus, rather than give the debtor’s management, known as the “debtor in possession,” control of the process, creditors of some sort should call the shots.

95. Thomas H. Jackson & Robert E. Scott, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors’ Bargain*, 75 VA. L. REV. 155, 155 (1989). This is an “enhanced” version of the bargain model, one which attempted to respond to some of its critics. In its original, strong form, Thomas Jackson argued that any deviation from prebankruptcy entitlements would be both inefficient and offensive to the hypothetical bargain that creditors would strike *ex ante*. See Jackson, *supra* note 94, at 87 (“The creditors’ bargain model, then, provides a satisfying theoretical explanation of why bankruptcy law should make a fundamental decision to honor negotiated non-bankruptcy entitlements.”). Others who have embraced this model include Douglas Baird and Barry Adler. See Barry E. Adler, *Bankruptcy and Risk Allocation*, 77 CORNELL L. REV. 439 (1992); Baird, *supra* note 87.

96. See Douglas G. Baird & Thomas H. Jackson, *Bargaining After the Fall and the Contours of the Absolute Priority Rule*, 55 U. CHI. L. REV. 738, 775 (1988) (“[T]he law of corporate reorganizations should focus on identifying the residual owner, limiting agency problems in representing the residual owner, and making sure that the residual owner has control over the negotiations that the firm must make while it is restructuring.”).

97. George G. Triantis & Ronald J. Daniels, *The Role of Debt in Interactive Corporate Governance*, 83 CAL. L. REV. 1073, 1100 (1995).

98. See Jonathan C. Lipson, *Directors’ Duties to Creditors: Power Imbalance and the Financially Distressed Corporation*, 50 UCLA L. REV. 1189, 1229 (2003). Proceduralists might argue that control rights should vest not strictly according to priority, but instead according to contract. Thus, Douglas Baird and Robert Rasmussen write, “A debt contract may give a lender the right to put a person on the board of directors in the case of financial distress.” Baird & Rasmussen, *The End*, *supra* note 88, at 779. The absence of contract in any meaningful sense in the diocesan cases is one of many features that renders this conception of bankruptcy policy incomplete.

99. See Stephen J. Lubben, *The “New and Improved” Chapter 11*, 93 KY. L.J. 839, 845–48 (2004) (discussing the conceptions of control rights). Cf. Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795, 859–60 (2004) (discussing the problems with residual claimant control).

Needless to say, like the creditors' bargain model generally, the existence and virtues of the residual claimant have been hotly debated. A number of writers have observed that it would be difficult, if not impossible, to ascertain at any given point in time who among the debtor's constituents may be the residual claimant.¹⁰⁰ Some valuation of the debtor would be required, and this would not necessarily be a cheap or useful undertaking.¹⁰¹ Valuations can change during a case; would the identity of the residual claimant then also change? And merely answering the question of who the residual claimant is does not necessarily answer more difficult questions about what rights the residual claimant should have, and to what extent those rights should be able to capture value that might otherwise flow to other claimants.¹⁰²

The creditors' bargain model presents interesting challenges for the diocesan cases because it is not entirely clear who the "residual" claimant would be, or whether we would necessarily want that claimant to exercise control in the ordinary way. Is the residual claimant supposed to be the Vatican? If one views the diocesan debtors as akin to for-profit business corporations, then that might make sense when the debtor is solvent.¹⁰³ When the diocesan debtor is insolvent, however, things become more complicated. On a standard theory of priority, creditors would become the residual claimants. Yet, the reorganization process gives them little immediate control over the reorganization of the debtor or the distribution

100. See Lubben, *supra* note 99, at 856 ("Determining which creditor is at the bottom of the heap at any given time is a difficult exercise that does not lend itself to ex ante contracting, as asset values may change daily . . .").

101. See, e.g., Lynn M. LoPucki, *The Myth of the Residual Owner: An Empirical Study*, 82 WASH. U. L.Q. 1341, 1345 (2004) ("To identify the residual owner presumably would require valuation of the firm. . . . Yet, valuation is notoriously expensive and difficult." (internal footnotes omitted)).

102. A number of writers have jumped from the observation that a residual claimant exists to the conclusion that such a claimant would prefer a market to a judicial solution. See, e.g., Barry E. Adler, *Finance's Theoretical Divide and the Proper Role of Insolvency Rules*, 67 S. CAL. L. REV. 1107, 1116 (1994) (arguing that ex ante contracts may be a superior alternative to judicially imposed rules of absolute priority); Frank H. Easterbrook, *Is Corporate Bankruptcy Efficient?*, 27 J. FIN. ECON. 411, 416 (1990) ("[H]ow does a judge identify the residual claimant when there are several layers of debt? To do this the judge must know the firm's value—yet the superiority of market over judicial processes in pricing the firm's assets is the impetus for holding an auction.").

103. Indeed, this analogy has been offered by the tort creditors in the Spokane case. See *Comm. of Tort Litigants v. Catholic Diocese of Spokane (In re Catholic Bishop)*, 329 B.R. 304, 330 (Bankr. E.D. Wash. 2005) (analogizing the parishes to operating divisions of a large corporation). The court in the Portland property decision used a similar analogy, determining that the parishes could not be beneficiaries of trusts formed under canon law or Oregon's corporation sole statute. See *Tort Claimants Comm. v. Roman Catholic Archbishop (In re Roman Catholic Archbishop) (Portland Property Decision)*, 335 B.R. 842, 867 (Bankr. D. Or. 2005) ("There is no authority to which the parties direct me or of which I am aware . . . that would allow a division of a corporation . . . to be a beneficiary of a trust.").

of its assets; that control remains in the debtor's management (for example, the bishop). While that could change under certain circumstances, discussed further below,¹⁰⁴ it leaves unanswered larger prudential questions about whether tort creditors should control the church. Nor do we know how to account for the parishioners. Are they equivalent to the "customers" of the corporation? If so, would they have breach of warranty or similar claims in the event the church failed to perform (because, for example, it was sold to pay tort claims)?

The various elements of the creditors' bargain model, from its assumptions,¹⁰⁵ to its method and logic,¹⁰⁶ have, not surprisingly, been hotly contested. No elegant theory has yet been proposed to supplant it, however. The best we have been able to do is to develop important empirical insights into what actually occurs when businesses become financially distressed,¹⁰⁷ and to make tentative stabs at incorporating alternative theories. Donald Korobkin, for example, has urged that bankruptcy involves more than "mere property."¹⁰⁸ Rather, bankruptcy "provides a forum in which competing and various interests and values accompanying financial distress may be expressed and sometimes recognized."¹⁰⁹ It thus offers discourse that is "radical and far-reaching" because "it is a medium by which the enterprise's moral, political, social and economic aims are defined and redefined."¹¹⁰

104. See *infra* Part III.B.2.

105. See, e.g., Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 827 (1985) (noting that Jackson and other proponents of the creditors' bargain model "assume that every creditor—apparently including asbestos victims and other tort claimants . . .—will have full information and competent legal advice in dealing with the debtor," and that such proponents "assume further that every creditor will make the same assumptions they do and bring to bear their same highly skilled free market economic analysis . . . I do not find their approach helpful . . .").

106. See generally David Gray Carlson, *Philosophy in Bankruptcy*, 85 MICH. L. REV. 1341 (1987) (reviewing THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* (1986), and strongly criticizing the creditors' bargain model on which Jackson's work heavily relies). David Gray Carlson asserts that "at his best, Jackson rises to mere tautology. Beyond that, Jackson entangles himself in unreconciled contradictions and depends upon factual assertions that no one could accept as true." *Id.* at 1342.

107. See, e.g., Lynn M. LoPucki & William C. Whitford, *Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 141 U. PA. L. REV. 669 (1993); Warren & Westbrook, *supra* note 88.

108. Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717, 745 (1991).

109. *Id.* at 766.

110. *Id.* at 772.

Although this broader vision of bankruptcy has its critics,¹¹¹ it too poses interesting questions for the diocesan cases. If Korobkin is correct that bankruptcy is a process to manage conflicting “moral” and “political” aims, the dioceses may appear to be in the right place. The bankruptcy process may, on this analysis, be well-equipped to manage the special normative problems these cases present. Yet, how that would play out is not clear. On the one hand, it might provide a theoretical justification for recognizing religious liberty accommodations to parishioners and perhaps the dioceses, themselves. On the other hand, it might encourage courts to look beyond the notional amount of the tort creditors’ claims, to the underlying harms they have suffered. It might be viewed as a basis for treating a bankruptcy court as something akin to a commission of truth and reconciliation.

Ultimately, the diocesan cases press the limits of these theoretical models. The proceduralists may tell us to allocate losses in bankruptcy according to prebankruptcy entitlements. But they cannot tell us how to select among those entitlements, especially when (as we shall see) they may conflict for reasons having little to do with bankruptcy law. Nor would a pragmatic or normatively inclined program solve the diocesan dilemmas. It is easy to imagine that both parishioners and tort claimants present strong and legitimate moral, political, and social claims. To date, no bankruptcy theory offers a meaningful way to select among these claims. In short, although the competing camps in the bankruptcy policy debate have much to say about the traditional, for-profit business debtor, it is less clear whether any school can tell us how to solve the exceedingly difficult cases presented by the diocesan debtors.¹¹²

B. BANKRUPTCY PROCESS

Given the limited utility of existing bankruptcy policy and theory, we should perhaps consider the concrete disputes that have arisen, or are likely to arise, and how they would be addressed if ordinary bankruptcy rules applied. Disputes can arise at virtually any point during the bankruptcy process. Practically speaking, the two most important types of disputes—

111. See James W. Bowers, *Whither What Hits the Fan?: Murphy’s Law, Bankruptcy Theory, and the Elementary Economics of Loss Distribution*, 26 GA. L. REV. 27, 72 (1991) (noting Donald Korobkin’s claim that Baird and Jackson’s work lacks “rehabilitative discourse,” which really amounts to “talk that makes somebody feel better” (quoting Korobkin, *supra* note 108, at 766–68)).

112. See David A. Skeel, Jr., “Sovereignty” *Issues and the Church Bankruptcy Cases*, 29 SETON HALL J. LEGIS. 345, 346 (2005) (stating that “church bankruptcy is uncharted waters for a bankruptcy process that is designed with ordinary business in mind”).

the ones that raise the greatest religious liberty stakes—will involve attempts to sell property against the bishop's will and to wrest control of the diocese from the bishop. Procedurally, these disputes will develop as challenges to (1) the determination of what is included in the property of the bankruptcy estate, (2) diocesan management of the bankruptcy estates, and (3) the resolution of the cases.¹¹³

1. Property of the Estate

The commencement of a bankruptcy case creates an estate “comprised of . . . all legal or equitable interests of the debtor in property as of the commencement of the [bankruptcy] case.”¹¹⁴ Absent some important countervailing concern, perhaps including religious liberty, bankruptcy courts generally look to state law to determine what constitutes property for this purpose.¹¹⁵ As is often the case with property problems, the basic questions under state law involve identity and governance:¹¹⁶ who, or what, is the debtor whose property composes the estate in question, and who controls that property? In the diocesan cases, these questions are complicated both by religious liberty doctrine, which is discussed in greater detail in Part IV, and by the presence of trusts and trust-like relationships that may arise under state and canon law.

a. Who, or What, Is the Debtor?

Although we typically think of bankruptcy as involving business and individual debtors, nothing in the Bankruptcy Code prevents religious organizations from commencing cases under Chapter 11.¹¹⁷ The problem here is that we do not know exactly how to view the dioceses in the pending cases. All three dioceses that have filed for bankruptcy are organized as “corporations sole.” As such, they resemble traditional,

113. Religious liberty concerns might also challenge other aspects of these cases. There may, for example, be a claim that the cases were not commenced in good faith. Indeed, depending on how one resolves the governance questions, one might argue that the bishops required, but lacked, authority to commence these cases from the Vatican.

114. 11 U.S.C. § 541(a)(1) (2000 & Supp. 2005).

115. See, e.g., *Raleigh v. Ill. Dep't of Revenue*, 530 U.S. 15, 16 (2000) (noting that “[t]he basic federal rule of bankruptcy is that state law governs the substance of claims”); *Butner v. United States*, 440 U.S. 48, 55 (1979) (asserting that “[p]roperty interests are created and defined by state law”).

116. See, e.g., Henry E. Smith, *Exclusion Versus Governance: Two Strategies for Delineating Property Rights*, 31 J. LEGAL. STUD. 453, 457 (2002).

117. Section 109(a) of the Bankruptcy Code provides that “only a person that resides or has a domicile, a place of business, or property in the United States . . . may be a debtor under this title.” 11 U.S.C. § 109(a) (2000 & Supp. 2005). The Code defines a debtor as a “person . . . concerning which a case under [the Bankruptcy Code] has been commenced,” *id.* § 101(13), and defines “person” to include “[an] individual, partnership, and corporation.” *Id.* § 101(41).

single-member, not-for-profit corporations.¹¹⁸ Thus, for example, their agents are not generally liable for their debts; they may own, sell, and encumber property; and they may sue and be sued. Each is, as Paul Kauper and Stephen Ellis have observed, “exactly what [the] name implies—a one-man corporation.”¹¹⁹

The first question, then, is simply whether the parishes are legally distinct from the corporations sole. If canon law applied, it appears that they would be. Canon law provides that parishes are “separate juridic persons” that own property independently of the diocese.¹²⁰ Canon 1256 provides that if property is actually owned by the parish, and not the diocese, the diocese has no interest in it because the parish and diocese are considered legally distinct (“juridic”) persons.¹²¹ The “ownership over goods,” Canon 1256 provides, “belongs to that juridic person which has acquired them legitimately.”¹²² According to canon commentary, this means that “property legitimately acquired by a parish . . . is owned by the parish, not by the diocese.”¹²³ Thus, the dioceses in the current bankruptcy cases have all argued that parish property is not diocesan property and should therefore not be part of the bankruptcy estates.¹²⁴

The dioceses face two hurdles on the entity question: one procedural and the other substantive. Procedurally, these and other dioceses have previously argued the opposite of the position they now take, specifically, that the parishes have no independent identity and no interest in diocesan property. In the Spokane case, for example, Judge Williams held that the diocese was “judicially estopped” from asserting that the individual

118. Most states authorize the formation of a corporation sole and the vesting of decisionmaking authority in the head of the religious organization in question. *See, e.g.*, ARIZ. REV. STAT. ANN. § 10-11901 (2001); OR. REV. STAT. § 65.067 (2003); WASH. REV. CODE ANN. § 24.12.010 (West 2005).

119. Paul G. Kauper & Stephen C. Ellis, *Religious Corporations and the Law*, 71 MICH. L. REV. 1500, 1540 (1973). The corporation sole “envisages the incorporation of an office, with corporate privileges granted to the individual lawfully holding the office.” *Id.*

120. Commentary to Canon 1255 provides that “juridic persons include parishes, religious institutes and their provinces and houses, societies of apostolic life, secular institutes, seminaries, episcopal conferences, and, if so erected by decree of competent authority . . . hospitals, and other health-care and charitable institutions.” *See* THE CANON LAW SOC’Y OF AM., NEW COMMENTARY ON THE CODE OF CANON LAW 1456 (John P. Beal, James A. Coriden & Thomas J. Green eds., 2000) [hereinafter NEW CANON COMMENTARY].

121. 1983 CODE c.1256; 1983 CODE c.515, § 3 (“A legitimately erected parish has juridic personality by the law itself.”).

122. 1983 CODE c.1256.

123. NEW CANON COMMENTARY, *supra* note 120, at 1457.

124. *See supra* Part II.

parishioners owned the disputed property.¹²⁵ In prior litigation, *Munns v. Martin*, the diocese had asserted that it and not the parishes owned certain property.¹²⁶ The dispute was actually between the diocese and certain parishioners, known as the Munns group, which sought to prevent the diocese from obtaining a permit to demolish the St. Patrick's School in Walla Walla, Washington.¹²⁷ According to the bankruptcy court, the diocese repeatedly claimed that it, through the bishop, owned the property in question.¹²⁸ The Supreme Court of Washington agreed with the diocese.¹²⁹

Indeed, other dioceses have argued both frequently and successfully that the parishes are not separate entities, and that they own no property. In *St. Peter's Roman Catholic Parish v. Urban Redevelopment Authority*, for example, the bishop of the Diocese of Pittsburgh struck a deal with the Urban Redevelopment Authority of Pittsburgh that certain parishioners did not like: in exchange for a damage award from the authority of approximately \$1.24 million, the bishop agreed to permit the Authority to condemn and demolish St. Peter's Roman Catholic Church, which was located in a blighted section of town.¹³⁰ Despite the fact that St. Peter's Church may have been "an ecclesiastical monument of rare and priceless beauty,"¹³¹ the church's parishioners had no standing to sue the Authority because the bishop "own[ed] the property, in trust for the parish, and [he] alone [could] dispose of it in accordance with the canons of the Roman Catholic Church."¹³² Although it disposed of the case on procedural grounds, the court also noted that, at least under Pennsylvania law, "a member of a parish has no property right in his membership or any property right in church property save as a member," and that a member's rights are "governed by the laws of his denomination."¹³³ Because, under canon law, a diocese has the right to "extinguish" a parish, the court

125. *Comm. of Tort Litigants v. Catholic Diocese of Spokane (In re Catholic Bishop)*, 329 B.R. 304, 318–20 (Bankr. E.D. Wash. 2005).

126. *See Munns v. Martin*, 930 P.2d 318, 319–20 (Wash. 1997) (en banc).

127. *Id.* at 319.

128. *In re Catholic Bishop*, 329 B.R. at 319–20 (quoting the diocese's contention that "[t]he BISHOP OF SPOKANE, not THE MUNNS GROUP, owns the St. Patrick's school building in question. THE MUNNS GROUP have no proprietary interest, and are not in any way owners of the building in question").

129. *See Munns*, 930 P.2d at 319 & n.1.

130. *St. Peter's Roman Catholic Parish v. Urban Redev. Auth.*, 146 A.2d 724, 725 (Pa. 1958).

131. *Id.* at 728 (Musmanno, J., concurring).

132. *Id.* at 726 (majority opinion).

133. *Id.*

reasoned that “[i]f a parish can be extinguished, a church building can be razed.”¹³⁴

These cases are not limited to disputes about the disposition of real property. In *F.E.L. Publications, Ltd. v. Catholic Bishop*, for example, the Seventh Circuit concluded that where a diocese was organized as a corporation sole, a parish had no distinct legal interest in copyrighted music.¹³⁵ There, a religious music publisher sued the bishop of Chicago, claiming that parishes were using its copyright-protected sheet music without a license. The plaintiff, F.E.L., won a damage award for both compensatory losses and also prevailed on a claim for tortious interference with contract by the bishop.¹³⁶ The publisher claimed that the tortious interference stemmed from the bishop’s decision to instruct parishes to refrain from using F.E.L.’s sheet music.¹³⁷ On appeal, the bishop argued that because the diocese was organized as a corporation sole under Illinois law, the parishes had no separate legal existence.¹³⁸ The Seventh Circuit agreed, reasoning that “the parishes within the Archdiocese are not legal entities separate and independent from the Catholic Bishop, but are subsumed under the Catholic Bishop.”¹³⁹ Because “a party cannot be liable in tort for interfering with its own contract,” the court concluded that no tortious interference had occurred.¹⁴⁰

From a substantive standpoint, bankruptcy courts appear unmoved by claims that parishes within a corporation sole should have independent legal status, at least as a matter of state law. In the Portland case, for example, the debtor and parishioners argued that canon law compelled the

134. *Id.* See also *St. Matthew’s Slovak Roman Catholic Congregation v. Wuerl*, 106 Fed. App’x 761, 767 (3d Cir. 2004) (holding that “Pennsylvania courts do not recognize the right of an unincorporated association of former parishioners to sue under Pennsylvania law on behalf of their suppressed parish”); *EEOC v. St. Francis Xavier Parochial Sch.*, 77 F. Supp. 2d 71, 75 (D.D.C. 1999) (holding, in the context of a claimed violation of the Americans with Disabilities Act, that “the Church and the School[] are part of the Parish, which itself is part of the larger Archdiocese. Because neither defendant is separately incorporated, defendants are in fact unincorporated divisions of a corporation.”).

135. See *F.E.L. Publ’ns, Ltd. v. Catholic Bishop*, 754 F.2d 216, 221 (7th Cir. 1985).

136. *Id.* at 222.

137. *Id.* at 218.

138. *Id.* at 220–21.

139. *Id.* at 221.

140. *Id.* (citing *Fuller v. Chi. Coll. of Osteopathic Med.*, 719 F.2d 1326, 1334 (7th Cir. 1983); *DP Serv., Inc. v. AM Int’l*, 508 F. Supp. 162, 167–68 (N.D. Ill. 1981)). Interestingly, the plaintiff also based its tortious interference claim on the fact that the bishop had instructed other dioceses, as well as its parishes, to refrain from using F.E.L.’s sheet music. Without discussion, the court of appeals observed that “[t]he various Roman Catholic dioceses in the United States function as independent entities.” *Id.* at 222. Thus, it concluded that “this part of F.E.L.’s tortious interference claim is not infirm.” *Id.*

court to recognize the legal existence of the 124 parishes, only one of which was actually separately incorporated at civil law.¹⁴¹ They made this argument based in part on an Oregon statute which, they claimed, incorporated canon law by reference.¹⁴² This statute, like others that enable the creation of corporations sole, provides that “[a]ny individual may, in conformity with the Constitution, canons, rules, regulations and disciplines of any church or religious denomination, form a corporation hereunder to be a corporation sole.”¹⁴³

The court rejected the claim that this effectively meant that Oregon law incorporated by reference canon law on parish identity. While the statute may obligate the archbishop to apply canon law in governing the archdiocese, Judge Perris reasoned, it “does not mean that this court is also required to apply and be bound by that internal church doctrine in deciding the purely secular matter of property interests under the Bankruptcy Code and state law.”¹⁴⁴ Rather, she noted, “unincorporated religious associations are not legal persons that may take title to real property in their names. . . . They are not separate from, but are merely part of debtor.”¹⁴⁵

Modern corporation sole statutes, like those at issue in the Portland and Spokane cases, grow out of a long history of struggle between church hierarchy and parishioners over diocesan assets.¹⁴⁶ Although today most states recognize corporations sole and their right to hold church property, this was not always the case. In the United States in the nineteenth century, both the laity and non-Catholics sought to reduce the power of the church hierarchy over parishioners “since it was feared that, with its hierarchical control, it would accumulate wealth and power incompatible with the American idea of democracy.”¹⁴⁷ In Pennsylvania, for example, control of church property had to be vested in lay members of a congregation, not in

141. Tort Claimants Comm. v. Roman Catholic Archbishop (*In re Roman Catholic Archbishop*) (*Portland Property Decision*), 335 B.R. 842, 854 (Bankr. D. Or. 2005).

142. *Id.* at 855 (citing OR. REV. STAT. § 65.067(1) (2003)).

143. *Id.*

144. *Id.* at 857. The bankruptcy court in the Spokane case came to a substantially similar conclusion based on a similar statute. *See* Comm. of Tort Litigants v. Catholic Diocese of Spokane (*In re Catholic Bishop*), 329 B.R. 304, 326 (Bankr. E.D. Wash. 2005).

145. *Portland Property Decision*, 335 B.R. 842 at 866.

146. *Cf.* Kauper & Ellis, *supra* note 119, at 1500 (citing the edict of Constantine as a “decisive event in the history of Christianity” because it “recognized the validity of bequests to the Catholic Church, thereby enabling the Church in its corporate capacity to receive, hold, and accumulate property”).

147. *Id.* at 1536.

the bishop.¹⁴⁸ Yet the church was eventually able to prevail upon state legislatures to permit the formation of corporations sole precisely so that the hierarchy could control diocesan property.

Commentators and church-watchers have long understood that the corporation sole qua entity creates liability problems. “[T]he corporation sole is viewed . . . as highly undesirable from the viewpoint of liability,” canon commentary explains, because it exposes “all parochial and other church-related assets within a diocese to satisfy creditors’ claims against any individual parish or institution.”¹⁴⁹ Jill Manny has thus urged that dioceses separately incorporate the parishes and other, related organizations.¹⁵⁰ “If properly structured,” she observes, “the incorporation of each organization will limit the liability of the individual parishes and diocese by reducing their exposure to the actions and negligence of parish employees, volunteers, and associated parties.”¹⁵¹ Among bankruptcy lawyers, this is sometimes referred to, euphemistically, as “bankruptcy planning.” It is usually tolerated, although bankruptcy professionals and commentators tend to hold their noses when discussing the subject.¹⁵² Yet

148. *Id.* at 1524 (asserting that “[w]hensoever any property . . . shall hereafter be bequeathed, devised or conveyed to any ecclesiastical corporation . . . the same shall not be otherwise taken and held, or inure, than subject to the control and disposition of the lay-members of such church” (quoting 2 PA. DIGEST OF LAWS 1860 (12th ed. 1895) (codified as amended 10 PA. STAT. ANN. § 81 (West 1965)))).

149. NEW CANON COMMENTARY, *supra* note 120, at 1457 (noting that “[diocesan] control of all church property within a diocese is contrary to the law of the Church”).

150. Jill S. Manny, *Governance Issues for Non-profit Religious Organizations*, 40 CATH. LAW. 1, 1–2 (2000).

151. *Id.*

152. The propriety of bankruptcy planning is often debated in the context of converting nonexempt assets into exempt assets. In the classic case, a debtor from a state other than Florida puts all assets into a homestead in Florida which, due to its unlimited exemption, means that the house, now the debtor’s sole valuable asset, will be outside the reach of creditors or a bankruptcy trustee. For general discussions of the bankruptcy planning problem and its ethical implications see, for example, William Houston Brown, *Political and Ethical Considerations of Exemption Limitations: The “Opt-out” as Child of the First and Parent of the Second*, 71 AM. BANKR. L.J. 149 (1997); Theodore Eisenberg, *Bankruptcy Law in Perspective*, 28 UCLA L. REV. 953 (1981); J.T. Hardin, *Bankruptcy Planning: Risks of Converting Nonexempt Property to Exempt Property on the Eve of Bankruptcy*, 12 OKLA. CITY U. L. REV. 279 (1987); Steven L. Harris, *A Reply to Theodore Eisenberg’s Bankruptcy Law in Perspective*, 30 UCLA L. REV. 327 (1982); Lawrence Ponoroff, *Exemption Limitations: A Tale of Two Solutions*, 71 AM. BANKR. L.J. 221 (1997); Lawrence Ponoroff & F. Stephen Knippenberg, *Debtors Who Convert Their Assets on the Eve of Bankruptcy: Villains or Victims of the Fresh Start?*, 70 N.Y.U. L. REV. 235 (1995); Alan N. Resnick, *Prudent Planning or Fraudulent Transfer? The Use of Nonexempt Assets to Purchase or Improve Exempt Property on the Eve of Bankruptcy*, 31 RUTGERS L. REV. 615 (1978); Lloyd D. Cowell, Jr., Comment, *The Debtor and Conversion of Nonexempt Assets to Exempt Assets on the Eve of Bankruptcy: Astute Bankruptcy Estate Planning or Fraud?*, 18 CAP. U. L. REV. 567 (1989); Leslie A. Shames, Comment, *Calling a Fraud a Fraud: Why Congress Should Not Adopt a Uniform Cap on Homestead Exemptions*, 16 BANKR. DEV. J. 191 (1999).

the dioceses in the current cases appear not to have heeded Manny's advice, and have retained their traditional structure, despite the availability of corporate forms that would insulate parish assets from liability.¹⁵³

Enabling statutes, like those that create corporations sole, force courts to walk a fine line. On the one hand, they appear to exist to enable religious entities to enjoy the benefits of corporate status, just as other, nonreligious entities do (for example, limited liability and perpetual existence). On the other hand, and as the archdiocese in Portland has (thus far unsuccessfully) argued, they may to some extent incorporate into state law religious governance rules of particular sects (for example, canon law). To what extent is, of course, the most important question. Bankruptcy courts in the cases commenced to date would appear inclined to eschew religious governance rules in determining the effect that those rules might have on third parties. Whether this resolution of this portion of the diocesan dilemmas stands on appeal (or in other cases) remains to be seen.

b. Substantive Consolidation

Even if a bankruptcy court accepted the diocesan position that the parishes are legally distinct from the dioceses, there remains another weapon in the bankruptcy arsenal that could operate to bring parish property into the estate: substantive consolidation. Substantive consolidation is a remedial power bankruptcy courts occasionally invoke to merge the assets and liabilities of allegedly separate corporate entities. It "treats separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities (save for interentity liabilities, which are erased). The result is that claims of creditors against separate debtors morph to claims against the consolidated survivor."¹⁵⁴

Substantive consolidation is a power with no obvious statutory locus. Instead, courts use section 105 of the Bankruptcy Code, which provides that the court "may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title,"¹⁵⁵ as well as a fairly small body of case law, beginning with *Sampsell v. Imperial Paper & Color Corp.*¹⁵⁶

153. Interestingly, an important provision of the Tucson plan was the separate incorporation of parishes and the "proper" allocation of "their" property. Reorganization Plan, Tucson, *supra* note 18, at 69.

154. *In re Owens Corning*, 419 F.3d 195, 205 (3d Cir. 2005) (quoting *Genesis Health Ventures, Inc. v. Stapleton (In re Genesis Health Ventures, Inc.)*, 402 F.3d 416, 423 (3d Cir. 2005)).

155. 11 U.S.C. § 105(a) (2000 & Supp. 2005).

156. *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 218 (1941) (observing, in recognizing the rights of trustees to consolidate the assets and liabilities of the debtor and the debtor's

A variety of standards have been developed to determine when substantive consolidation might be appropriate. Some courts have reasoned that the proponent of a substantive consolidation must show (1) “substantial identity between the entities to be consolidated,” and (2) that “consolidation is necessary to avoid some harm or to realize some benefit.”¹⁵⁷ The Second Circuit developed a similar, but somewhat simpler, test in the *Augie/Restivo* case, under which substantive consolidation may be granted if (1) “creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit,” or (2) “the affairs of the debtors are so entangled that consolidation will benefit all creditors.”¹⁵⁸ This test appears to be alternative, not conjunctive.¹⁵⁹ The *Augie/Restivo* test has subsequently been adopted by the Ninth Circuit, where the Portland and Spokane cases are pending.¹⁶⁰

The most elaborate expression about substantive consolidation comes from the Third Circuit’s recent opinion in the *Owens Corning* bankruptcy:

In our Court what must be proven (absent consent) concerning the entities for whom substantive consolidation is sought is that (i) prepetition they disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity, or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors.¹⁶¹

Substantive consolidation is an equitable determination, which creates questions about its viability. In *Grupo Mexicano de Desarrollo S.A. v. Alliance Bond Fund, Inc.*, the U.S. Supreme Court held that federal courts have only those equitable powers which existed in English Chancery Courts in 1789.¹⁶² While the *Grupo Mexicano* decision did not address the issue of substantive consolidation, and therefore did not expressly reverse the *Sampsell* decision, it is not clear whether the remedy survives. Some

corporation, that “[m]ere legal paraphernalia will not suffice to transform into a substantial adverse claimant a corporation whose affairs are so closely assimilated to the affairs of the dominant stockholder that in substance it is little more than his corporate pocket”).

157. *Eastgroup Props. v. S. Motel Ass’n*, 935 F.2d 245, 249 (11th Cir. 1991); *Drabkin v. Midland-Ross Corp.* (*In re Auto-Train Corp.*), 810 F.2d 270, 276 (D.C. Cir. 1987).

158. *Union Sav. Bank v. Augie/Restivo Baking Co.* (*In re Augie/Restivo Baking Co.*), 860 F.2d 515, 518 (2d Cir. 1988) (internal quotation marks and citation omitted).

159. *See, e.g., In re Standard Brands Paint Co.*, 154 B.R. 563, 572 (Bankr. C.D. Cal. 1993) (“The two prongs of the *Augie/Restivo* test are in the alternative.”).

160. *See In re Bonham*, 229 F.3d 750, 766 (9th Cir. 2000).

161. *In re Owens Corning*, 419 F.3d 195, 211 (3d Cir. 2005) (internal footnotes omitted).

162. *See Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308, 318–19 (1999).

claim that it was not a power of the 1789 English Court of Chancery, and is therefore today *ultra vires*.¹⁶³ Others, however, are more circumspect.¹⁶⁴

In the diocesan cases, tort claimants may argue that, even if separate, this well-established bankruptcy doctrine should apply to merge the allegedly independent debtors and their parishes. In support of these claims, the creditors might quote a 2002 issue of the Catholic magazine, *America*:

Since a diocese is a large, complex and independent entity, it is also reasonable to expect “creative” accounting in the church records. There may very well be assets that are “off the books,” known only to the bishop. Pastors sometimes engage in bookkeeping strategies of their own in dealing with the diocesan administration.¹⁶⁵

Substantive consolidation has been threatened in the Spokane case. The committee of tort litigants in that case has filed a complaint alleging that the parishes are “mere instrumentalities” of the diocese without a separate legal existence.¹⁶⁶ The complaint further asserts that the diocese’s affairs are entangled with the parishes, and that the creditors would benefit from substantive consolidation.¹⁶⁷ The complaint alleges that significant time and expense would be required “to unscramble” the entanglement, and that without consolidation, it will be impossible to identify and allocate assets accurately.¹⁶⁸ If, however, the court’s ruling on the property of the estate stands on appeal, the substantive consolidation motion would become moot.

163. See J. Maxwell Tucker, *Grupo Mexicano and the Death of Substantive Consolidation*, 8 AM. BANKR. INST. L. REV. 427, 442–45 (2000).

164. Bankruptcy courts themselves would appear not to be daunted by *Grupo Mexicano*. In *In re American HomePatient, Inc.*, 298 B.R. 152 (Bankr. M.D. Tenn. 2003), for example, the court expressly held that *Grupo Mexicano* was no bar to substantive consolidation due, in part, to the long lineage of the remedy. See *id.* at 164–65. Writers have also questioned *Grupo Mexicano*’s power to disable substantive consolidation. See Robert B. Chapman, *Coverture and Cooperation: The Firm, the Market, and the Substantive Consolidation of Married Debtors*, 17 BANKR. DEV. J. 105, 144 n.183 (2000) (“It is far from clear . . . that English courts before 1789 lacked authority to treat an aggregate of participants in an endeavor as an entity.”). See also Frederick Pollock, *Has the Common Law Received the Fiction Theory of Corporations?*, 27 L.Q.R. 219, 232 (1911). Compare *Inhabitants of Stockbridge v. Inhabitants of W. Stockbridge*, 12 Mass. 400 (1815), and *State v. Helmes*, 3 N.J.L. 1050 (N.J. 1813), with *Greene v. Dennis*, 6 Conn. 292 (1826), and *Trustees of Phila. Baptist Ass’n v. Hart’s Ex’rs*, 17 U.S. 1 (1819), overruled by *Vidal v. Girard’s Ex’rs*, 43 U.S. 127 (1844). I discuss the *Grupo Mexicano* problem in Part V.B, *infra*.

165. Fred J. Naffziger, *A New Chapter*, AMERICA, Oct. 21, 2002, available at <http://www.americamagazine.org/gettext.cfm?textID=2553&articleTypeID=1&issueID=408>.

166. Complaint for Declaratory Relief & Substantive Consolidation, *supra* note 63, at 14.

167. *Id.*

168. *Id.* at 15.

c. What Is the Debtor's Property?

A third class of issues involving property of the estates in these cases is created by the alleged presence of trusts for the benefit of parishioners. Both the *Restatement (Second) of Trusts* and the *Restatement (Third) of Trusts* recognize that an unincorporated association (for example, an unincorporated parish) has the capacity to be the beneficiary of a trust even when it does not otherwise have legal existence.¹⁶⁹ Since ordinary bankruptcy law respects properly formed trusts, the estate would have no beneficial interest in trust property if the diocese itself had none, and such property would thus be beyond the reach of creditors.¹⁷⁰ Congress, the Supreme Court has observed, “plainly excluded property of others held by the debtor in trust at the time of the filing of the petition.”¹⁷¹

As with the entity question, the dominant inquiry would then become whether the trust was effective under state law. In the Spokane case, the diocese and parishioners argued that Washington's corporation sole statute created a trust for the benefit of parishioners.¹⁷² Among other things, the

169. RESTATEMENT (THIRD) OF TRUSTS § 43 (2003); RESTATEMENT (SECOND) OF TRUSTS § 119 (1959). Oregon and Washington both recognize that unincorporated associations may be beneficiaries of a trust. The Supreme Court of Oregon has held that because “[m]ere voluntary associations . . . cannot take the title to real property in their society name, . . . it may be held for their use and benefit by trustees, and their right to the enjoyment of the property be secured in that way.” *Liggett v. Ladd*, 21 P. 133, 135–36 (Or. 1888). Similarly, in *Good Samaritan Hospital & Medical Center v. United States National Bank*, 425 P.2d 541 (Or. 1986), the Supreme Court of Oregon stated, “It is well recognized that a valid charitable trust may be created where the beneficiary is an association with varying membership whose purposes are charitable.” *Id.* at 543. In *Leslie v. Midgate Center, Inc.*, 436 P.2d 201 (Wash. 1967), the Supreme Court of Washington noted that while an unincorporated association was not a legal entity at common law, its members could be beneficiaries of a trust. *Id.* at 205.

170. Section 541(d) of the Bankruptcy Code provides that [p]roperty in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold. 11 U.S.C. § 541(d) (2000 & Supp. 2005). See *Stevenson v. J.C. Bradford & Co. (In re Cannon)*, 277 F.3d 838 (6th Cir. 2002); *Foothill Capital Corp. v. Clare's Food Mkt., Inc. (In re Coupon Clearing Serv., Inc.)*, 113 F.3d 1091 (9th Cir. 1997); *Marrs-Winn Co. v. Giberson Elec., Inc. (In re Marrs-Winn Co.)*, 103 F.3d 584 (7th Cir. 1996). See also H.R. Rep. No. 95-595, at 368 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6324; *id.* at 176 (“[A] trust is protected from creditors under applicable State law.”); S. Rep. No. 95-989, at 82 (1977), reprinted in 1978 U.S.C.C.A.N. 5787; Daniel J. McCarthy, *Avoiding the Bankruptcy Code's Ratable Distribution Scheme: A Purported Creditor May Be a Beneficiary of an Express, Implied, or Statutory Trust*, L.A. LAW., June 2004, at 17.

171. *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 n.10 (1983).

172. *Comm. of Tort Litigants v. Catholic Diocese of Spokane (In re Catholic Bishop)*, 329 B.R. 304, 325–26 (Bankr. E.D. Wash. 2005) (citing WASH. REV. CODE § 24.12.040 (2005)).

Revised Code of Washington provides that “[a]ll property held in such official capacity by such bishop, overseer or presiding elder, as the case may be, shall be in trust for the use, purpose, benefit and behoof of his religious denomination, society or church.”¹⁷³ Judge Williams rejected this argument, reasoning that

[t]he statute does not designate any particular beneficiary but merely identifies the nature or character of the possible beneficiaries. The beneficiary must be a religious organization. The statute does not establish a trust for any specific religious organization or for a congregation or a synod or parish or any component or subgroup or member of any religious organization. Religious organizations vary considerably in their structure and organization. The statute is neutral and allows the religious organization itself to determine the nature of any trust established. The statute allows the natural person, the Bishop, to hold property in trust for the religious organization, the corporation sole. This is the plain meaning of the statute.¹⁷⁴

The court in the Portland case also rejected a claim that the diocese held property in trust for the parishes. Although the court recognized that unincorporated associations may be the beneficiaries of trusts, the court apparently held that no such trusts could be found in these cases:

There is no authority to which the parties direct me or of which I am aware . . . that would allow a division of a corporation or a unit or part of a legal entity to be a beneficiary of a trust. It is one thing to hold that an independent unincorporated association has the capacity to be the beneficiary of a trust. It is quite another to hold that a corporation can hold property in trust for a unit or part of itself.¹⁷⁵

Courts have occasionally held that church property might be held in an implied trust created by religious law. In *Mannix v. Purcell*, for example, the Diocese of Cincinnati narrowly avoided forfeiting diocesan assets to satisfy personal debts of the bishop.¹⁷⁶ There, the bishop, Purcell, assumed his brother’s liabilities. He was, however, unable to pay them and assigned to Mannix, for the benefit of creditors, “all his property which could at law or in equity, be subjected to such payment, expressly excepting all property held by him in trust.”¹⁷⁷ The question then, was whether parish property, which was titled in the bishop’s name, was held in trust for the

173. WASH. REV. CODE § 24.12.030 (2005).

174. *In re Catholic Bishop*, 329 B.R. at 326.

175. Tort Claimants Comm. v. Roman Catholic Archbishop (*In re Roman Catholic Archbishop*) (*Portland Property Decision*), 335 B.R. 842, 867 (Bankr. D. Or. 2005).

176. *Mannix v. Purcell*, 19 N.E. 572 (Ohio 1888).

177. *Id.* at 582.

unincorporated parishes or was available to creditors. The court concluded that parish assets were held by the bishop in trust for the parishes, noting that

[t]he parties have gone back 15 centuries into the laws and canons of the church, for proof of the nature of the tenure by which the archbishop held the legal title to the ecclesiastical property, and the proof is overwhelming that he was not invested with an absolute title to it as his own. It is practically conceded that he held it in trust; but the parties are very far from a concurrence of views concerning the terms of the trust. The right to go to the rules and canons of the Catholic Church for the purposes of establishing, defining, and limiting the trust is denied. That parol evidence may be resorted to to engraft a trust upon a title held by deed absolute upon its face is a question which in this state has passed beyond the range of serious discussion, though the proof in such cases should be clear, strong, and convincing.¹⁷⁸

The *Mannix* court recognized that permitting canon law to form the evidentiary basis for a trust might mean that canon supplanted civil law. But the court downplayed the concern:

The contention is that to resort to the law of the church as proof upon which to qualify the absolute terms of the grant is to permit the law of the church to supersede or dominate the civil law, and much sensitiveness is shown by eminent counsel upon this subject. There is here no ground for alarm. It is no innovation upon the law of evidence, in determining questions like the one at bar, to call, in aid of the civil tribunal, upon the law of the particular church involved for the purpose of determining the title to church property. It surely is not unreasonable, in a case like the present, to hold one of the great prelates of the church of Rome to the terms upon which, by the very law to which he has vowed his fealty, he has consented to accept the legal title to property which is appointed to the uses of the church to whose service he has with most solemn unction dedicated his life. It is but a form of establishing, by conven[i]ent and very convincing proof, what entered into the contemplation of the parties to the grant at the time the title vested. . . . It is no more than establishing, by a form of proof which the courts have held to be competent, the terms upon which, by the convention of the parties, the title to church property was granted and accepted.¹⁷⁹

Despite cases like *Mannix*, however, courts are reluctant to find property rights implied in religious rules. In *Watson v. Jones*, for example, the U.S. Supreme Court rejected a claim that church property was held in

178. *Id.* at 584.

179. *Id.* at 584–85.

an implied trust for the benefit of a minority of members following an internal schism.¹⁸⁰ There, the Presbyterian Church had split over the question of slavery, with both sides claiming that their positions represented the “true church.”¹⁸¹ The proslavery minority claimed that church property was held in an “implied trust” in favor of the “doctrine” to which the property was devoted.¹⁸² The Supreme Court rejected the departure-from-doctrine rule, and held that property disputes within a hierarchical church can only be resolved by deference to the highest power within the church organization: “[W]henever the questions of discipline, or of faith, or ecclesiastical rule, custom, or law have been decided by the highest of these church judicatories to which the matter has been carried, the [civil] legal tribunals must accept such decisions as final, and as binding on them”¹⁸³ Because the church hierarchy had rejected slavery, the minority lost.¹⁸⁴

Deferring to church hierarchy sounds like it might lead to favorable results for the parishioners. Presumably, if the rules of cases like *Mannix* and *Watson* applied, the bankruptcy court would be required to defer to the bishop’s determination of what constitutes estate property. But the Supreme Court has more recently developed a second way of approaching church property issues, which allows courts to consider only “neutral” legal documents in establishing their rights. In *Jones v. Wolf*, for example, the Supreme Court held that civil courts may respect dispositions of church property effectuated under “neutral” documents that reflect “objective, well-established concepts of trust and property law familiar to lawyers and judges.”¹⁸⁵ According to the Court, the “neutral principles” test permits a court to ascertain the holder of legal title to property by interpreting and applying “secular” provisions of the church’s governing documents.¹⁸⁶

But the *Jones* Court was open to other possibilities: it noted that “a State may adopt *any* one of various approaches for settling church property

180. *Watson v. Jones*, 80 U.S. (13 Wall.) 679, 725 (1871).

181. *See id.* at 690–93.

182. *Id.* at 706.

183. *Id.* at 727.

184. Strictly speaking, *Watson* was not a constitutional case, but one decided at common law. Nevertheless, its rejection of the departure-from-doctrine rule was constitutionalized in *Kedroff v. St. Nicholas Cathedral of Russian Orthodox Church*, 344 U.S. 94 (1952). Interestingly, even though the *Mannix* court discussed the role that cases on internal schisms, such as that in *Watson*, played in determining rules about distributing church property, and even though *Mannix* followed *Watson* by about seventeen years, the *Mannix* court does not cite *Watson*. *See Mannix*, 19 N.E. at 585 (discussing church-property cases, but not citing *Watson*).

185. *Jones v. Wolf*, 443 U.S. 595, 603 (1979).

186. *See id.* at 599–604.

disputes so long as it involves no consideration of doctrinal matters, whether the ritual and liturgy of worship or the tenets of faith.”¹⁸⁷ In fact, the *Jones* decision may simply leave unanswered these basic property questions, as the majority also reiterated that the First Amendment “requires that civil courts defer to the resolution of issues of religious doctrine or polity by the highest court of a hierarchical church organization.”¹⁸⁸ If “polity” includes canon law on governance and structure, perhaps the dioceses’ failure to use “neutral” deeds and documents is of no moment in bankruptcy.

While the Bankruptcy Code excludes from the estate property held in properly formed trusts, bankruptcy courts are understandably suspicious of “trusts” that fail to conform to applicable state law.¹⁸⁹ This stems from concerns that debtors, or preferred creditors, will miraculously “discover” that valuable property is held in trust, and is thus outside the reach of the estate.¹⁹⁰ In the *Portland* case, for example, the court concluded that the failure to give effective notice of the alleged trusts was fatal: “[I]t was not the character of the trust that determined whether the interest was avoidable, but whether there was constructive notice of that interest at the time of bankruptcy.”¹⁹¹ Because title to the properties considered in these motions was not in the names of the parishes, and the property was not impressed with trusts recorded in their favor, the court concluded that the estate should be treated as a bona fide purchaser under section 544(a)(3) of the Bankruptcy Code and that any beneficial interest that might exist in favor of the parishes would be avoided and brought into the estate.¹⁹²

187. *Id.* at 602 (quoting *Md. & Va. Eldership of the Churches of God v. Church of God of Sharpsburg, Inc.*, 396 U.S. 367, 368 (1970) (Brennan, J., concurring)).

188. *Id.* (internal citations omitted).

189. *See, e.g.*, *Torres v. Eastlick (In re N. Am. Coin & Currency, Ltd.)*, 767 F.2d 1573, 1575 (9th Cir. 1985). This is especially true for “constructive trusts.” *See Mullins v. Burtch (In re Paul J. Paradise & Assocs., Inc.)*, 249 B.R. 360, 366 (Bankr. D. Del. 2000) (stating that section 544 permits a trustee to bring into the estate property held in constructive trust). *See also* Carlos J. Cuevas, *Bankruptcy Code Section 544(a) and Constructive Trusts: The Trustee’s Strong Arm Powers Should Prevail*, 21 SETON HALL L. REV. 678, 769–72 (1991). *Compare* Emily L. Sherwin, *Constructive Trusts in Bankruptcy*, 1989 U. ILL. L. REV. 297, with Thomas H. Jackson, *Statutory Liens and Constructive Trusts in Bankruptcy: Undoing the Confusion*, 61 AM. BANKR. L.J. 287 (1987).

190. *See Tort Claimants Comm. v. Roman Catholic Archbishop (In re Roman Catholic Archbishop) (Portland Avoidance Decision)*, 335 B.R. 868, 877 (Bankr. D. Or. 2005).

191. *Id.* at 878.

192. *Id.* at 889. Section 544(a) of the Bankruptcy Code provides in pertinent part as follows:
The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by—

....

It is possible that other (for example, appellate) courts will disagree with the conclusions of the Spokane and Portland courts on the role that canon law plays in the creation of trusts in these cases. Bankruptcy courts have long recognized statutory trusts, and the force of the Washington statute would appear to be a question of state law that has not yet been resolved. Yet, “property,” at least for purposes of determining the parameters of the estate, “has been construed most generously.”¹⁹³ It is a term that is said in bankruptcy to be “all-encompassing.”¹⁹⁴ For better or for worse, bankruptcy courts appear to have a tendency to bring property into the estate whenever they plausibly can do so.¹⁹⁵ If nothing else, this may be what is really at work in the recent Portland and Spokane decisions.

The role that property doctrine plays in bankruptcy is also a good example of the indeterminacy of existing bankruptcy theory, at least as applied to cases of this form. As discussed in Part III.A, above, a

(3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

11 U.S.C. 544(a) (2000). There is a technical curiosity in the Portland holding. If, as the court held, the parishes had no legal existence apart from the diocese, it is not clear who the beneficiaries of these unrecorded trust interests could have been. Judge Perris recognized in the property-of-the-estate decision that unincorporated associations could be the beneficiaries of a trust. *Tort Claimants Comm. v. Roman Catholic Archbishop (In re Roman Catholic Archbishop) (Portland Property Decision)*, 335 B.R. 842, 867 (Bankr. D. Or. 2005). As noted above, however, she apparently believed that the parishes lacked even this status, and were nothing more than a “division of a corporation.” *Id.* If so, the decision to avoid transfers to the trust must, oddly, assume a transfer by the diocese to itself. Perhaps the court used this avoidance power as a precautionary measure, reasoning that because this provision applies even when there has been no transfer of property, it would apply even where there was no one to receive the allegedly infirm transfer. *Portland Avoidance Decision*, 335 B.R. at 877 (reasoning that this avoidance power “also applies when there has been no transfer” and citing *Nat’l Bank of Alaska v. Erickson (In re Seaway Express Corp.)*, 912 F.2d 1125, 1128–29 (9th Cir. 1990)).

193. See Official Comm. of Unsecured Creditors v. PSS S.S. Co. (*In re Prudential Lines Inc.*), 928 F.2d 565, 572 (2d Cir. 1991).

194. *Am. Nat’l Bank of Austin v. MortgageAmerica Corp. (In re MortgageAmerica Corp.)*, 714 F.2d 1266, 1274 (5th Cir. 1983) (stating that “[e]ven on its face, section 541(a)(1) is all-encompassing, and Congress meant for it to be construed commensurately”). See *S.I. Acquisition, Inc. v. Eastway Delivery Serv., Inc. (In re S.I. Acquisition, Inc.)*, 817 F.2d 1142, 1149 (5th Cir. 1987) (noting that “property of the estate” is broadly defined in section 541(a)(1) as including “all legal or equitable interests of the debtor”).

195. The infamous example of this is *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983), where the Supreme Court held that assets in which a debtor had no equity, and which were validly seized by the Internal Revenue Service prior to bankruptcy, were nevertheless property of the debtor’s estate. The decision has been heavily criticized. See Thomas E. Plank, *The Creditor in Possession Under the Bankruptcy Code: History, Text, and Policy*, 59 MD. L. REV. 253, 301–05, 310–11, 339–44 (2000) (criticizing the *Whiting Pools* Court’s failure to follow the statutory language of the Bankruptcy Code, its use of weak legislative history, and its ignorance of direct, contrary legislative history, along with its overly general policy analysis).

proceduralist's chief concern should be the nonbankruptcy entitlements of the various stakeholders. If, for example, state law recognized a constitutionally permissible trust in favor of the parishes, proceduralists would presumably say that is fine, and should be recognized. If, instead, nonbankruptcy entitlements make no provision for the interests of parishioners, the Bankruptcy Code itself should not change that result. Pragmatists, by contrast, might be open to broader inquiries that consider the competing equities in these cases, such as the harm suffered by the tort creditors of a reduced recovery, the harm to parishioners of losing their churches, and the harm to communities of losing their schools and hospitals.

The problem, as noted above, is that neither approach creates a tractable basis for decision when the underlying rules or norms or values are themselves in conflict. Proceduralists cannot say which prebankruptcy entitlements—those of pure state law, or those of canon law—should control. Pragmatists cannot say which values or policies—protection for parishioners or victims or communities—should control. No metatheory yet exists for resolving the property questions created by the diocesan dilemmas.

d. What Role Should Parishioners Play?

The bankruptcy policy debates would also expose, but not necessarily answer, a nagging practical question created by these cases: what, if any, status do parishioners have? If we care about the identity and interests of the residual claimant on a proceduralist view, the parishioners would not likely qualify as such. If there is an analogue to a “shareholder” in these cases, it would appear to be the Catholic Church itself, akin to the “parent corporation.”¹⁹⁶ Moreover, merely being parishioners, without more, does not appear to render them creditors, as there would be no obvious basis for asserting a claim.¹⁹⁷ Thus, under a proceduralist view, bankruptcy might not only be indifferent to parishioners' religious liberty claims, but also it

196. See *Comm. of Tort Litigants v. Catholic Bishop of Spokane (In re Catholic Bishop)*, 329 B.R. 304, 330 (Bankr. E.D. Wash. 2005) (noting that the “Committee analogizes the parishes to operating divisions of a large corporation”).

197. The Bankruptcy Code defines a “creditor” as an “entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor.” 11 U.S.C. § 101(10)(A) (2000 & Supp. 2005). “Claim” means the “right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.” *Id.* § 101(5)(A). As discussed below, there may be equitable grounds to protect the basic rights of parishioners to use core church assets. Since any equitable right of this sort would not arise before commencement of the case, however, the parishioners would not appear to be creditors under the statute.

might not even recognize their existence in these cases.¹⁹⁸ Pragmatists, by contrast, and as suggested above, might be more flexible in their thinking about who should be considered stakeholders in the bankruptcy process. In either case, it is not clear that the models developed by the bankruptcy theory debates thus far would solve the diocesan debtor dilemmas.

2. Management of the Estate

Determining the contours of the estate will not be the only problems arising in the diocesan cases. The cases will also present difficult questions about how the estates should be managed and what to do if there are legitimate complaints about management.

Commencement of a bankruptcy case automatically results in the appointment of a fiduciary for the debtor's estate.¹⁹⁹ In Chapter 11 reorganization, this fiduciary is, in the first instance, charged with management of the reorganizing debtor, which has the rights and duties of a trustee, and is known as the "debtor in possession" ("DIP").²⁰⁰ Here, the DIP would be the bishop of the diocese. In an ordinary Chapter 11 case, the DIP's duties run principally, if not exclusively, to creditors.²⁰¹ The fiduciary duties of the DIP include a duty to protect the assets of the estate, a duty of loyalty, and a duty of care.²⁰² The duty of loyalty encompasses a duty to avoid self-dealing, the appearance of impropriety, and conflicts of interest; it also imposes a duty of impartiality.²⁰³

The diocesan case management problems will in many respects be exaggerated forms of the "agent-with-two-masters" problem. Unlike the ordinary DIP, whose duties run to creditors, the diocesan debtor's management, the bishop, has also sworn another allegiance to the church

198. See Reorganization Plan, Tucson, *supra* note 18, at 69 (proposing a plan that does not even mention the parishioners).

199. See 11 U.S.C. §§ 701–703 (2000); *Commodity Futures Trading Comm. v. Weintraub*, 471 U.S. 343, 354–55 (1985).

200. See §§ 701–704 (describing the duties of a trustee); § 1101(1) (stating that "'debtor in possession' means 'debtor'"); § 1106 (describing the duties of a trustee); § 1107(a) (stating that "a debtor in possession shall have all the rights . . . of a trustee serving in a case under this chapter"). See also LoPucki & Whitford, *supra* note 107, at 679 (noting that "bankruptcy procedure thrusts management of the debtor corporation into a central role").

201. See 5 COLLIER BANKRUPTCY PRACTICE GUIDE pt. 84.02950, at 82-22 (Alan N. Resnick & Henry J. Sommer eds., 2000 & Supp. 2005) (stating that "the fiduciary duties of a trustee . . . [including a DIP under Code § 1107] will run primarily to the debtor's creditors"); *id.* at pt. 84.03910, at 84-26 (explaining that a "debtor in possession becomes a fiduciary of the estate" and must, therefore, "exercis[e] its powers in the best interest of creditors").

202. See *In re Bowman*, 181 B.R. 836, 843 (Bankr. D. Md. 1995).

203. *Id.* See *In re Herberman*, 122 B.R. 273 (Bankr. W.D. Tex. 1990).

and its members.²⁰⁴ If, as seems to be the case, creditors are concerned that the bishops are not maximizing the estate, they will be tempted to object to the bishop's continued management.²⁰⁵

Creditors who are dissatisfied with the DIP's performance have some options. Although a bankruptcy court cannot liquidate a nonconsenting diocese under Chapter 7,²⁰⁶ the court may dismiss the case,²⁰⁷ or appoint a Chapter 11 trustee either "for cause," or if the appointment would be "in the interests of creditors."²⁰⁸ "Cause" to appoint a trustee may include "fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after commencement of the case."²⁰⁹ Parties may also seek the appointment of an examiner.²¹⁰ As a practical matter, however, the appointment of a trustee or an examiner in a Chapter 11 case is an "extraordinary remedy."²¹¹ There is a "strong presumption" that the debtor should be permitted to remain in possession

204. See, e.g., 1983 CODE c.383, § 1 (requiring the bishop to "show that he is concerned with all the Christian faithful who are committed to his care"). Cf. *Matthew* 6:24 (stating, "No one can serve two masters.").

205. Archbishop Vlazny has reportedly indicated that he will not comply with the Portland property decisions. See William McCall, *Archbishop Says Church Will Resist Judge's Ruling*, MSNBC, Dec. 30, 2005, <http://famulus.msnbc.com/famulusgen/ap12-30-131122.asp?t=apnew&vts=123020052106#body>.

206. Section 1112(b) of the Bankruptcy Code provides that a Chapter 11 case may be converted to a liquidation under Chapter 7 or dismissed "for cause, including—(1) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation; (2) inability to effectuate a plan; [or] (3) unreasonable delay by the debtor that is prejudicial to creditors." 11 U.S.C. § 1112(b) (2000 & Supp. 2005). This provision would not, however, permit a bankruptcy court to convert a diocesan case over the DIP's objection. The court may not convert a case to Chapter 7 if the debtor is "a corporation that is not a moneyed, business, or commercial corporation." *Id.* § 1112(c). This presumably applies to religious nonprofit organizations.

207. *Id.* § 1112(b).

208. See *id.* § 1104(a).

209. *Id.* § 1104(a)(1).

210. Section 1104(c) of the Bankruptcy Code provides that "a party in interest" may request the appointment of an examiner, which the court may order after notice and a hearing, "to conduct such an investigation of the debtor as is appropriate." *Id.* § 1104(c). The duties include investigation of the debtor, the operation of the debtor's business, and "any other matter relevant to the case or to the formulation of a plan." See *id.* § 1106(a)(3). In most cases, examiners do not have the power to sue. See § 1106(b) (allowing an examiner to perform the duties of a trustee set forth in sections 1106(a)(3) and 1106(a)(4)). But cf. *In re Carnegie Int'l Corp.*, 51 B.R. 252 (Bankr. S.D. Ind. 1984) (authorizing an examiner to bring suit on behalf of a debtor).

211. See 7 COLLIER BANKRUPTCY PRACTICE GUIDE pt. 1104.02(3)(b)(i), at 1104-10 (Alan N. Resnick & Henry J. Sommer eds., 15th rev. ed. 2005). See also *In re Sharon Steel Corp.*, 871 F.2d 1217, 1226 (3d Cir. 1989) ("It is settled that appointment of a trustee should be the exception, rather than the rule.").

unless there has been either “a showing of need for the appointment of a trustee or a significant postpetition change in the debtor’s management.”²¹²

It is not clear whether a bankruptcy court would have the constitutional power to appoint a Chapter 11 trustee for a religious entity debtor. On the one hand, some precedent limits the extent to which a court can reconfigure or control management of a religious entity.²¹³ As the Supreme Court noted in an admittedly different context, “[n]either a state nor the Federal Government can, openly or secretly, participate in the affairs of any religious organizations or groups.”²¹⁴ To the extent a receiver is an arm of the government, that receiver would be participating quite heavily in the affairs of the diocese. On the other hand, and as discussed further below, the Supreme Court had little trouble with the appointment of a receiver to liquidate the property of the Mormon Church in the late nineteenth century.²¹⁵ Moreover, a number of other courts have appointed trustees or receivers to manage or liquidate the property of religious entities.²¹⁶

212. 7 COLLIER BANKRUPTCY PRACTICE GUIDE pt. 1104.02(3)(b)(i), at 1104-10. *See also In re Marvel Entm’t Group, Inc.*, 140 F.3d 463, 471 (3d Cir. 1998); *Cajun Elec. Power Coop., Inc. v. Cent. La. Elec. Co. (In re Cajun Elec. Power Coop., Inc.)*, 69 F.3d 746, 749 (5th Cir. 1995), *reh’g granted and rev’d*, 74 F.3d 599 (5th Cir. 1996); *Comm. of Dalkon Shield Claimants v. A.H. Robins Co.*, 828 F.2d 239, 240–41 (4th Cir. 1987).

An intermediate solution, at least for certain problems, would be to permit a creditors’ committee to pursue certain causes of action that the DIP cannot or does not wish to pursue. *See Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery*, 330 F.3d 548, 566 (3d Cir. 2003) (en banc) (holding that an official creditors’ committee may have standing to sue former insiders to recover alleged fraudulent transfers). *But see United Phosphorus, Ltd. v. Fox (In re Fox)*, 305 B.R. 912, 916 (B.A.P. 10th Cir. 2004) (explaining that the statute limits standing for avoidance actions to trustee/debtor in possession).

213. *See State ex rel. Heitkamp v. Family Life Servs., Inc.*, 616 N.W.2d 826, 841–42 (N.D. 2000) (reversing, on First Amendment grounds, a district court order reconstituting a religious entity’s board of directors).

214. *Everson v. Bd. of Educ.*, 330 U.S. 1, 16 (1947).

215. *See Late Corp. of the Church of Jesus Christ of Latter-Day Saints v. United States*, 136 U.S. 1 (1890) (upholding the receivership and escheat of church property). *Cf. Todd M. Gillett, Note, The Absolution of Reynolds: The Constitutionality of Religious Polygamy*, 8 WM. & MARY BILL RTS. J. 497, 518 (2000) (arguing that the *Late Corp.* decision “clearly violat[ed] the separation of church and state”). I discuss the Mormon Church cases in Part IV.A.1, *infra*.

216. *See In re United Church of the Minister of God*, 74 B.R. 271, 280 (Bankr. E.D. Pa. 1987) (appointing a trustee in a Chapter 11 case filed by a church); *Wilson v. Upreach Ministries (In re Missionary Baptist Found. of Am., Inc.)*, 24 B.R. 973, 974 (Bankr. N.D. Tex. 1982) (hearing a case by a trustee for the debtor, a religious organization, regarding the avoidance of fraudulent transfers); *In re Immanuel Presbyterian Church*, 36 So. 408, 357 (La. 1904) (noting that a petition for a receiver had been filed and a receiver had been appointed in a bankruptcy proceeding filed by a church). *See also Darrell R. Shepard, Note, Receivers, Churches and Nonprofit Corporations: A First Amendment Analysis*, 56 IND. L.J. 175 (1980).

Dismissal of these cases creates more interesting problems. The bankruptcy courts in both the Spokane and Portland cases observed that if the First Amendment truly constrained the Bankruptcy Code, the remedy would not be to modify its particular rules, but to dismiss the cases entirely.²¹⁷ The problem is that dismissal may serve no good purpose. It would not solve the underlying dilemmas, but would merely shift them to other courts that would be confronted with individual tort creditors seeking to collect on their claims. While reasonable minds can and do differ on the virtues and vices of the bankruptcy system, few argue that it should be entirely displaced by state lien law, at least when a debtor has multiple creditors and a potentially limited pool of assets.

3. Resolution of Cases

Like other bankruptcy cases, the diocesan cases can either be resolved consensually or nonconsensually, and may in either case involve sales of diocesan property.

a. Consensual Resolution

A Chapter 11 case is considered consensually resolved when a plan of reorganization is confirmed without being “crammed down” against dissenting creditors or shareholders.²¹⁸ Indeed, consent is a central aspiration of Chapter 11 reorganization, which is premised on the complex proposition that value can be maximized for all stakeholders in a debtor if the debtor is given a reasonable opportunity to negotiate a reordering of its

217. Tort Claimants Comm. v. Roman Catholic Archbishop (*In re Roman Catholic Archbishop*) (*Portland Property Decision*), 335 B.R. 842, 853 n.9 (Bankr. D. Or. 2005); Comm. of Tort Litigants v. Catholic Bishop (*In re Catholic Bishop*), 329 B.R. 304, 324 n.5 (Bankr. E.D. Wash. 2005).

That the Portland court makes this observation is curious. In a later portion of the decision, Judge Perris observes that RFRA may nevertheless create a defense to the avoidance of interests in diocesan property that would “substantially burden” “parishioners and those who have donated and sent children to the Archdiocesan high schools.” *Portland Property Decision*, 335 B.R. at 863. Since RFRA allegedly incorporates a constitutional standard of free exercise accommodation, one would think that application of RFRA creates the same basis for dismissal. I discuss the use of RFRA in these cases in Part IV.A.3, *infra*.

218. A plan will generally be considered consensual if it has been approved by holders of claims or interests entitled to vote on it. Holders of claims and interests are entitled to vote if their claims or interests are “impaired” and they will receive something under the plan. *See* 11 U.S.C. § 1124 (2000 & Supp. 2005) (defining “impairment” of claims); *id.* § 1126(f)–(g) (providing that holders of unimpaired claims, or claims that receive nothing under the plan, shall not vote on the plan). A class entitled to vote is deemed to have accepted the plan if holders of at least two-thirds in amount and (for claims of creditors only) more than one-half in number have voted to accept the plan. *Id.* § 1126(c)–(d). As discussed in the next subsection, a plan may be confirmed nonconsensually, in a process referred to as “cram down.” For a definition and discussion of “cram down,” see notes 225–26 and accompanying text.

affairs.²¹⁹ Although disagreements about the nature and duration of this opportunity lie at the heart of the proceduralist/pragmatist debate, consent usually eliminates the need for judicial valuation, one of the costlier features of bankruptcy.²²⁰ Steven Schwarcz has observed that “[t]he genius of bankruptcy reorganization law is that it provides incentives for debtors and their creditors, notwithstanding their disparate interests, to reach a voluntary agreement on the terms of the restructuring.”²²¹

If the Tucson case is any indication, it would appear that reorganization plans can be consensually confirmed in diocesan cases. According to a lawyer for the diocese, the plan was overwhelmingly approved, even by creditors whose claims had been disallowed.²²² Although certain creditors objected to confirmation, raising objections that the plan’s use of canon law violated the Establishment Clause,²²³ in the end, the plan provided sufficient recoveries to make it worthwhile for the creditors to sign on.²²⁴

219. See, e.g., *Bank of Am. Nat’l Trust & Sav. Ass’n v. 203 N. LaSalle St. P’ship*, 526 U.S. 434, 457 n.28 (1999) (holding that “the Chapter 11 process relies on creditors and equity holders to engage in negotiations toward resolution of their interests” (quoting G. Eric Brunstad, Jr., Mike Sigal & William H. Schorling, *Review of the Proposals of the National Bankruptcy Review Commission Pertaining to Business Bankruptcies: Part I*, 53 BUS. LAW. 1381, 1405–06 n.136 (1998))); Richard F. Broude, *Cramdown and Chapter 11 of the Bankruptcy Code: The Settlement Imperative*, 39 BUS. LAW. 441 (1984); Kenneth N. Klee, *Cram Down II*, 64 AM. BANKR. L.J. 229 (1990); Lynn M. LoPucki & William C. Whitford, *Bargaining over Equity’s Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125, 126 (1990) (“Current law provides a complex legal environment in which representatives of thousands of creditors and shareholders bargain over the disposition of billions of dollars in assets. Adjudication of cases within that environment is thought to be virtually impossible.”).

220. Judicial valuation in bankruptcy has been characterized as “a guess compounded by an estimate.” Peter F. Coogan, *Confirmation of a Plan Under the Bankruptcy Code*, 32 CASE W. RES. L. REV. 301, 313 n.62 (1982).

221. Steven L. Schwarcz, *Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach*, 85 CORNELL L. REV. 956, 959 (2000). As discussed *supra* in Part III.B.2, different parties will have different incentives. In the case of management of the DIP, these incentives include the fear of losing control of the company if creditors seek the appointment of a trustee or the liquidation of the DIP. In the case of creditors, these incentives include the fear that a plan of reorganization will be “crammed down” such that the rights of dissenting junior creditors or interest holders will be eliminated. See also *supra* notes 100–01.

222. Telephone Interview with Kasey Nye (Aug. 1, 2005). A firsthand account of the Tucson case appears in James M. Marlar, Kasey C. Nye & Christopher Graver, *Confirming the Catholics—The Diocese of Tucson Experience*, 11 NORTON BANKR. L. ADVISER 1 (2005). Bankruptcy Judge Marlar presided over the Tucson diocese’s case.

223. See *Objections of Certain Tort Claimants to the Debtor’s Plan of Reorganization at 26*, *In re Roman Catholic Church Diocese of Tucson*, No. 4-04-bk-04721-JMM (Bankr. D. Ariz. July 1, 2005).

224. I note that the plan was confirmed despite the requirement of section 1129(a)(1) that “[t]he plan compl[y] with the applicable provisions of [the Bankruptcy Code].” 11 U.S.C. § 1129(a)(1) (2000 & Supp. 2005). If the contours of the estate were determined by canon law, and not section 541 of the Bankruptcy Code, the plan arguably flunked this technical provision. Given the strong support for the

b. Nonconsensual Resolution

As the Spokane and Portland cases suggest, however, there is no guarantee that all diocesan cases will be resolved consensually. If not, the Bankruptcy Code contemplates several paths the cases might take. First, as discussed above, a Chapter 11 trustee may be appointed, or the case may be dismissed. Second, a reorganization plan may be confirmed despite significant objection from junior stakeholders, a process known as “cram down.” Thus, a bankruptcy court may approve a plan that lacks broad support if it “does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.”²²⁵ The cram down provisions also establish parallel rules for the cram down of plans against dissenting classes of secured claims and equity interests.²²⁶

In essence, cram down provides that a class of junior claimants will receive nothing if a senior impaired class dissents. Cram down therefore substitutes priority for consent. Here, the ambiguities of the diocese’s corporate structure start to matter. It is difficult, for example, to imagine the bishop proposing a cram down plan, since he would likely be subverting the church hierarchy. It is not so difficult, however, to imagine creditors proposing a cram down plan that has the same effect. If, for example, the Spokane or Portland property decisions stand, and the dioceses’ plans lack sufficient support from holders of impaired claims, creditors may propose alternatives that eliminate the dioceses’ interests in their property.²²⁷

plan, it is not surprising that the argument would have had no traction here. As noted above, *supra* note 9, a recent amendment to section 1129(a) of the Bankruptcy Code requires that conveyances of property by a not-for-profit entity conform to applicable nonbankruptcy law. *Id.* § 1129(a)(16). Presumably, this change is not meant to contradict section 1129(a)(1) to require bankruptcy plans of dioceses to conform to canon law, although as a textual matter, this provision may buttress the constitutional claims to that effect being made by parishioners, and discussed in Part IV, *infra*.

225. *Id.* § 1129(b)(1). The cram down rules require that the condition that a plan be fair and equitable with respect to a class includes the following requirements:

....

(B) With respect to a class of unsecured claims[,] (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property

Id. § 1129(b)(2)(B)(i)–(ii).

226. See *Koelbl v. Glessing (In re Koelbl)*, 751 F.2d 137, 140 (2d Cir. 1984) (discussing the scope of the “fair and equitable” standard); *Union Trust Co. v. Wagner (In re Cent. Funding Corp.)*, 75 F.2d 256, 259 (2d Cir. 1935) (same).

227. The Spokane plan of reorganization is discussed *supra* in notes 70–71 and accompanying text. The debtor has the exclusive right to propose a plan during the first 120 days of a Chapter 11 case.

Cram down would probably not be good for parishioners. As noted above, they do not have any obvious status in these cases. They would not necessarily be the most junior stakeholders, with equity interests, because arguably the church itself would fill that role. While they may be “beneficiaries” in some sense, which will be explored in greater detail below, it is not clear that state law, and therefore bankruptcy law, would recognize this status. It is clear, however, that if the dioceses lose their churches and other properties, the parishioners would, too.

c. Asset Sales

Resolution of bankruptcy cases, whether consensual or not, often involves the sale of some or all of a debtor’s property. Indeed, some proceduralist writers believe that bankruptcy is, or should be, geared principally toward facilitating asset sales.²²⁸

If the ordinary rules applied, a sale of assets would be governed by section 363 of the Bankruptcy Code.²²⁹ Bankruptcy courts will typically approve such sales after notice and a hearing, if supported by a “good business reason.”²³⁰ If the ordinary rules do not apply, then sales may be delayed or denied. If, for example, property is determined to be part of the “stable patrimony” of the diocese, Canon 1291 provides that “[t]he permission of the competent authority according to the norm of law is required in order validly to alienate the goods which through lawful designation constitute by legitimate designation the stable patrimony of a public juridic person and whose value exceeds the sum determined in law.”²³¹ This property should not, according to at least one Catholic writer, be made available to satisfy tort judgments.²³²

11 U.S.C. § 1121(b) (2000 & Supp. 2005). This period can be reduced or increased “for cause,” up to eighteen months from commencement of the case (twenty months if a plan is filed during the initial 120 days). *Id.* § 1121(d). In considering whether “cause” exists to extend the exclusive period, courts consider a number of factors, including (1) the size and complexity of the case, (2) the time needed to permit the debtor to negotiate a plan and prepare adequate information, (3) evidence of good faith progress toward reorganization, (4) the fact that the debtor is current on bills during the case, (5) evidence that the debtor reasonable prospects for filing a viable plan, (6) evidence that the debtor has made progress in negotiations with creditors, (7) the length of the case, (8) whether the debtor is using exclusivity to pressure creditors, and (9) whether any unresolved contingency exists. *See In re Dow Corning Corp.*, 208 B.R. 661, 664–65 (Bankr. E.D. Mich. 1997).

228. *See, e.g.*, Baird & Rasmussen, *The End*, *supra* note 88.

229. *See* 11 U.S.C. § 363 (2000 & Supp. 2005).

230. *Id.* *See also* Comm. of Equity Sec. Holders v. Lionel Corp. (*In re Lionel Corp.*), 722 F.2d 1063, 1071 (2d Cir. 1983).

231. 1983 CODE c.1291.

232. *See* Mark T. Reeves, *Satisfaction of Civil Judgments Against Public Juridic Persons in the United States in Light of Canons 22 and 1291: Aliud Iure Canonico Caveatur?*, 42 CATH. LAW. 139,

Who is the “competent authority” that must approve such transactions? In the absence of religious liberty concerns, the “competent authority” generally required to approve a nonordinary course sale of assets in bankruptcy is the bankruptcy court.²³³ According to section 1 of Canon 1292, however, the “competent authority” that approves significant property dispositions is “the finance council, the college of consultors, and the parties concerned,” all of whom appear to be official advisors to the archbishop.²³⁴ In addition, the Holy See (the Vatican) must approve of the alienation of stable patrimony in excess of \$1,000,000.²³⁵

If the Portland and Spokane cases are any indication, the application of ordinary bankruptcy and state law would likely produce results which parishioners would find troubling. Bankruptcy rules and norms could strip core religious assets, including churches, schools, and cemeteries, that parishioners understandably consider to be “theirs,” especially if a liquidating plan is crammed down against a diocese. These rules may also force dioceses to cede management to outsiders, including Chapter 11 trustees. Although the Portland court held out the faint possibility that RFRA may, as discussed below, create a defense to complete liquidation,²³⁶ the Spokane court appears to have been unmoved by such concerns. Other courts—in particular, appellate courts—may view matters differently, however. They may, therefore, be persuaded that ordinary bankruptcy rules should not apply.

163 (2002) (arguing that “the stable patrimony of a public juridic person should not be available for the purpose of satisfying civil judgments”).

233. 11 U.S.C. § 363(b)(1) (2000 & Supp. 2005). As noted above, *supra* note 9, and like new rules on plan confirmation contained in section 1129(a)(16), section 363(d) of the Bankruptcy Code now requires that sales of property by a not-for-profit entity conform to applicable nonbankruptcy law. *Id.* § 1129(a)(16). It is, as noted above, unlikely that this change was meant to capture canon law and make it applicable to sales of diocesan assets.

234. 1983 CODE c.1292, § 1.

235. *Id.* §§ 2–4 & cmt. As of this writing, there have been no forced sales of diocesan property in any of the pending U.S. cases. *Cf. supra* note 16 (discussing the forced liquidation of property of a Canadian diocese). Although the opinion is somewhat unclear on the point, it would appear that Judge Perris in the Portland case believes that there may be a religious liberty defense to such sales under certain circumstances:

The possibility . . . [of] the loss of all parish church and Archdiocesan school properties titled in debtor’s name raises a question of fact regarding whether application of [the Bankruptcy Code] would impose a substantial burden on the parishioners’ exercise of religion. . . . [If] application of [the Bankruptcy Code] leaves the parishioners and school children with no place to worship and study, because no facilities are available, and if they establish that worship and study are central to religious doctrine, the burden [on religious exercise] could be substantial.

Tort Claimants Comm. v. Roman Catholic Archbishop (*In re Roman Catholic Archbishop*) (*Portland Property Decision*), 335 B.R. 847, 863 (Bankr. D. Or. 2005).

236. *See infra* notes 309–11.

IV. RELIGIOUS LIBERTY CLAIMS IN BANKRUPTCY

The bankruptcy process described in the preceding section would apply in these cases only if it passed constitutional muster. Yet, for at least three reasons, the harshest aspects of this process—in particular, the involuntary loss of church assets and/or control of the dioceses—might not. First, such applications of bankruptcy law may substantially burden parishioners' exercise of religion, whether under the Constitution or statutory enhancements of religious liberties. Second, precepts of church autonomy may require bankruptcy courts to defer to canon law, even if it conflicts with bankruptcy law. Third, and most troubling, virtually any result is likely to create problems under the Establishment Clause.

A. FREE EXERCISE CLAIMS

One basis for limiting or displacing ordinary bankruptcy laws is a claim that they would “substantially burden” the free exercise of parishioners' religion. Such a claim could be asserted in at least three ways: as a free exercise claim, a hybrid rights claim, or under RFRA.

1. Free Exercise of Religion

The First Amendment of the Constitution is the source of protection for religious liberty, providing that neither federal nor state governments may make any law “respecting an establishment of religion, or prohibiting the free exercise thereof.”²³⁷ For much of our history, the Free Exercise Clause was “feeble,”²³⁸ having been essentially neutralized in the polygamy cases of the late nineteenth century.²³⁹

From 1963 to 1990, this arguably changed. In *Sherbert v. Verner*, the Court first held that neutral laws of general application would be subject to strict scrutiny if they imposed a “substantial burden” on the exercise of

237. U.S. CONST. amend. I.

238. See Christopher L. Eisgruber & Lawrence G. Sager, *Why the Religious Freedom Restoration Act Is Unconstitutional*, 69 N.Y.U. L. REV. 437, 446–47 (1994).

239. See *Davis v. Beason*, 133 U.S. 333, 347–48 (1890) (upholding a law requiring Mormons to swear that they were not polygamists), *abrogated by Romer v. Evans*, 517 U.S. 620 (1996); *Reynolds v. United States*, 98 U.S. 145, 166–68 (1878) (upholding a conviction for polygamy). As discussed *infra* in notes 254–66 and accompanying text, the unhappy experience of the Church of Latter-Day Saints involved not only the problem of religious liberty, but also the scope of U.S. insolvency laws. Ultimately, the U.S. government was able to end polygamy not by edict, but by federal receivership. See *Late Corp. of the Church of Jesus Christ of Latter-Day Saints v. United States*, 136 U.S. 1, 3–8, 44–48, 65–66 (1890) (upholding federal laws which proscribed plural marriage and allowed the government to dissolve the church's corporate charter and seize its property in response to violations).

religion.²⁴⁰ There, the Court held that the state was required to show a compelling interest in denying unemployment benefits to a Seventh Day Adventist Church member who was ineligible for work due to religious observance requirements.²⁴¹

This brief show of strength ended with the 1990 decision in *Employment Division v. Smith*, in which the Court held that religious actors were not exempt from neutral laws of general application, no matter what harm the actors suffered.²⁴² The claimants in *Smith* were fired from their jobs at a private drug rehabilitation center because they ingested the hallucinogenic drug peyote, in violation of Oregon law, while attending a religious ceremony of the Native American Church.²⁴³ When they applied for unemployment compensation benefits, the state denied their request on the grounds that they had lost their jobs because of work-related misconduct.²⁴⁴ The claimants sued, alleging that the Oregon law denying their claim violated their rights under the Free Exercise Clause. Although the Oregon Supreme Court agreed with the claimants,²⁴⁵ the U.S. Supreme Court did not. Instead, it held that the right to free exercise did not relieve an individual of the duty to comply with an otherwise valid and “neutral” law of general application.²⁴⁶ The court reasoned:

To make an individual’s obligation to obey such a [neutral and generally applicable] law contingent upon the law’s coincidence with his religious beliefs, except where the State’s interest is “compelling”—permitting him, by virtue of his beliefs, “to become a law unto himself”—contradicts both constitutional tradition and common sense.²⁴⁷

The force of the Free Exercise Clause has long been contested, and the diocesan cases are not likely to resolve legitimate disagreements over its scope. On the one hand, a hefty body of scholarship assails *Smith* and its

240. *Sherbert v. Verner*, 374 U.S. 398 (1963).

241. *See id.* at 406–09.

242. *See Employment Div. v. Smith*, 494 U.S. 872, 879, 890 (1990).

243. *See id.* at 874. The drug rehabilitation center where the claimants worked had a no-tolerance rule for its employees. During the state court proceedings, one of their supervisors testified that employees would similarly have been dismissed had they taken wine during Catholic Mass. *See* Brief for Respondents at 20, *Employment Div. v. Smith*, 494 U.S. 872 (1990) (No. 88-1213) (noting that during the appeal process, the employer suggested that a discharge would have occurred if they had ingested wine at a Christian ceremony).

244. *Smith*, 494 U.S. at 874.

245. *See Smith v. Employment Div.*, 721 P.2d 445, 450–51 (Or. 1986), *vacated*, 485 U.S. 660 (1988), *cert. granted*, 489 U.S. 1077 (1989), *rev’d*, 494 U.S. 872 (1990).

246. *See Smith*, 494 U.S. at 879.

247. *Id.* at 885 (quoting *Reynolds v. United States*, 98 U.S. 145, 167 (1878)) (internal citation omitted).

weak vision of religious liberty.²⁴⁸ On the other hand, as Perry Dane has observed, *Sherbert's* rule may have been a “constitutional anomaly,”²⁴⁹ both because exemptions can arise idiosyncratically—not due to an objective, across-the-board defect in the challenged law²⁵⁰—and because they depend for their force on the ideological makeup and sincerity of the claimant.²⁵¹ This sort of “differential libertarianism”²⁵² would, if taken seriously, “permit every citizen to become a law unto himself.”²⁵³

At least some of our discomfort with *Smith* lies in its lineage. *Smith* relied heavily on *Reynolds v. United States*, one of several much-maligned decisions that pilloried the Church of Latter-Day Saints (“LDS”) in the late nineteenth century.²⁵⁴ *Reynolds* rested on a distinction between “belief” and “practice,” providing that only the former is protected by the Free Exercise Clause.²⁵⁵ In those cases, the practice in question, plural marriage, was one which was apparently important to Mormons, but which the federal government viewed as “barbarous.”²⁵⁶

Indeed, the Mormon experience provides an important, if disturbing, backdrop against which to consider the diocesan cases. In *Late Corp. of the Church of Jesus Christ of Latter-Day Saints v. United States*, the LDS challenged federal legislation that dissolved the church corporation, appointed a federal equity receiver, and caused the church’s property to escheat to the federal government,²⁵⁷ a process similar to involuntary bankruptcy under current law, but with the proceeds going to the government rather than creditors. The LDS objected to the legislation on,

248. See Lipson, *On Balance*, *supra* note 27, at 643 n.279 (collecting criticisms of *Smith*).

249. Perry Dane, “*Omalous*” *Autonomy*, 2004 BYU L. REV. 1715, 1723–24 (quoting *Smith*, 494 U.S. at 886).

250. *Id.* at 1728–29.

251. *Id.* at 1731 (stating that “[e]ntitlement to the benefits of a particular constitutional protection . . . rarely depends on the claimant’s specific ideological motivation”).

252. *Id.*

253. *Reynolds v. United States*, 98 U.S. 145, 167 (1878). An important recent defense of *Smith* appears in MARCI A. HAMILTON, *GOD VS. THE GAVEL: RELIGION AND THE RULE OF LAW*, 219–29 (2005).

254. See *Smith*, 494 U.S. at 885.

255. See *Reynolds*, 98 U.S. at 164 (“Congress was deprived of all legislative power over mere opinion, but was left free to reach actions which were in violation of social duties or subversive of good order.”). This was not a distinction that met with wide praise. See, e.g., Michael W. McConnell, *Free Exercise Revisionism and the Smith Decision*, 57 U. CHI. L. REV. 1109, 1114 (1990) (“The conclusion that the clause protects conduct as well as speech or belief would seem to follow from its very words: ‘exercise’ means conduct. The point . . . is important because the Supreme Court originally held the opposite [in *Reynolds*].” (internal footnotes omitted)).

256. *Late Corp. of the Church of Jesus Christ of Latter-Day Saints v. United States*, 136 U.S. 1, 49 (1890).

257. *Id.*

among others, religious liberty grounds. The Supreme Court was wholly unmoved by their concerns:

It is distinctly stated in the pleadings and findings of fact that the property of the [church] corporation was held for the purpose of religious and charitable uses. But it is also stated in the findings of fact, and is a matter of public notoriety, that the religious and charitable uses intended to be subserved and promoted are the inculcation and spread of the doctrines and usages of the Mormon Church, or Church of Latter-Day Saints, one of the distinguishing features of which is the practice of polygamy—a crime against the laws, and abhorrent to the sentiments and feelings of the civilized world. Notwithstanding the stringent laws which have been passed by Congress—notwithstanding all the efforts made to suppress this barbarous practice—the sect . . . perseveres, in defiance of law, in preaching, upholding, promoting, and defending it.²⁵⁸

The *Latter-Day Saints* opinion was the high (or low) point in the federal government's efforts to abolish plural marriage. Initially, Congress went after the “abhorrent” act itself, without seeking to disenfranchise the church entirely.²⁵⁹ Congress recruited debtor-creditor law in its effort, providing in 1862 legislation that

[i]t shall not be lawful for any corporation or association for religious or charitable purposes to acquire or hold real estate in any Territory of the United States during the existence of the territorial government of a greater value than fifty thousand dollars; and all real estate acquired or held by any such corporation or association contrary to the provisions of this act shall be forfeited and escheat to the United States: *Provided*, That existing vested rights in real estate shall not be impaired by the provisions of this section.²⁶⁰

Because the Mormon Church already owned property valued well in excess of \$50,000,²⁶¹ Congress eventually realized that the 1862 legislation was not likely to be effective. In 1887, therefore, Congress amended the act to terminate the church's corporate status entirely.²⁶² Except for houses of worship, parsonages, and cemeteries, all of the church's property escheated to the United States.²⁶³ The attorney general was given the power to wind

258. *Id.* at 48–49.

259. In 1862, Congress enacted legislation to “annul all acts and laws which establish, maintain, protect, or countenance the practice of polygamy.” Act of July 1, 1862, ch. 126, § 2, 12 Stat. 501 (amended 1887).

260. *Id.* § 3.

261. Kauper & Ellis, *supra* note 119, at 1517 & n.78.

262. Act of Mar. 3, 1887, ch. 397, §§ 13–17, 24 Stat. 635, 637–38.

263. Section 13 of the 1887 legislation provided as follows:

up the affairs of the church, and to that end, had a receiver appointed, which was the action sustained in the *Latter-Day Saints* decision.²⁶⁴ After the *Latter-Day Saints* decision, the church relented and abolished polygamy.

It is difficult to know what to make of the LDS cases, and it is not surprising that they are not cited with much enthusiasm. As Kauper and Ellis observe, the corporate history of the Mormon Church demonstrates “governmental regulation with a vengeance.”²⁶⁵ Because it is unlikely that society has developed a greater tolerance of plural marriage in the last century, there are few critics of the results in these cases. Yet, the decisions are often held up as examples of the worst disingenuity in our thinking about religious liberty.²⁶⁶ These are exceedingly ugly decisions, which many would probably rather deny than defend.²⁶⁷

That it shall be the duty of the Attorney General of the United States to institute and prosecute proceedings to forfeit and escheat to the United States the property of corporations obtained or held in violation of section three of the act of Congress approved the first day of July, eighteen hundred and sixty-two, entitled ‘An act to punish and prevent the practice of polygamy in the Territories of the United States and other places, and disapproving and annulling certain acts of the legislative assembly of the Territory of Utah, or in violation of section eighteen hundred and ninety of the Revised Statutes of the United States’; and all such property so forfeited and escheated to the United States shall be disposed of by the Secretary of the Interior, and the proceeds thereof applied to the use and benefit of the common schools in the Territory in which such property may be; *Provided*, That no building, or the grounds appurtenant thereto, which is held and occupied exclusively for purposes of the worship of God, or parsonage connected therewith, or burial ground, shall be forfeited.

Id. § 13.

264. *United States v. Church of Jesus Christ of Latter-Day Saints*, 15 P. 473, 482–84 (Utah 1887), *aff’d sub nom. Late Corp. of the Church of Jesus Christ of Latter-Day Saints v. United States*, 136 U.S. 1 (1890). According to Kauper and Ellis, “[t]he irony of the entire affair is that, after the Supreme Court upheld the validity of the legislation in question and the appointment of the receiver thereunder, very little property was seized.” Kauper & Ellis, *supra* note 119, at 1517 n.78. Although the government claimed that the church was worth approximately \$3 million, the U.S. Attorney for Utah later reported that he had been able to seize only about \$380,000, including \$10,000 for “[c]redits due on sheep.” *Id.*

265. Kauper & Ellis, *supra* note 119, at 1516.

266. Elizabeth Harmer-Dionne, Note, *Once a Peculiar People: Cognitive Dissonance and the Suppression of Mormon Polygamy as a Case Study Negating the Belief-action Distinction*, 50 STAN. L. REV. 1295, 1322–25 (1998) (criticizing the LDS cases, and arguing that they have the effect of impairing both conduct and belief).

267. Edward Gaffney, Jr., Dean of Valparaiso University School of Law, described the treatment of the LDS as akin to “the sort of dictatorial rule that one associates with Henry VIII’s dissolution of the monasteries in sixteenth century England, . . . not with the spirit of the First Amendment.” See *Religious Freedom Restoration Act of 1991: Hearings on H.R. 2797 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 102d Cong. 153 (1992) (statement of Edward McGlynn Gaffney, Jr.). See also Keith E. Sealing, *Polygamists Out of the Closet: Statutory and State Constitutional Prohibitions Against Polygamy Are Unconstitutional Under the Free Exercise Clause*, 17 GA. ST. U. L. REV. 691 (2001) (arguing that the antipolygamy statutes were unconstitutional because they were enacted out of antipathy toward a religion and were thus not laws of general applicability, they did not further a compelling government interest, and they placed a substantial burden on a tenet of the religion); Stephanie Forbes, Comment, “*Why Just Have One?*”: An Evaluation

Yet, they persist, and pose an awkward challenge to any position parishioners or tort creditors might take in the diocesan cases. As to the parishioners, there is an unseemly parallel between the cases. Like *Latter-Day Saints* and its siblings, the diocesan cases harness economic restructuring to remedy perceived sexual misconduct by religious actors or institutions. If bankruptcy—involuntary, highly selective bankruptcy, no less—can be used to reform the LDS, why should Catholic dioceses be any different, especially when they availed themselves of the process? Yet, it is no surprise that tort creditors are not citing these decisions enthusiastically. They are difficult decisions to justify in modern terms. It is difficult, for example, to imagine the federal government enacting legislation to strip the dioceses of property in order to remedy the established cases of sexual abuse.

2. Hybrid Rights

As noted above, between the LDS cases and *Smith* came a brief period of somewhat stronger protection for religious liberty, principally under the test of *Sherbert v. Verner*.²⁶⁸ In order to dodge the force of this precedent, *Smith* “conveniently discovered”²⁶⁹ what has come to be known as the “hybrid rights” exception:

The only decisions in which we have held that the First Amendment bars application of a neutral, generally applicable law to religiously motivated action have involved not the Free Exercise Clause alone, but the Free Exercise Clause in conjunction with other constitutional protections, such as freedom of speech and of the press, or the right of parents . . . to direct the education of their children.²⁷⁰

In other words, the *Smith* Court suggested that strong protection for religious liberty was really protection for religious liberty *plus* some other liberty interest.

of the Anti-polygamy Laws Under the Establishment Clause, 39 HOUS. L. REV. 1517, 1535, 1546–47 (2003) (analyzing the antipolygamy laws under the current Establishment Clause cases, finding that the antipolygamy laws were aimed at the Mormon Church and that the government coerced Mormons into abandoning their religious beliefs, and concluding that the laws were not neutral and did not have a secular purpose). Keith Sealing further asserts that *Reynolds* “demonstrates the degree to which . . . the Supreme Court . . . was willing to ignore constitutional concepts of fundamental fairness in trials against Mormons.” Sealing, *supra*, at 710.

268. See *Sherbert v. Verner*, 374 U.S. 398 (1963); *supra* notes 240–42 and accompanying text.

269. James M. Donovan, *Restoring Free Exercise Protections by Limiting Them: Preventing a Repeat of Smith*, 17 N. ILL. U. L. REV. 1, 4–5 n.18 (1996).

270. *Employment Div. v. Smith*, 494 U.S. 872, 881 (1990) (internal citations omitted).

Courts have taken three different approaches to the “hybrid rights” exemption suggested by *Smith*. First, the Second and Sixth Circuits have rejected it entirely, treating it merely as dicta.²⁷¹ Second, the D.C. Circuit and at least one court in the First Circuit have held that the hybrid right must be an independently viable constitutional claim.²⁷² Third, and most important for purposes of the diocesan cases, the Ninth and Tenth Circuits have held that the supplemental right must state a “colorable” constitutional claim.²⁷³

Miller v. Reed is a good example of the Ninth Circuit’s comparatively liberal approach to hybrid rights claims.²⁷⁴ In *Miller*, the religious claimant sued California’s Department of Motor Vehicles, claiming that he should be exempt from a rule requiring him to give his social security number in order to renew his driver’s license because it violated his constitutional rights to interstate travel and the free exercise of his religion.²⁷⁵ Although the court acknowledged that making a valid hybrid rights claim was theoretically possible, it held that the “free exercise plaintiff must make out a ‘colorable claim’ that a companion right has been violated—that is, a ‘fair probability’ or a ‘likelihood,’ but not a certitude, of success on the merits.”²⁷⁶ Here, the claimant failed because the Constitution recognizes no right to drive.²⁷⁷

Shortly after *Miller*, the Ninth Circuit again considered the hybrid rights exception, in *Thomas v. Anchorage Equal Rights Commission*.²⁷⁸ In *Thomas*, the Ninth Circuit initially held that a combination of religious liberty and private property rights under the U.S. Constitution entitled religious landlords to defy Alaska’s fair housing laws and refuse to rent residential real estate to unmarried couples.²⁷⁹ On rehearing en banc,

271. *Leebaert v. Harrington*, 332 F.3d 134, 143 (2d Cir. 2003) (explaining that the language in *Smith* “relating to hybrid claims is dicta and not binding on this court” (quoting *Knight v. Conn. Dep’t of Pub. Health*, 275 F.3d 156, 167 (2d Cir. 2001))); *Kissinger v. Bd. of Trs. of the Ohio State Univ.*, 5 F.3d 177, 180 (6th Cir. 1993).

272. *See Henderson v. Kennedy*, 253 F.3d 12, 19 (D.C. Cir. 2001); *Gary S. v. Manchester Sch. Dist.*, 241 F. Supp. 2d 111, 121 (D.N.H. 2003).

273. *Miller v. Reed*, 176 F.3d 1202, 1207 (9th Cir. 1999); *Swanson v. Guthrie Indep. Sch. Dist. No. I-L*, 135 F.3d 694, 700 (10th Cir. 1998).

274. *Miller*, 176 F.3d 1202.

275. *Id.* at 1204–05.

276. *Id.* at 1207 (quoting *Thomas v. Anchorage Equal Rights Comm’n*, 165 F.3d 692, 707 (9th Cir. 1999), *reh’g granted and opinion withdrawn*, 192 F.3d 1208 (9th Cir. 1999)). *See also Am. Family Ass’n v. City & County of S.F.*, 277 F.3d 1114, 1124–25 (9th Cir. 2002); *Ventura County Christian High Sch. v. City of San Buenaventura*, 233 F. Supp. 2d 1241, 1251 (C.D. Cal. 2002).

277. *Miller*, 176 F.3d at 1208.

278. *See Thomas*, 165 F.3d at 702–09.

279. *Id.*

however, the court declined to exempt the landlords from the fair housing law, reasoning that the matter was not ripe, since no enforcement action had been brought against the landlords.²⁸⁰

But for the Ninth Circuit's apparent receptivity to the hybrid rights exception, it would warrant no discussion here. As a theory of religious liberty exemptions, it has generally been ridiculed. As Justice Souter wrote in *Church of the Lukumi Babalu Aye, Inc. v. City of Hialeah*:

[T]he distinction *Smith* draws strikes me as ultimately untenable. If a hybrid claim is simply one in which another constitutional right is implicated, then the hybrid exception would probably be so vast as to swallow the *Smith* rule, and, indeed, the hybrid exception would cover the situation exemplified by *Smith*, since free speech and associational rights are certainly implicated in the peyote ritual. But if a hybrid claim is one in which a litigant would actually obtain an exemption from a formally neutral, generally applicable law under another constitutional provision, then there would have been no reason for the Court in what *Smith* calls the hybrid cases to have mentioned the Free Exercise Clause at all.²⁸¹

It is thus not surprising that the vast majority of courts have rejected hybrid rights claims.²⁸²

280. See *Thomas v. Anchorage Equal Rights Comm'n*, 220 F.3d 1134, 1142 (9th Cir. 2000) (en banc). Plaintiffs fared even worse in the Ninth Circuit's first consideration of the exception. In *American Friends Service Committee Corp. v. Thornburgh*, Quakers sued the United States for violating their constitutional right to free exercise and an employer's right to employ individuals for that employer's business. *Am. Friends Serv. Comm. Corp. v. Thornburgh*, 941 F.2d 808, 808–10 (9th Cir. 1991), amended by 961 F.2d 1405 (9th Cir. 1991). The court held that the right to employ is not a cognizable right and thus fails as a right that could support a free exercise claim and invoke the hybrid rights analysis as stated in *Smith. Id.*

281. *Church of the Lukumi Babalu Aye, Inc. v. City of Hialeah*, 508 U.S. 520, 567 (1993) (Souter, J., concurring).

282. Despite the general antipathy toward these claims, they are most frequently sustained when a parent asserts some sort of religion-based right to direct a child's education. In *Hicks v. Halifax County Board of Education*, 93 F. Supp. 2d 649 (E.D.N.C. 1999), the plaintiff successfully challenged a school uniform policy, arguing that "adherence to the uniform policy would violate her basic religious beliefs" and would "[demonstrate] an allegiance to the spirit of the anti-Christ." *Id.* at 653. In *Chalifoux v. New Caney Independent School District*, 976 F. Supp. 659 (S.D. Tex. 1997), the Southern District of Texas held that a school district could not forbid student plaintiffs from wearing rosaries as necklaces in school, even though the rosaries could be gang symbols. *Id.* at 665–66. The court found that the plaintiffs presented a valid hybrid claim comprised of free exercise and free speech causes of action, and that the prohibition on wearing rosaries violated the plaintiffs' free exercise rights. *Id.* at 671. In *Alabama & Coushatta Tribes v. Trustees of the Big Sandy Independent School District*, 817 F. Supp. 1319 (E.D. Tex. 1993), the Eastern District of Texas held that a school district's prohibition on the length of Native American boys' hair violated both the Free Exercise Clause and parents' rights to raise and educate their children in a traditional religion. *Id.* at 1324–27. In *People v. DeJonge*, 501 N.W.2d 127 (Mich. 1993), the Michigan Supreme court ruled that Roman Catholic parents need not be certified

If the Ninth Circuit remains receptive to the hybrid rights theory, however, the claim might take any of several forms. A facially appealing, but likely unsuccessful, claim would conjoin religious liberty and property rights.²⁸³ The problem here, however, is that the property half of the equation remains indeterminate: whose property rights—the parishioners’ or the dioceses’—would be in issue? If the parishioners have no property rights in parish assets—because they all belong to the dioceses—then they could assert no hybrid claim.

A more promising tactic might merge religious and associational rights. The Constitution apparently protects the right to associate “for the purpose of engaging in those activities protected by the First Amendment—speech, assembly, petition for the redress of grievances, and the exercise of religion.”²⁸⁴ In *Boys Scouts of America v. Dale*, for example, the Supreme Court held that the Boy Scouts of America (“BSA”) could exclude homosexual members on associational grounds.²⁸⁵ In *Dale*, the plaintiff was a long-time Boy Scout and assistant scoutmaster who also

like regular school teachers in order to home-school their children. *Id.* at 129–30. *Smith* itself alluded to two classes of companion rights: those involving First Amendment rights to speech, association and press, on the one hand, and a parent’s Fourteenth Amendment right to control a child’s education, on the other. *See* *Employment Div. v. Smith*, 494 U.S. 872, 881–82 (1990).

283. *See* Peter M. Stein, *Smith v. Fair Employment and Housing Commission: Does the Right to Exclude, Combined with Religious Freedom, Present a “Hybrid Situation” Under Employment Division v. Smith?*, 4 GEO. MASON L. REV. 141, 180–95 (1995) (considering whether property rights of religious landlords are grounds to recognize a hybrid religious exemption). *See also* Steckler v. United States, No. 96-1054, 1998 WL 28235, at *1–2 (E.D. La. Jan. 26, 1998) (rejecting a hybrid rights claim including takings under the Fifth Amendment).

284. *Roberts v. U.S. Jaycees*, 468 U.S. 609, 618 (1984). The right of association was first recognized in *NAACP v. Alabama ex rel. Patterson*, 357 U.S. 449 (1958), where the Court struck down a government order for the membership list of the NAACP. *Id.* at 462–64. Other cases in which plaintiffs have attempted to assert associational rights include *New York State Club Ass’n v. City of New York*, 487 U.S. 1 (1988) and *Board of Directors of Rotary, International v. Rotary Club*, 481 U.S. 537 (1987). Strictly speaking, there appear to be two forms of associational right: “intimate” and “expressive.” Intimate associational rights protect an individual’s decision to establish and preserve “highly personal relationships” from unjustified state interference. *Roberts*, 468 U.S. at 618. *See also* Kenneth L. Karst, *The Freedom of Intimate Association*, 89 YALE L.J. 624 (1980) (first articulating the right). “Expressive” associational rights, by contrast, are those which invoke or involve First Amendment expressive activities, such as speech and religion. *Roberts*, 468 U.S. at 618. They appear, not surprisingly, to blur with the purely expressive rights contemplated by the First Amendment. *See* *Hurley v. Irish-Am. Gay, Lesbian & Bisexual Group*, 515 U.S. 557, 570 (1995) (holding that under traditional First Amendment analysis, parade organizers could not be forced to permit homosexuals to march). *See also* *Boy Scouts of Am. v. Dale*, 530 U.S. 640, 659 (2000) (“In *Hurley*, we applied traditional First Amendment analysis to hold that the application of the Massachusetts public accommodations law to a parade violated the First Amendment rights of the parade organizers.”); Stephen P. Anway, Note, *The Restoration of States’ Civil Rights Authority: An Alternative Approach to Expressive Association After Boy Scouts of America v. Dale*, 62 OHIO ST. L.J. 1473, 1477–87 (2001).

285. *See Dale*, 530 U.S. at 644–45, 659.

happened to be homosexual. Upon discovering this, the BSA terminated Dale's membership. Dale challenged the termination in New Jersey state court and won under New Jersey's public accommodations statute, which prohibits discrimination based on sexual orientation.²⁸⁶ The Supreme Court reversed, holding that requiring the BSA to accept a homosexual member violated the BSA's "freedom of expressive association."²⁸⁷ Writing for the majority, Justice Rehnquist reasoned that "associations do not have to associate for the 'purpose' of disseminating a certain message in order to be entitled to the protections of the First Amendment. An association must merely engage in expressive activity that could be impaired in order to be entitled to protection."²⁸⁸

This strategy may have special force in Washington, where the Spokane case is pending. Even before *Dale*, the Washington Supreme Court used a hybrid religious liberty and association rule to strike down a landmarking statute. In *First United Methodist Church v. Hearing Examiner for the Seattle Landmarks Preservation Board*, the court held that designating a church building a historic landmark violated both rights of free exercise and free expression because the "church building itself was 'an expression of Christian belief and message.'"²⁸⁹ It is not, of course,

286. N.J. STAT. ANN. § 10:5-4 (West 2005). The New Jersey Supreme Court held that the BSA violated the state's public accommodations law by revoking Dale's membership based on his avowed homosexuality. *Dale v. Boy Scouts of Am.*, 734 A.2d 1196, 1218–19, 1230 (N.J. 1999), *rev'd*, 530 U.S. 640 (2000). The BSA's case may have been helped by the fact that four state supreme courts and one U.S. court of appeals had ruled that the BSA was not a place of public accommodation. See *Welsh v. Boy Scouts of Am.*, 993 F.2d 1267, 1269–70, 1276–77 (7th Cir. 1993); *Curran v. Mount Diablo Council of the Boy Scouts of Am.*, 952 P.2d 218, 235–37 (Cal. 1998); *Quinnipiac Council, Boy Scouts of Am., Inc. v. Comm'n on Human Rights & Opportunities*, 528 A.2d 352, 357–59 (Conn. 1987); *Seabourn v. Coronado Area Council, Boy Scouts of Am.*, 891 P.2d 385, 406 (Kan. 1995); *Schwenk v. Boy Scouts of Am.*, 551 P.2d 465, 469 (Or. 1976).

287. *Dale*, 530 U.S. at 648 ("The forced inclusion of an unwanted person in a group infringes the group's freedom of expressive association if the presence of that person affects in a significant way the group's ability to advocate public or private viewpoints.").

288. *Id.* at 655. The majority was apparently not impressed by the claim that, until that point, the Court had not held that associational rights defeated state antidiscrimination law. "To the contrary," Justice Stevens (joined by Justices Breyer, Ginsburg, and Souter) wrote in dissent, "we have squarely held that a State's antidiscrimination law does not violate a group's right to associate simply because the law conflicts with that group's exclusionary membership policy." *Id.* at 679 (Stevens, J., dissenting). The full force of *Dale* is uncertain, although it would seem to have vigor in the eyes of some scholars. See, e.g., Douglas Laycock, *Theology Scholarships, The Pledge of Allegiance, and Religious Liberty: Avoiding the Extremes but Missing the Liberty*, 118 HARV. L. REV. 155, 198 (2004) (noting, in the context of religious funding, that "[t]here may be some protection in the right of expressive association, most recently illustrated by *Boy Scouts v. Dale*").

289. *First United Methodist Church v. Hearing Exam'r for the Seattle Landmarks Pres. Bd.*, 916 P.2d 374, 379 (Wash. 1996) (en banc) (quoting *First Covenant Church v. City of Seattle*, 840 P.2d 174, 182 (Wash. 1992) (en banc)). See also *Munns v. Martin*, 930 P.2d 318, 322–26 (Wash. 1997) (en banc) (holding a city ordinance that imposed controls on demolition of historic structures inapplicable to the

clear that a state court's interpretation of a federal statute should be binding on federal courts. Nevertheless, the *First United Methodist Church* case might provide a persuasive analogy. If involuntary sales of church assets impair the basic associational right to exercise religion—to worship, for example—the hybrid rights claim gains traction. Even if parish assets, such as churches, are property of the dioceses, selling them in satisfaction of tort claims might constitute the same kind of threat to “an expression of Christian belief and message” that the court in *First United Methodist Church* found to be impermissible. While it may be true that if the parish assets were sold, the individual parishioners would be free to worship on their own, or even in groups, the existence and symbolic function of churches, and perhaps other diocesan assets, suggest an associational claim that courts might, and perhaps should, take seriously.

3. RFRA

A third type of religious liberty claim would rely on the legislative articulation of religious liberty rights. In RFRA, Congress sought to undo *Smith* and restore the stronger substantive protections of the *Sherbert* era.²⁹⁰

RFRA's force in this context is uncertain. On the one hand, there are those (including Douglas Laycock) who argue that RFRA should be viewed as proxy for a Free Exercise clause with teeth.²⁹¹ On the other hand, many (most notably Christopher Eisgruber and Lawrence Sager) argue that even if RFRA “restores” the pre-*Smith* standard, it would have little consequence, as even the “strict” scrutiny of the *Sherbert* era was quite weak.²⁹² Thus, even before RFRA was limited in *City of Boerne v.*

Catholic Church's plan to demolish an old school building and build a new pastoral center because the facilities are intimately associated with the church's religious mission).

290. See Religious Freedom Restoration Act (RFRA) of 1993, 42 U.S.C. §§ 2000bb–2000bb-4, held unconstitutional as to state law by *City of Boerne v. Flores*, 521 U.S. 507 (1997). RFRA's stated purposes are:

(1) to restore the compelling interest test as set forth in *Sherbert v. Verner* . . . and *Wisconsin v. Yoder* . . . and to guarantee its application in all cases where free exercise of religion is substantially burdened; and (2) to provide a claim or defense to persons whose religious exercise is substantially burdened by government.

§ 2000bb(b) (internal citations omitted).

291. Douglas Laycock, *The Religious Freedom Restoration Act*, 1993 BYU L. REV. 221, 221 (“[RFRA] can work only if it is as broad as the Free Exercise Clause.”).

292. See Eisgruber & Sager, *supra* note 238, at 446–47 (characterizing free exercise jurisprudence as “feeble”); Christopher L. Eisgruber & Lawrence G. Sager, *Protecting Without Favoring Religiously Motivated Conduct*, 2 NEXUS 103, 104 (1997) (stating that free exercise jurisprudence was “strict only in theory and notoriously feeble in fact”).

Flores,²⁹³ “there is,” according to Ira Lupu, “absolutely no evidence that RFRA did anything to protect religion in decision making by the agencies of the United States.”²⁹⁴ It is not surprising that Gregory Magarian reports that RFRA has had what he characterizes as “middling” success in creating religious liberty accommodations, creating exemptions in some, but not many, cases.²⁹⁵

But for the use of RFRA to defeat application of the Bankruptcy Code, RFRA would not warrant serious consideration here. In *In re Young*, however, the U.S. Court of Appeals for the Eighth Circuit found that RFRA trumped section 548 of the Bankruptcy Code, the constructive fraudulent conveyance provisions.²⁹⁶ In *Young*, the debtors regularly gave ten percent of their annual income to their church, notwithstanding their growing insolvency.²⁹⁷ During the year preceding the filing of their bankruptcy petition, and while insolvent, they contributed a total of \$13,450 to the Crystal Evangelical Free Church.²⁹⁸ After the Youngs went into bankruptcy, their Chapter 7 trustee sued the Youngs and their church under section 548(a) of the Bankruptcy Code to recover these payments as constructive fraudulent conveyances.²⁹⁹

293. *Boerne*, 521 U.S. at 507. The *Boerne* case is discussed *infra* in notes 316–18 and accompanying text.

294. Ira C. Lupu, *The Failure of RFRA*, 20 U. ARK. LITTLE ROCK L.J. 575, 589 (1998).

295. Magarian, *supra* note 22, at 1962–63 (“RFRA has met with middling success in its aim of protecting religious exercise. Many more federal RFRA claims have failed than succeeded.” (internal footnotes omitted)).

296. See *Christians v. Crystal Evangelical Free Church (In re Young)*, 82 F.3d 1407 (8th Cir. 1996), *cert. granted, vacated by* 521 U.S. 1114 (1997).

297. See *In re Young*, 82 F.3d at 1410. See also Laurie Goodstein, *Religious Groups Fight U.S. in Bankruptcy Case*, WASH. POST, May 23, 1994, at A1; Pierre Thomas, *Clinton Stops Justice Department from Seeking Forfeiture of Tithes*, WASH. POST, Sept. 16, 1994, at A8.

298. See *In re Young*, 82 F.3d at 1409–10.

299. See 11 U.S.C. § 548 (2000 & Supp. 2005). This section of the Bankruptcy Code empowers a bankruptcy trustee to avoid and recover transfers by an insolvent debtor to the extent that the debtor received less than reasonably equivalent value in exchange for the debtor’s transfer.

Both the bankruptcy court³⁰⁰ and the district court³⁰¹ held that the Youngs received little or no value in exchange for their donations. Since they were insolvent when they made the donations, the payments were avoidable constructive fraudulent conveyances. Before the U.S. Court of Appeals for the Eighth Circuit, the Youngs claimed that tithing was a religious exercise that was protected by RFRA. After reasoning that it could apply RFRA retroactively,³⁰² the Eighth Circuit reversed the lower courts, concluding that recovery of the Youngs' tithes "substantially burden[ed]" their free exercise of religion, was not in furtherance of a compelling governmental interest, and therefore violated RFRA.³⁰³

Young has received a fair amount of attention, and a number of other courts have also addressed fraudulent conveyance challenges to religious donations.³⁰⁴ As I have argued elsewhere, *Young's* application of RFRA would appear to mean, among other things, that the religious rights of

300. *Christians v. Crystal Evangelical Free Church (In re Young)*, 148 B.R. 886, 896 (Bankr. D. Minn. 1992), *rev'd*, 82 F.3d 1407 (8th Cir. 1996), *cert. granted, vacated by* 521 U.S. 1114 (1997). In the bankruptcy court, the parties stipulated that the only significant issue to resolve was whether the Youngs received reasonably equivalent value in exchange for their donations. The bankruptcy court, acting prior to the enactment of RFRA, granted the trustee's motion and denied the Youngs' motion, holding that the debtors had received no economic value for their tithe. Any benefit the Youngs received was religious, not economic, in nature. *See id.* at 893-94 & n.10.

301. *Christians v. Crystal Evangelical Free Church (In re Young)*, 152 B.R. 939, 948-49 (D. Minn. 1993), *rev'd*, 82 F.3d 1407 (8th Cir. 1996), *cert. granted, vacated by* 521 U.S. 1114 (1997). On appeal from the bankruptcy court, the district court upheld the bankruptcy court's finding that the debtors received inadequate consideration. *See id.* at 949. Goodwill and church services, the district court concluded, were not the sort of fairly concrete benefits that constitute reasonably equivalent value for fraudulent conveyance purposes. *See id.* at 950.

302. *In re Young*, 82 F.3d 1407, 1416-17.

303. *Id.* at 1417-20.

304. *See Watson v. Boyajian (In re Watson)*, 309 B.R. 652, 664 (B.A.P. 1st Cir. 2004) (finding that RFRA was not violated where the debtor was prevented from using disposable income to pay for a child's tuition for a religious school), *aff'd*, 403 F.3d 1 (1st Cir. 2005); *Magic Valley Evangelical Free Church, Inc. v. Fitzgerald (In re Hodge)*, 220 B.R. 386, 393, 395 (D. Idaho 1998) (noting that RFRA is a defense where a trustee attempts to recover tithes paid by the debtor); *Weinman v. Word of Life Christian Ctr. (In re Bloch)*, 207 B.R. 944, 951 (D. Colo. 1997) (applying RFRA to an avoidance action to recover the debtor's tithes and concluding that recovering the tithes would not violate RFRA); *Geltzer v. Crossroads Tabernacle (In re Rivera)*, 214 B.R. 101, 102, 105-08 (Bankr. S.D.N.Y. 1997) (applying RFRA to an avoidance action and concluding that the debtor's rights under RFRA would not be violated by avoiding the tithes); *Morris v. Midway S. Baptist Church (In re Newman)*, 203 B.R. 468, 477-78 (D. Kan. 1996) (applying RFRA and concluding that RFRA was not violated by avoiding the tithes); *In re Tessier*, 190 B.R. 396, 407 (Bankr. D. Mont. 1995) (finding RFRA unconstitutional and therefore including the debtor's contributions to their church in a Chapter 13 plan); *Cedar Bayou Baptist Church v. Gregory-Edwards, Inc.*, 987 S.W.2d 156, 157-59 (Tex. Ct. App. 1999) (discussing the Religious Liberty and Charitable Donation Protection Act of 1998 and noting that the debtor's church claimed RFRA prevented the recovery of the debtor's tithes). I collect and discuss some of these cases in Lipson, *First Principles*, *supra* note 27, at 267-69, 285-91.

debtors should trump the collection rights of creditors.³⁰⁵ If a diocese is threatened with the more draconian consequences of the Bankruptcy Code—forced liquidation of assets, for example—it is easy to imagine a court concluding that *Young* and its reasoning should apply to protect the diocese and/or its parishioners.³⁰⁶

Indeed, if the recent decision in the Portland case creates any hope for parishioners, it would be in Judge Perris's use of *Young* to suggest that RFRA may defeat or limit the Bankruptcy Code.³⁰⁷ "Although I do not doubt the importance of the uniform application of the Bankruptcy Code," she observed, "I agree with the Eighth Circuit's view first articulated in the first *Young* case that 'the interests advanced by the bankruptcy system are not compelling under the RFRA.'"³⁰⁸

As discussed above, tort creditors in the Portland case sought declarations that parish property belonged to the debtor's estate and that any unrecorded trusts for the benefit of parishioners should be avoided under section 544(a)(3) of the Bankruptcy Code.³⁰⁹ In the most confusing part of her decisions on property of the estate, Judge Perris held that avoidance of these unrecorded interests might create a substantial burden on parishioners' exercise of religion under RFRA:³¹⁰ "[I]f application of [the Bankruptcy Code] leaves the parishioners and school children with no place to worship and study, because no facilities are available, and if they

305. See Lipson, *On Balance*, *supra* note 27, at 627–38.

306. Many have criticized *Young*'s use of RFRA. See Arnold H. Loewy, *Rethinking Free Exercise of Religion After Smith and Boerne: Charting a Middle Course*, 68 MISS. L.J. 105, 153–55 (1998) (contending that the claim in *Young* clashed with the Establishment Clause); Magarian, *supra* note 22, at 1916 n.58 ("I maintain that *Young* was incorrectly decided because the result in that case violated the Establishment Clause."); Caitlin Garvey, Note, *Through Amos-Colored Glass: The Eighth Circuit Fails to See the RFRA's Real Meaning in Young v. Crystal Evangelical Free Church*, 141 F.3d 854 (8th Cir. 1998), 24 U. DAYTON L. REV. 491 (1999) (criticizing the Eighth Circuit's Establishment Clause analysis). Today, tithes are protected from avoidance by the Religious Liberty and Charitable Donation Protection Act of 1998, Pub. L. 105-183, 112 Stat. 517 (codified as amended in scattered sections of 11 U.S.C.).

307. Tort Claimants Comm. v. Roman Catholic Archbishop (*In re Roman Catholic Archbishop*) (*Portland Property Decision*), 335 B.R. 842, 864 (Bankr. D. Or. 2005).

308. *Id.* (quoting *In re Young*, 82 F.3d at 1420).

309. Tort Claimants Comm. v. Roman Catholic Archbishop (*In re Roman Catholic Archbishop*) (*Portland Avoidance Decision*), 335 B.R. 868, 875–76 (Bankr. D. Or. 2005). See also Parts II.A and III.B.

310. See *Portland Property Decision*, 335 B.R. at 863 ("The possibility that the result of [avoidance of these interests] could be the loss of all parish church and Archdiocesan school properties titled in [the] debtor's name raises a question of fact regarding whether application of § 544(a)(3) would impose a substantial burden on the parishioners' exercise of religion.").

establish that worship and study are central to religious doctrine, the burden [on their exercise of religion] could be substantial.”³¹¹

Her holdings are confusing for at least three reasons. First, she spoke only of RFRA limiting application of section 544(a)(3) of the Bankruptcy Code, a provision which (as noted above) may be used to avoid unrecorded interests in real property. If, however, RFRA set up a defense only to an avoidance action, it would have no practical value to parishioners, since Judge Perris also held that all parish property was already property of the archdiocesan estate.³¹²

Second, her real concern appeared not to be with avoidance under section 544, but with the effect that asset sales would have on parishioners. But, as noted above, asset sales will occur, if at all, under section 363 of the Bankruptcy Code and/or a cram down plan of liquidation, not by virtue of any avoidance provisions. RFRA may create a defense to a forced sale, but that would have little to do with avoidance under section 544(a)(3), especially if the assets in question were already in the estate, and therefore available for sale by creditors.

Third, her opinions appeared confused about the role of state law.³¹³ On the one hand, she correctly noted that property of the estate is determined largely by state law. Because she concluded that RFRA does not trump applicable state law, RFRA would not determine property of the estate.³¹⁴ Yet, she also acknowledged that state law determines whether a transfer may be avoided under section 544(a)(3).³¹⁵ It is not clear why state law would trump RFRA as to one provision of the Bankruptcy Code (section 541) but not another (section 544(a)(3)).

That said, there is certainly support for Judge Perris’s view that RFRA would not defeat state law as it may be applied in bankruptcy. In *City of Boerne v. Flores*, the Supreme Court struck RFRA as applied to a local zoning ordinance, holding that RFRA exceeded Congress’s remedial

311. *Id.* at 864.

312. *See id.*

313. *Id.* at 860 (“I question whether RFRA applies at all to a determination of what is property of the bankruptcy estate under § 541 . . . ; issues such as ownership of property are determined by application of state law.”).

314. *Id.*

315. *See* Tort Claimants Comm. v. Roman Catholic Archbishop (*In re Roman Catholic Archbishop*) (*Portland Avoidance Decision*), 335 B.R. 868, 877 (Bankr. D. Or. 2005) (“The powers of a bona fide purchaser of real property are defined by state law.” (quoting *Nat’l Bank of Alaska v. Erickson* (*In re Seaway Express Corp.*), 912 F.2d 1125, 1128 (9th Cir. 1990)) (emphasis in *In re Seaway*)).

powers under section 5 of the Fourteenth Amendment.³¹⁶ Although *Boerne* is not viewed as having struck RFRA as to federal law (such as the Bankruptcy Code), the case should create a basic question about the relationship between state and federal law in determining property of the bankruptcy estate. To the extent the Bankruptcy Code is merely a conduit for state law, RFRA should have no force. To the extent the Bankruptcy Code has independent legal significance, however, it may change outcomes.

RFRA might also be constrained by the Establishment Clause. As Magarian (among others) has argued, and reflecting the constitutional dilemma discussed throughout this Article, the Establishment Clause must place some limit on RFRA's ability to alter the Bankruptcy Code.³¹⁷ Magarian has argued that although RFRA does not on its face violate the Establishment Clause, "many of its conceivable applications do."³¹⁸ Applications of RFRA that should withstand scrutiny, Magarian argues, include those that are "idiosyncratic" to the religious actor.³¹⁹ Such exemptions would be permissible under both RFRA and the Establishment Clause because they would "neither deny adherents of other religions, or of no religion, any benefit that they want and have a factual basis for claiming, nor impose substantial costs on nonbeneficiaries."³²⁰ The problem in the diocesan cases would be that exempting the church from the

316. *City of Boerne v. Flores*, 521 U.S. 507, 529–36 (1997). In the wake of *Boerne*, Congress enacted a variety of specialized protections for religious actors. One is the Religious Liberty and Charitable Donation Protection Act, which expressly protects religious (and other) donations from avoidance in bankruptcy. Religious Liberty and Charitable Donation Protection Act of 1998, Pub. L. 105-183, 112 Stat. 517 (codified as amended in scattered sections of 11 U.S.C.). Another, the Religious Land Use and Institutionalized Persons Act (RLUIPA) of 2000, 42 U.S.C. §§ 2000cc–2000cc-5, was recently upheld by the Supreme Court in *Cutter v. Wilkinson*, 125 S. Ct. 2113, 2115 (2005) (finding that RLUIPA strikes a balance that "protects institutionalized persons who are unable freely to attend to their religious needs" but "does not elevate accommodation of religious observances over an institution's need to maintain order and safety").

317. Magarian, *supra* note 22 (discussing Establishment Clause problems with RFRA). See also Marci A. Hamilton, *The Religious Freedom Restoration Act Is Unconstitutional, Period*, 1 U. PA. J. CONST. L. 1 (1998) (arguing that RFRA violates the Establishment Clause); William P. Marshall, *The Religious Freedom Restoration Act: Establishment, Equal Protection and Free Speech Concerns*, 56 MONT. L. REV. 227 (1995) (same).

318. Magarian, *supra* note 22, at 1907. Magarian thus parts company with Justice Stevens, who noted in his concurrence in *City of Boerne v. Flores* that RFRA was facially infirm. See *Boerne*, 521 U.S. at 537 (Stevens, J., concurring). See also Ira C. Lupu, *Statutes Revolving in Constitutional Law Orbits*, 79 VA. L. REV. 1, 60 & n.272 (1993) (noting that "[a]ll courts need do with [discretionary accommodations under statutes such as RFRA] is measure them against the Establishment Clause" but acknowledging that such measurement "is no simple task").

319. Magarian, *supra* note 22, at 1995–96.

320. *Id.* That is, the Establishment Clause should tolerate RFRA-driven accommodations "based on the absence of externalized costs." *Id.* at 1996.

obligation to satisfy claims for reasons idiosyncratic to the church—for example, canon law—would impose “substantial costs” on those who would not benefit from recognizing the accommodation (tort creditors).

B. INTERNAL AFFAIRS (CHURCH PROPERTY) CASES

Even if bankruptcy courts see no free exercise problems in these cases, they may have to wrestle with a second challenge to the bankruptcy system emanating from a “hoary”³²¹ but increasingly important line of cases in which courts have been asked to address internal church disputes about the disposition of property following schisms within the churches. As a general matter, this rather poorly understood body of cases holds that civil courts, which presumably include bankruptcy courts, should tread lightly in the face of such disputes.³²² If a church is “hierarchical,” which the Catholic Church is generally thought to be, then courts should defer to the decision of the highest church authority on the matter unless “neutral” documents, such as documents of title and transfer, indicate that the church hierarchy has made some other choice about how property should be distributed.

The view that courts must defer to property distribution decisions made by a church’s hierarchy dates as far back as the late nineteenth century.³²³ As discussed above, in *Watson v. Jones*, the Supreme Court held that courts must defer to the decisions of the church’s hierarchy.³²⁴ This has been tempered to some extent by neutral principles cases, such as

321. See Ira C. Lupu, *Where Rights Begin: The Problem of Burdens on the Free Exercise of Religion*, 102 HARV. L. REV. 933, 959 (1989).

322. See *Presbyterian Church v. Mary Elizabeth Blue Hull Mem’l Presbyterian Church*, 393 U.S. 440, 449 (1969) (“[T]he First Amendment severely circumscribes the role that civil courts may play in resolving church property disputes.”). See also *Serbian E. Orthodox Diocese for the U.S. & Can. v. Milivojevich*, 426 U.S. 696, 712–20 (1976); *Kreshik v. St. Nicholas Cathedral*, 363 U.S. 190, 191 (1960); *Kedroff v. St. Nicholas Cathedral of Russian Orthodox Church*, 344 U.S. 94, 113–15 (1952); *Gonzalez v. Roman Catholic Archbishop*, 280 U.S. 1, 16–17 (1929); *Shepard v. Barkley*, 247 U.S. 1, 2 (1918).

323. Indeed, Michael McConnell has shown that some of the earliest religious liberty jurisprudence involves questions of church property. See Michael W. McConnell, *The Supreme Court’s Earliest Church-state Cases: Windows on Religious-Cultural-Political Conflict in the Early Republic*, 37 TULSA L. REV. 7 (2001) (discussing the property rights of churches in *Terrett v. Taylor*, 13 U.S. 43 (1815) and *Town of Pawlet v. Clark*, 13 U.S. 292 (1815)). It should be noted that although Judge McConnell has reminded us of this important precedent, he was not the first to do so. Paul Kauper did so in 1969 in an important article on the development of the church property cases. See Paul G. Kauper, *Church Autonomy and the First Amendment: The Presbyterian Church Case*, 1969 SUP. CT. REV. 347, 349–53.

324. *Watson v. Jones*, 80 U.S. (13 Wall.) 679 (1871). See *supra* Part III.B.1.c.

Jones v. Wolf.³²⁵ Where church property has been held in trusts valid under civil law, *Jones v. Wolf* tells us that the trust should be enforced.³²⁶ As seen in the Portland case, however, when a trust has been formed pursuant only to religious (for example, canon) law, but does not satisfy ordinary bankruptcy law, the questions become more difficult.

The role of the church property decisions in the diocesan abuse cases has been hotly contested. At one end of the continuum we find statements like those of Douglas Laycock, who argues for broad protection for churches:

The Church says that this is the Catholic Church, Catholics will decide how it should be run, and the government should not be regulating the internal operations of the Church. A church should not have to show a particular doctrinal basis for every internal management decision. The faithful or the hierarchy, depending on church polity, ought to be entitled to run their own religious organization.³²⁷

On the other hand, we have the views of those like Marci Hamilton, who essentially argues that except for matters of belief and doctrine, churches should be treated just like everyone else:

It is not that the religious institution was autonomous at one moment and then became encumbered by the social obligation to obey the law the next. Rather, religious institutions in the United States are and have always been part and parcel of the larger society. When a dispute extends beyond their shared beliefs into action that potentially harms others, religious institutions are treated as any other integral element of society. They are accountable to the larger good, as it is expressed through duly enacted laws.³²⁸

For Hamilton, there would presumably be nothing “internal” about the church’s obligation to pay judgments or otherwise to compensate the tort claimants.³²⁹ The tort claimants would be third parties, no different than contract creditors, entitled to press their claims in civil courts and execute on civil judgments unimpeded by claims of religious liberty protections.³³⁰

325. *Jones v. Wolf*, 443 U.S. 595 (1979). See *supra* Part III.B.1.c.

326. *Jones*, 443 U.S. at 595.

327. Douglas Laycock, *The Supreme Court and Religious Liberty*, 40 CATH. LAW. 25, 48 (2000).

328. Marci A. Hamilton, *Religious Institutions, the No-harm Doctrine, and the Public Good*, 2004 BYU L. REV. 1099, 1185. See generally HAMILTON, *supra* note 253.

329. See Hamilton, *supra* note 328, at 1189 (“The courts may, and indeed must, apply neutral principles of law, even if the case involves a religious institution and religiously motivated conduct, because harm resulting from actions must be redressed or prevented to serve the public good.”).

330. As Justice Rehnquist has observed,

There are constitutional limitations on the extent to which a civil court may inquire into and determine matters of ecclesiastical cognizance and polity in adjudicating intrachurch disputes.

Thus, we might expect that autonomy-based exemptions should meet the same fate in bankruptcy as they have in the underlying litigations, which was often failure. Courts have admittedly gone both ways on the effectiveness of church-autonomy defenses to liability.³³¹ They have become increasingly intolerant of such defenses, however. Ira Lupu and Robert Tuttle observe that “First Amendment defenses once thought likely to insulate defendants . . . have been aggressively advanced and explicitly rejected.”³³² Courts generally reject these defenses because, or to the extent that, they conclude that sexual abuse is not within the scope of religious activity, and that the rules establishing liability are “neutral” and generally applicable.³³³

But this Court never has suggested that those constraints similarly apply outside the context of such intraorganization disputes. . . . [The intrachurch] cases are premised on a perceived danger that in resolving intrachurch disputes the State will become entangled in essentially religious controversies or intervene on behalf of groups espousing particular doctrinal beliefs. Such considerations are not applicable to purely secular disputes between third parties and a particular defendant, albeit a religiously affiliated organization

Gen. Council on Fin. & Admin. of the United Methodist Church v. Superior Court, 439 U.S. 1369, 1372–73 (1978) (internal citations omitted). *See also* Malicki v. Doe, 814 So. 2d 347, 356–57 (Fla. 2002) (distinguishing internal church disputes from third-party harm cases).

331. A number of courts have recognized an internal affairs defense to diocesan liability. *See, e.g.*, Ehrens v. Lutheran Church-Mo. Synod, 269 F. Supp. 2d 328 (S.D.N.Y. 2003); Ayon v. Gourley, 47 F. Supp. 2d 1246 (D. Colo. 1998), *aff'd*, 185 F.3d 873 (10th Cir. 1999); Schmidt v. Bishop, 779 F. Supp. 321 (S.D.N.Y. 1991); Swanson v. Roman Catholic Bishop, 692 A.2d 441 (Me. 1997); H.R.B. v. J.L.G., 913 S.W.2d 92, 99 (Mo. Ct. App. 1995). Other courts have declined to do so. *See, e.g.*, Doe v. Norwich Roman Catholic Diocesan Corp., 268 F. Supp. 2d 139 (D. Conn. 2003); Smith v. O’Connell, 986 F. Supp. 73, 76–77 (D.R.I. 1997); Rosado v. Bridgeport Roman Catholic Diocesan Corp., 716 A.2d 967 (Conn. Super. Ct. 1998); Malicki, 814 So. 2d 347; Konkle v. Henson, 672 N.E.2d 450 (Ind. Ct. App. 1996); Mrozka v. Archdiocese of St. Paul & Minneapolis, 482 N.W.2d 806, 812 (Minn. Ct. App. 1992); Kenneth R. v. Roman Catholic Diocese, 654 N.Y.S.2d 791 (N.Y. App. Div. 1997); Jones v. Trane, 591 N.Y.S.2d 927 (N.Y. Sup. Ct. 1992). Finally, some courts have, within a single case, announced seemingly contradictory holdings on the question. *See, e.g.*, J.M. v. Minn. Dist. Council of the Assemblies of God, 658 N.W.2d 589, 594–98 (Minn. Ct. App. 2003) (rejecting a negligent hiring claim, which would “force the court into an examination of church doctrine governing who is qualified to be a pastor,” but also holding that the determinations of whether an employee-employer relationship existed, whether the pastor had acted as a psychotherapist, and whether there was “negligent retention” were within the purview of the court); Gibson v. Brewer, 952 S.W.2d 239 (Mo. 1997) (en banc) (holding that the First Amendment barred causes of action for negligent hiring, ordination, and retention of, as well as failure to supervise, perpetrator priest, but allowing a cause of action for intentional failure to supervise).

332. Lupu & Tuttle, *supra* note 32, at 1792.

333. *See, e.g.*, Malicki, 814 So. 2d at 354. Lupu and Tuttle warn that religious institutions should not be exposed to liability for reasons unique to religious institutions. A court should not, for example, conclude that a diocese breached a uniquely religious fiduciary or other duty in failing to detect or deter sexual misconduct by its priests, especially since courts seem unwilling to impose similar fiduciary duties on parallel secular organizations. *See* Lupu & Tuttle, *supra* note 32, at 1797, 1832–49. *See also* Dane, *supra* note 249, at 1767 (“[W]e need to worry about holding churches liable in sexual abuse cases on the basis of ‘duties’ grounded in ‘special relationships’ that exist in the internal life of the religious community.”).

The problem can be measured by the distance between liability and remedy, and it is not clear that the doctrinal positions established for the former make sense for the latter. The principal goals in a Chapter 11 case are remedial: debtor rehabilitation and creditor maximization. These two sometimes conflicting goals can usually be met only if the debtor is able to discharge a large portion of its debt and enjoin creditors from future collection. To reach discharge, however, a significant portion of the diocesan debtor's assets may have to be sold, perhaps over objections of parishioners or, for that matter, the church hierarchy. If, as discussed above, there are serious failings in the management of these cases, a plan may be crammed down, or a Chapter 11 trustee may be appointed.³³⁴ The trustee may have a very different view about what property should remain with parishes, and what should be sold or otherwise used to fund a plan. Any of these problems would likely lead to serious internal disputes about the direction and continued viability of the diocese as a religious entity. These are the very questions that the church property cases have attempted to address.

While I have argued that religious liberty rules should not create defenses to claims of harm to third parties, I have also suggested that identifying who actually is a third party for this purpose is difficult, determined, at least in some important respects, by the "consent" of the party in question to be governed by the religious institution's internal rules.³³⁵ Here, consent presents a complex proposition. On the one hand, we tend to assume that any tort creditor has established, ipso facto, the absence of consent by the nature of the sexual abuse claim. To the extent that liability arose from abuse of children, consent is even more difficult to find. Children cannot by law be deemed to have consented to virtually anything in these cases.

On the other hand, it is likely that at least some tort creditors remain members of the church. To that extent, would their claims against the church be comparable to the claims made in prior church property cases, where members of a church dispute the allocation and distribution of church assets? If so, should two different sets of rules apply depending on the tort creditors' self-identified religious affiliations? Should the tort creditor who remains in the church receive less than the nonmember because canon law would apply to the claim of the former but not the latter? This would seem to be an odd result.

334. See *supra* Part III.B.3.

335. Lipson, *On Balance*, *supra* note 27, at 604–05, 614–15.

C. ESTABLISHMENT CLAUSE PROBLEMS

A third set of constitutional problems would derive from the Establishment Clause. Although our thinking about the Establishment Clause is in transition,³³⁶ it may, oddly enough, provide important doctrinal ammunition for both parishioners and tort claimants.

Under a broad construction of the clause³³⁷ the Court appears to be concerned with two distinct sorts of potential establishment problems: economic and expressive. Economic establishment was at issue in *Lemon v. Kurtzman*,³³⁸ and the many school and other funding cases that came in its wake.³³⁹ Although the Court has grown increasingly tolerant of state economic support for religious actors,³⁴⁰ especially where the support

336. See Ira C. Lupu & Robert W. Tuttle, *Zelman's Future: Vouchers, Sectarian Providers, and the Next Round of Constitutional Battles*, 78 NOTRE DAME L. REV. 917, 918 (2003) (observing that, in light of recent Establishment Clause precedent, "only the most ostrich-like Separationist could have denied the flux in the law of the Establishment Clause").

337. The real scope and purpose of the clause is simply not clear. "The First Amendment contains no textual definition of 'establishment,'" the Court recently observed, "and the term is certainly not self-defining. No one contends that the prohibition of establishment stops at a designation of a national (or . . . a state) church, but nothing in the text says just how much more it covers." *McCreary County v. ACLU*, 125 S. Ct. 2722, 2742 (2005) (striking a display of the Ten Commandments in county courthouses). *But cf.* *Van Orden v. Perry*, 125 S. Ct. 2854 (2005) (plurality opinion) (upholding a Ten Commandments display on the grounds of the Texas capital and holding that the Establishment Clause was not violated by the display).

338. *Lemon v. Kurtzman*, 403 U.S. 602 (1971) (assessing the constitutionality of state statutes that provided aid to church-related schools, among others).

339. See *Zelman v. Simmons-Harris*, 536 U.S. 639 (2002) (upholding a school voucher program); *Good News Club v. Milford Cent. Sch.*, 533 U.S. 98 (2001) (holding that allowing religious school groups to use school facilities does not violate the Establishment Clause); *Agostini v. Felton*, 521 U.S. 203 (1997) (approving a program that provided public employees to teach remedial classes at religious and other private schools), *overruling* *Aguilar v. Felton*, 473 U.S. 402 (1985) (barring public school teachers from going to parochial schools to provide remedial education to disadvantaged children), *and* *Sch. Dist. of Grand Rapids v. Ball*, 473 U.S. 373 (1985) (striking down a program that provided classes to religious school students at public expense in classrooms leased from religious schools); *Rosenberger v. Rector & Visitors of the Univ. of Va.*, 515 U.S. 819 (1995) (holding that the Establishment Clause does not bar disbursement of funds from student activity fees to religious organizations); *Zobrest v. Catalina Foothills Sch. Dist.*, 509 U.S. 1 (1993) (allowing a public school district to provide a publicly employed sign-language interpreter to a deaf student at a Catholic high school as part of a federal program for the disabled); *Lynch v. Donnelly*, 465 U.S. 668 (1984) (upholding a Christmas display including a nativity scene); *Marsh v. Chambers*, 463 U.S. 783, 795 (1983) (upholding a legislative prayer); *Mueller v. Allen*, 463 U.S. 388 (1983) (upholding a tax deduction for certain expenses incurred in sending a child to a religious school). *Cf.* *Texas Monthly, Inc. v. Bullock*, 489 U.S. 1 (1989) (plurality opinion) (invalidating a sales tax exemption for all religious periodicals).

340. In Laycock's words, "Federal constitutional restrictions on funding religious institutions have collapsed." Laycock, *supra* note 288, at 156. See *Mitchell v. Helms*, 530 U.S. 793 (2000) (plurality opinion) (upholding government lending of educational materials and equipment to private religious schools); *Agostini*, 521 U.S. 203 (upholding the government's sending public school teachers into private religious schools to provide remedial education for disadvantaged students).

reflects “true private choice,”³⁴¹ it remains somewhat cautious about expressive support or, in Justice O’Connor’s terms, “endorsement.”³⁴²

Economic establishment has presented a challenge for the Court, in large part because government has become so deeply profused in public and private life that no religious entity or actor could be completely insulated from the fiscal reach of the state. Does the “wholesome neutrality” allegedly envisioned by the Establishment Clause³⁴³ require government to tax churches, or exempt them from taxation, to provide municipal services free, or charge separately for them?³⁴⁴ The problem can be traced to an apparent tension in *Everson v. Board of Education*.³⁴⁵ Although that case announced the “no-aid” principle, that “[n]o tax in any amount, large or small, can be levied to support any religious activities or institutions,”³⁴⁶ it also announced that religion could not be a basis for discrimination in distributing government benefits.³⁴⁷ *Everson* concluded that discrimination was worse than aid and, therefore, that the state could use tax-raised funds to pay for school buses for both public and parochial schools.³⁴⁸

Lemon v. Kurtzman represented a shift in emphasis, holding that states could not subsidize teachers’ salaries in religious schools.³⁴⁹ The opinion

341. *Zelman*, 536 U.S. at 643–50, 653–54, 662–63 (upholding a program in which publicly funded tuition vouchers could be used at secular or religious private schools).

342. *Id.* at 663–76 (O’Connor, J., concurring). The “no-endorsement” test requires a court to consider whether a government program is intended to advance or inhibit religion and whether the program creates the impression that it does so. *See County of Allegheny v. ACLU*, 492 U.S. 573, 625 (1989) (O’Connor, J., concurring) (discussing the no-endorsement test in a case involving the display of a nativity scene and menorah in county buildings); *Lynch*, 465 U.S. at 688 (O’Connor, J., concurring) (initially articulating the no-endorsement test in a case challenging a town’s nativity scene).

343. The phrase comes from *School District v. Schempp*, 374 U.S. 203, 222 (1963). Although neutrality has long been a watchword of Establishment Clause jurisprudence and, indeed, of religious liberty thought in general, it has been an especially difficult concept to put into practice. It may now be a dead letter. *See Van Orden v. Perry*, 125 S. Ct. 2854, 2892 (2005) (Souter, J., dissenting) (arguing that “[a] governmental display of an obviously religious text cannot be squared with neutrality”). *See also* Shannon Black, Note, *Locke v. Davey and the Death of Neutrality as a Concept Guiding Religion Clause Jurisprudence*, 19 ST. JOHN’S J. LEGAL COMMENT. 337, 368 (2005).

344. *Walz v. Tax Comm’n*, 397 U.S. 664 (1970) (permitting tax exemptions).

345. *Everson v. Bd. of Educ.*, 330 U.S. 1 (1947).

346. *Id.* at 16.

347. *Id.* (stating that the government “cannot exclude individual Catholics, Lutherans, Mohammedans, Baptists, Jews, Methodists, Non-believers, Presbyterians, or the members of any other faith, because of their faith, or lack of it, from receiving the benefits of public welfare legislation”).

348. *Id.* at 16–18.

349. *Lemon v. Kurtzman*, 403 U.S. 602 (1971).

set forth a famous, and famously derided,³⁵⁰ three-part test to determine whether a law will survive an Establishment Clause challenge: “First, the statute must have a secular legislative purpose; second, its principal or primary effect must be one that neither advances nor inhibits religion; finally, the statute must not foster ‘an excessive government entanglement with religion.’”³⁵¹

Skepticism about state aid for religious actors or activities persisted until the mid-1980s, when concerns about nondiscrimination again began to dominate Establishment Clause jurisprudence, at least in the economic context.³⁵² This must have been due in part to the “much-ridiculed distinctions” the Court was required to make under *Lemon* in deciding whether particular welfare programs that involved religious actors crossed the line.³⁵³

If the *Lemon* test were used at all—a big “if”³⁵⁴—its first two elements might help tort creditors, while its third might help parishioners, at least under certain circumstances. The first two requirements, “secular legislative purpose” and “neutral effect,” might conflict with any important actions sanctioned by the bankruptcy court that turn in significant part on canon law or that benefit the diocese economically for exclusively religious reasons.

350. *McCreary County v. ACLU*, 125 S. Ct. 2722, 2757 (2005) (Scalia, J., dissenting) (“As bad as the *Lemon* test is, it is worse for the fact that, since its inception, its seemingly simple mandates have been manipulated to fit whatever result the Court aimed to achieve.”).

351. *Lemon*, 403 U.S. at 612–13 (1971) (quoting *Walz v. Tax Comm’n*, 397 U.S. 664, 674 (1970)) (internal citation omitted).

352. See *Laycock*, *supra* note 288, at 166 (“Beginning in 1986, the Court progressively elevated the nondiscrimination principle and subordinated the no-aid principle.”).

353. See *id.* at 164.

354. In *Van Orden v. Perry*, 125 S. Ct. 2854 (2005), Justice Rehnquist’s plurality opinion announced that it would not use the *Lemon* test in deciding to uphold a display of the Ten Commandments on the grounds of the Texas legislature, stating that “[w]hatever may be the fate of the *Lemon* test in the larger scheme of Establishment Clause jurisprudence, we think it not useful in dealing with the sort of passive monument that Texas has erected on its Capitol grounds.” *Id.* at 2861. Justice Rehnquist, writing for what was arguably a bare majority (including Justices Scalia, Thomas, Kennedy and, by concurrence, Breyer) noted that the Court has moved away from the *Lemon* test in recent decisions. *Id.* (“Many of our recent cases simply have not applied the *Lemon* test.”). *Lemon* may be down, but it is not out. On the same day the Court issued the *Van Orden* opinion, it also announced a very different result in *McCreary*, using *Lemon* to strike down a display of the Ten Commandments. See *McCreary*, 125 S. Ct. at 2733–36 (applying *Lemon*’s “secular legislative purpose” test to strike down the display of the Ten Commandments in county courthouses). Even if *Lemon* survives, however, it appears to have lost a limb in *Agostini v. Felton*, 521 U.S. 203 (1997), where the Court merged the “advancement” and “excessive entanglement” elements “into a single inquiry into forbidden religious effects.” Lupu & Tuttle, *supra* note 336, at 927 n.45.

First, it would appear safe to claim that the Bankruptcy Code itself reflects a “secular legislative purpose.” If, however, bankruptcy courts granted discretionary exemptions based on religious liberty concerns, there might be a problem.³⁵⁵ For example, although apparently not successfully asserted in the Tucson case, it is possible that the plan’s reliance on canon law to establish the property available for distribution would be viewed as advancing religion and as lacking in a secular purpose. Objecting tort creditors might have argued that if their recovery is to be limited, it should be civil, and not canon, law that caused the reduction.

More problematic would be conferring an economic benefit on the diocese for exclusively religious reasons. This might offend the Court’s economic analysis of the effects prong of the *Lemon* test that religious actors should not enjoy economic benefits if such benefits are not available to others that are similarly situated. Thus, in *Texas Monthly, Inc. v. Bullock*, the plurality invalidated a sales tax exemption that was conferred solely on religious periodicals.³⁵⁶ “Every tax exemption constitutes a subsidy,” the plurality reasoned, “that affects nonqualifying taxpayers, forcing them to become ‘indirect and vicarious “donors.””³⁵⁷ While there is nothing inherently wrong with tax exemptions, they become problematic if available only to religious actors. On similar reasoning, the Court has held that neutral commercial laws of general application, such as the Fair Labor Standards Act, must apply to religious actors.³⁵⁸ If they did not, they would “undoubtedly give [religious] petitioners and similar organizations an advantage over their competitors. It is exactly this kind of ‘unfair method of competition’ that the [Fair Labor Standards Act] was intended to prevent and the admixture of religious motivations does not alter a business’s effect on commerce.”³⁵⁹ Economic benefits that are available more generally, however, may be permissible.

355. Cf. Richard F. Duncan, *Free Exercise and Individualized Exemptions: Herein of Smith, Sherbert, Hogwarts, and Religious Liberty*, 83 NEB. L. REV. 1178, 1187 (2005) (arguing that discretionary exemptions should be recognized because “the risk of discrimination and bias is significant when public benefits and burdens are allocated by a discretionary administrative process”).

356. *Tex. Monthly, Inc. v. Bullock*, 489 U.S. 1 (1989) (plurality opinion). Texas exempted from its sales tax “[p]eriodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith and books that consist wholly of writings sacred to a religious faith.” *Id.* at 5 (quoting TEX. TAX CODE ANN. § 151.312 (Vernon 1982)).

357. *Id.* at 14 (quoting *Bob Jones Univ. v. United States*, 461 U.S. 574, 591 (1983)). See also *Foremaster v. City of St. George*, 882 F.2d 1485, 1489 (10th Cir. 1989) (holding that an electric subsidy given by the city impermissibly advanced the Latter-Day Saints Church).

358. See *Tony & Susan Alamo Found. v. Sec’y of Labor*, 471 U.S. 290 (1985) (internal citation omitted).

359. *Id.* at 299. See also *Jimmy Swaggart Ministries v. Bd. of Equalization*, 493 U.S. 378 (1990) (holding that California’s sales and use tax was constitutional even as applied to sales of religious

Parishioners, on the other hand, may resort to the third element, which proscribes excessive government entanglement with religion, if the cases do not go well and the court appoints a Chapter 11 trustee or examiner or approves a cram down plan. In such events, the court, and perhaps a trustee or examiner, may become deeply involved in the operations of the diocese, while determining issues such as whether certain assets should remain property of the estate or be remitted to the parishes and whether management (the bishop) has fulfilled its duties to the estate.³⁶⁰

The Establishment Clause has occasionally presented problems in the bankruptcy context, especially when Chapter 13 debtors seek to use some of their income to tithe even as their plans may fail to pay creditors in full. Most bankruptcy courts have been able to manage these issues without finding significant constitutional problems. They have, for example, either found that continued tithing did not violate the Establishment Clause,³⁶¹ or

literature). See Lipson, *On Balance*, *supra* note 27, at 617–18 (discussing the competitive effects of religious liberty exemptions). *But see* Corp. of the Presiding Bishop of the Church of Jesus Christ of Latter-Day Saints v. Amos, 483 U.S. 327, 338 (1987) (observing that religious accommodations need not “come[] packaged with benefits to secular entities” in upholding against an Establishment Clause challenge a provision exempting religious organizations from the prohibition against religion-based employment discrimination in Title VII of the Civil Rights Act of 1964).

360. Although not free from doubt, it would appear that bankruptcy trustees are, like the courts that appoint them, “state actors” whose activities might create Establishment Clause problems. The court in *In re Barman* found that because a “sufficient nexus to the government and its power” exists, it was necessary and appropriate to apply Fourth Amendment limits to a bankruptcy trustee. Taunt v. Barman (*In re Barman*), 252 B.R. 403, 412–13 (Bankr. E.D. Mich. 2000). The court began by recognizing that a person acts under the color of law if that person’s conduct is “fairly attributable to the government,” including searching for property of the estate. *Id.* at 411–12. The court in *In re Kashani* observed that it had long been established that a trustee is an officer of the appointing court and granted a form of derivative judicial immunity from liability when the actions are within the scope of official duty. *Kashani v. Fulton (In re Kashani)*, 190 B.R. 875, 883 (B.A.P. 9th Cir. 1995).

361. In *In re Green*, the court confirmed a Chapter 13 plan that included in the debtor’s permitted monthly expenses contributions to their church. *State v. Green (In re Green)*, 103 B.R. 852, 855 (W.D. Mich. 1988). Applying *Lemon*, the court concluded that allowing debtors to continue tithing did not violate the Establishment Clause because no direct governmental involvement existed, and governmental machinery was not applied. *Id.* The court reasoned that the Bankruptcy Code and the bankruptcy court’s decision had a secular purpose, and that while the bankruptcy plan might have indirectly benefited the debtors’ church, it could not be construed as government approval of religion. Thus, government involvement in the case was minimal. *Id.* The plan’s approval would not result in an ongoing relationship between the government and the church. *Id.* See also *In re Navarro*, 83 B.R. 348, 353 (Bankr. E.D. Pa. 1988) (confirming a tithing plan). The court in *In re Miles*, 96 B.R. 348 (Bankr. N.D. Fla. 1989), however, rejected the constitutional analysis in *In re Green* and denied confirmation of a plan that included tithing. *Id.* at 349. The court reasoned that while church donations “may be a source of inner strength and comfort to those who feel compelled to make them, they are not necessary for the ‘maintenance or support of the debtor.’” *Id.* at 350.

they have disapproved the plan on other grounds, usually that it made inappropriate use of the debtor's disposable income.³⁶²

One exception was *In re Saunders*, where the court explicitly rejected a tithing Chapter 13 plan on Establishment Clause grounds.³⁶³ The United States, seeking to salvage whatever it could of RFRA in the wake of *Boerne*, argued that the statute permitted a debtor's Chapter 13 plan to include tithes. Judge Hillman disagreed for two reasons. First, he reasoned that such a plan would impermissibly advance religion by conferring an economic benefit unique to religious actors.³⁶⁴ Since RFRA would, if it permitted tithing under a plan, "ha[ve] the primary effect of advancing religion, not as one type of nonprofit institution preferred 'when the government, following neutral criteria and evenhanded policies, extends benefits to recipients whose ideologies and viewpoints, including religious ones, are broad and diverse.'"³⁶⁵ Second, applying both *Walz v. Tax Commission* and *Lemon*, the court reasoned that a tithing plan would present a bankruptcy court with an "acute problem" because determining whether tithing is "reasonably necessary" forces the court to "pass judgment on a debtor's lifestyle."³⁶⁶ Moreover, Judge Hillman observed, because "Chapter 13 plans are frequently modified as a result of claims litigation, changes of circumstances, etc., the judge may have to rule repeatedly as to the permissible amount of tithing."³⁶⁷

362. See, e.g., *Lynn v. Diversified Collection Serv. (In re Lynn)*, 168 B.R. 693 (Bankr. D. Ariz. 1994); *In re Cavanaugh*, 175 B.R. 369 (Bankr. D. Idaho 1994); *In re Lees*, 192 B.R. 756, 760 (Bankr. D. Mont. 1994); *In re Packham*, 126 B.R. 603, 608 (Bankr. D. Utah 1991); *In re Sturgeon*, 51 B.R. 82, 84 (Bankr. S.D. Ind. 1985).

In *In re Packham*, the court stated that the church is not in a position to "make the Lord a priority creditor in bankruptcy." *In re Packham*, 126 B.R. at 608 n.8. The court also noted that failure to tithe would not deny the debtors full participation in the church. *Id.* at 609. In addition, if the court allowed tithing, it would be impermissibly required to decide whether the debtor has a bona fide commitment to the religious organization. *Id.*

363. *In re Saunders*, 215 B.R. 800, 806 (Bankr. D. Mass. 1997).

364. *Id.* at 804-06.

365. *Id.* at 806 (quoting *Rosenberger v. Rector & Visitors of the Univ. of Va.*, 515 U.S. 819, 839 (1995)).

366. *Id.* (quoting *In re Andrade*, 213 B.R. 765, 768 (Bankr. E.D. Cal. 1997)).

367. *Id.* As with the fraudulent conveyance problem, this has apparently been remedied by statute. See Religious Liberty and Charitable Donation Protection Act of 1998, Pub. L. 105-183, 112 Stat. 517 (codified as amended in scattered sections of 11 U.S.C.). Even before that amendment to the Bankruptcy Code, there was support for the idea that tithing under a Chapter 13 plan presented no important Establishment Clause problems. See, e.g., Donald R. Price & Mark C. Rahdert, *Distributing the First Fruits: Statutory and Constitutional Implications of Tithing in Bankruptcy*, 26 U.C. DAVIS L. REV. 853, 926 (1993) (arguing that permitting a debtor to tithe "maintains a governmental neutrality that refusing the tithe would disturb").

It is easy to imagine a court in a diocesan Chapter 11 case sharing Judge Hillman's concerns. As already noted, reorganization plans are complex creatures. In the absence of the overwhelming consent seen in the Tucson case, a court may well have to take on a fairly intrusive role, both during the confirmation process and thereafter. How is determining property of the diocesan Chapter 11 estate, plan feasibility, or any of the cram down standards, easier or less intrusive than determining whether tithes are "reasonably necessary"? How much postconfirmation supervision is too much? Obviously, courts will have to supervise these cases, and that supervision will involve some entanglement. How will courts know when they have crossed the line?

A more troubling argument would build on our increasingly privatized conception of "choice" in Establishment Clause problems. In *Zelman v. Simmons-Harris*, for example, the Court upheld Ohio's school voucher program which permitted recipients to use vouchers to attend private secular or religious schools.³⁶⁸ The Court, per Justice Rehnquist, reasoned that Establishment Clause jurisprudence has often distinguished between government programs that provide aid "directly to religious schools"³⁶⁹ and "programs of true private choice, in which government aid reaches religious schools only as a result of the genuine and independent choices of private individuals."³⁷⁰

The "privacy" of the choice appears to be more important than the range of options available.³⁷¹ Justice Rehnquist observed for the Court that where a "neutral" program "provides assistance directly to a broad class of citizens who, in turn, direct government aid to religious schools wholly as a result of their own genuine and independent private choice, the program is

368. *Zelman v. Simmons-Harris*, 536 U.S. 639, 643–48, 652–54 (2002).

369. *Id.* at 649 (citing *Mitchell v. Helms*, 530 U.S. 793, 810–14 (2000) (plurality opinion); *id.* at 841–44 (O'Connor, J., concurring); *Agostini v. Felton*, 521 U.S. 203, 225–27 (1997); *Rosenberger*, 515 U.S. at 842)).

370. *Id.* (citing *Zobrest v. Catalina Foothills Sch. Dist.*, 509 U.S. 1 (1993); *Witters v. Wash. Dep't of Servs. for the Blind*, 474 U.S. 481 (1986); *Mueller v. Allen*, 463 U.S. 388 (1983)).

371. As Lupu and Tuttle have observed, the real choice in *Zelman* was rather narrow, as ninety-seven percent of the private schools in Cleveland were religious. Lupu & Tuttle, *supra* note 336, at 930–31. They note that

[t]he first option was illusory—no public school district in the Cleveland metropolitan area was willing to take Cleveland voucher students. The second option could hardly count as an equal alternative to private-school tuition; the tutoring voucher offered a maximum of \$360, or approximately \$10 per week for the school year. Religious schools dominated the third option; they offered nearly 97% of the voucher seats in the 1999–2000 academic year.

Id. (internal footnote omitted).

not readily subject to challenge under the Establishment Clause.”³⁷² Thus, as Justice Rehnquist later observed for the Court in *Locke v. Davey*, “[T]he link between government funds and religious training is broken by the independent and private choice of recipients.”³⁷³

This “choice” paradigm may, by a parity of reasoning, capture legitimate concerns of tort creditors. They certainly had no choice in incurring their claims; they are tort creditors, after all. Nor did they choose to have state actors—bankruptcy courts—reduce the amounts to which they are entitled, either by agreement with the debtor or by determination of another court. If the reduction in their claims is viewed as a form of “funding” to the church, which is a fairly standard economic way of viewing claims discharge, they may well ask why their “private choice” is being defeated.³⁷⁴ After all, Judge McConnell has observed, religious liberty should be protected ““in every case where it does not trespass on private rights.””³⁷⁵

When all is said and done, constitutional doctrine essentially leaves two distinct and somewhat unpalatable possibilities: either religious liberty rules and norms—and, by incorporation, canon law—will displace the Bankruptcy Code, or the Bankruptcy Code will apply without regard for the unusual nature of the religious entity debtor. The former may, paradoxically, be both compelled and forbidden by existing religious liberty jurisprudence. The latter may place judges in normatively untenable positions.

372. *Zelman*, 536 U.S. at 652. See also *Mitchell*, 530 U.S. at 810 (“[I]f numerous private choices, rather than the single choice of a government, determine the distribution of aid pursuant to neutral eligibility criteria, then a government cannot, or at least cannot easily, grant special favors that might lead to a religious establishment.”); *id.* at 843 (O’Connor, J., concurring) (“[W]hen government aid supports a school’s religious mission only because of independent decisions made by numerous individuals to guide their secular aid to that school, ‘[n]o reasonable observer is likely to draw from the facts . . . an inference that the State itself is endorsing a religious practice or belief.’” (quoting *Witters*, 474 U.S. at 493 (O’Connor, J., concurring) (second alteration in original))).

373. *Locke v. Davey*, 540 U.S. 712, 719 (2004). As discussed in the introduction to this Article, *Davey* upheld Washington State’s tuition assistance plan, even though it excluded certain religious studies. See *supra* note 23 and accompanying text.

374. It is, of course, possible to confirm a plan of reorganization that does not rely on canon law. It is equally possible, as the Tucson case illustrates, that creditors of all stripes will support the plan.

375. Michael W. McConnell, *Free Exercise Revisionism and the Smith Decision*, 57 U. CHI. L. REV. 1109, 1128 (1990) (quoting Letter from James Madison to Edward Livingston (July 10, 1822), in 9 THE WRITINGS OF JAMES MADISON 98, at 100 (Gaillard Hunt ed., 1901)).

V. HOW TO CHOOSE? ALTERNATIVES TO THE RECEIVED MODELS

Lupu and Tuttle have aptly observed that constitutional doctrine applied to liability questions like those posed by the diocesan cases is rigidly categorical, leaving courts with grim “all-or-nothing” options.³⁷⁶ This rigidity presents even greater problems in bankruptcy, which even our best theories (discussed in Part III.A, above) cannot solve. The proceduralist position would teach that the problems presented by these cases can be solved by recognizing only nonbankruptcy entitlements. But, as noted, it fails to say which nonbankruptcy entitlements—those of state property law, constitutional law, or some combination—should control. The pragmatist program, by contrast, may be more inclined to consider the competing values expressed by the parties and the context in which they find themselves. But it cannot tell courts which values to choose, on what basis, or how to justify such choices in adjudicative terms.

The best the bankruptcy courts in diocesan cases can hope for would be settlements with broad and strong support, as suggested by the Tucson example. Yet, if the Portland and Spokane cases are any indication, litigation positions can quickly harden in these cases, exposing intractable asymmetries between our bankruptcy and constitutional systems. The question thus becomes: how can courts make principled settlements more attractive, given their finite bag of judicial tools? This section argues that courts facing these types of cases can make settlement more attractive by using conflict-of-laws and equitable doctrines.

A. CONFLICT OF LAWS

Perry Dane has observed that religious exemption claims are in form much like conflict-of-laws problems.³⁷⁷ Religious liberty claims create problems of competing legal authorities—a conflict-of-laws problem—because, Dane argued, religious exercise refers to “behavioral, authoritative, and transcendent system[s] of command[.]” that may conflict with the commands of the state.³⁷⁸ Conflict-of-laws doctrine provides an apt analogy because both religious exceptionalism and conflict of laws “are

376. Lupu & Tuttle, *supra* note 32, at 1850.

377. See Dane, *supra* note 24, at 364. Nor is this sort of conflict new. King Henry II's twelfth-century dispute with Thomas Becket was in large measure about the power of the state to displace canon with state law. PAUL JOHNSON, A HISTORY OF CHRISTIANITY 207 (1976).

378. See Dane, *supra* note 24, at 364.

responses to claims that certain behaviour can be appropriately judged only by reference to an alien legal norm.”³⁷⁹

Dane acknowledged that religious liberty may not have a territorial locus, as is often the case in choice-of-law questions.³⁸⁰ Nevertheless, he suggested that courts could by analogy recognize a “territory” for religious considerations.³⁸¹ “A claim for a religion-based exemption,” he argued, “should . . . be thought of as an assertion that certain behaviour should be governed by the law of the religious territory in which it occurred.”³⁸² Dane did not suggest that courts in religious liberty disputes should actually engage in a conflict-of-laws analysis; rather, he viewed it as useful by analogy, arguing that religion created a metaphorical territory, beyond the reach of the forum court. Dane also asserted that the conflict-of-laws analogy must end when a dispute involves third parties.³⁸³ The theory is that third parties—those who are not members of the church—have not brought themselves into the metaphorical territory, and thus should not be subject to the chosen law.

Taken on its own terms, modern conflict-of-laws doctrine is a daunting proposition. It is dominated by “a wild-eyed community of intellectual zealots”³⁸⁴ who routinely insult one another and the enterprise in general.³⁸⁵ Most writing about choice of law begins with a history of the doctrine, and its migration from an “embarrassing” formalism³⁸⁶ to a more fulsome, if equally frustrating, realism.³⁸⁷

379. *Id.* at 366.

380. The diocesan cases may be the exception: the territorial locus would be the Vatican, and this would be understood as similar to a problem of conflict in private international laws.

381. Dane, *supra* note 24, at 367–68 (asserting that “[t]he analogy [between religious exemption claims and ‘choice-of-law’] can be pursued . . . by devising standards for cognizable religious claims that in effect carve out a ‘territory’ for religious concerns and articulate conditions that determine when persons are operating within that territory”).

382. *Id.* at 368.

383. *Id.* (“The parallel to territoriality suggests that one interest of the forum state may lead it to reject the religious exemption claim and apply its own law: protection of third parties not subject to the religious authority who would be directly affected by the granting of an exemption.”).

384. LEA BRILMAYER, *CONFLICT OF LAWS*, at xiii (2d ed. 1991).

385. *See, e.g.*, WILLIS L.M. REESE, MAURICE ROSENBERG & PETER HAY, *CONFLICT OF LAWS* 3 (9th ed. 1990) (characterizing conflict of laws as “one of the rare legal subjects about which a page of history is worth less than a blank sheet”); William L. Prosser, *Interstate Publication*, 51 MICH. L. REV. 959, 971 (1953) (claiming that “conflict of laws is a dismal swamp, filled with quaking quagmires, and inhabited by learned but eccentric professors who theorize about mysterious matters in a strange and incomprehensible jargon”).

386. *See, e.g.*, Louise Weinberg, *Theory Wars in the Conflict of Laws*, 103 MICH. L. REV. 1631, 1633 (2005). The formalist analysis of choice of law was lodged in the *Restatement (First) of Conflict of Laws* and the writings of its Reporter, Joseph Beale. The formalist position held, among other things, that “the law of a state prevails throughout its boundaries and, generally speaking, not outside them.”

The formalist position turned on the notion of “vestedness,” in which a contract or tort action would be governed by the law of the place where the rights in question vested.³⁸⁸ Generally, this was the place where the “last act” occurred.³⁸⁹ This territorially based formalism had the potential virtue of certainty. Parties had only to determine one salient fact: where the tort occurred or the contract was formed. The location of the forum, the domiciles of the parties, the interests of the various states in the dispute, and the analyses of the relative merits of the competing laws were simply beyond consideration. Indeed, even consideration of the effect of the choice of law was off limits.³⁹⁰

The formalist position also had two defects. First, it often compromised felt notions of justice.³⁹¹ Second, it was not what courts actually did. Whatever courts may have said, they were nevertheless “manipulating the seemingly fixed rules to produce desired results, and in this way obscure[d] to themselves and others the ‘inarticulate major premises’ of their decisions.”³⁹² In fact, maverick scholars like Brainerd Currie and Robert Lefflar have argued that courts were, and perhaps should be, choosing law based on substantive criteria, such as the “governmental interest” in the resolution of the dispute,³⁹³ or “choice-influencing

See JOSEPH H. BEALE, 1 A TREATISE ON THE CONFLICT OF LAWS § 59.2, at 308 (1935). See generally Kermit Roosevelt, III, *Resolving Renvoi: The Bewitchment of Our Intelligence by Means of Language*, 80 NOTRE DAME L. REV. 1821, 1831–33 (2005) (discussing the development of Beale’s analysis). Until recently, formalism was “a term of unquestionable insult.” Laura E. Little, *Hairsplitting and Complexity in Conflict of Laws: The Paradox of Formalism*, 37 U.C. DAVIS L. REV. 925, 950 (2004). It has, as Laura Little thoughtfully explains, made something of a comeback elsewhere, and may be due for one in conflicts analysis, as well. *Id.*

387. There are too many realist works on conflicts to cite usefully here. The realist approach appears to have its roots in the work of Walter Wheeler Cook, who, like many who followed, argued that even if courts said they were doing one thing, such as applying the law of the place a contract was formed, they were actually engaged in a much more complex and subtle business. WALTER WHEELER COOK, *THE LOGICAL AND LEGAL BASES OF THE CONFLICT OF LAWS* (1942); Walter Wheeler Cook, *The Logical and Legal Bases of the Conflict of Laws*, 33 YALE L.J. 457 (1924).

388. See BRILMAYER, *supra* note 384, § 1.2, at 23.

389. See, e.g., RESTATEMENT (FIRST) OF CONFLICT OF LAWS § 377 (1934) (asserting that the “place of wrong” determines the choice of law).

390. Cf. David F. Cavers, *A Critique of the Choice-of-Law Problem*, 47 HARV. L. REV. 173, 189 (1933) (“The court is not idly choosing a law; it is determining a controversy. How can it choose wisely without considering how the choice will affect that controversy?”).

391. See Weinberg, *supra* note 386, at 1634 (detailing one commentator’s realization that the problem with formalism was that it produced arbitrary and irrational decisions and showed too little regard for “the flesh-and-blood men and women for whom too often the casualty of abstraction is justice”).

392. *Id.* at 1633 (quoting *Lochner v. New York*, 198 U.S. 45, 76 (1905) (Holmes, J., dissenting)).

393. Brainerd Currie, *Married Women’s Contracts: A Study in Conflict-of-Laws Method*, 25 U. CHI. L. REV. 227 (1958). In this, an article that Louise Weinberg has suggested may be “the greatest law review article ever written,” Weinberg, *supra* note 386, at 1637, Currie deconstructed the infamous

considerations,” in particular an undisclosed preference for “the better rule of law.”³⁹⁴ Like it or not, Currie wrote, courts facing choice-of-law problems “*adjudicated* the [choice-of-law] case. . . . [T]hey looked for a result they could live with.”³⁹⁵ The real task was to figure out which were the right criteria by which adjudication at this level could occur.

The major practical contribution of the realists was section 6 of the *Restatement (Second) of Conflict of Laws*, which concluded that a court should choose the law of the state with “the most significant relationship” to the dispute.³⁹⁶ Courts would, under the *Restatement (Second)*, make this choice based on considerations set forth in section 6.³⁹⁷ Unfortunately, as Kermit Roosevelt, among many others, has observed, this iteration of the *Restatement* contains “no explanation of how to weigh [the considerations] or decide cases in which the factors point to different states.”³⁹⁸ “No matter

case of *Milliken v. Pratt*, 125 Mass. 374 (1878), in which the Massachusetts Supreme Judicial Court concluded that Maine law should govern a collection action commenced in a Massachusetts court against Massachusetts residents and where the contract was executed in Massachusetts. Currie, *supra*, at 227–33. The underlying problem involved the fact that Massachusetts law prevented married women, including one of the defendants, from contracting. Maine, by contrast, was more enlightened. Thus, if Massachusetts law applied, the Maine creditor could not collect, but if Maine law applied, he could. “By trying to identify a legitimate governmental interest at the place of contracting for each of his charted variants of *Milliken v. Pratt*,” Weinberg explains, “Currie demonstrated that the one physical contact between a state and a lawsuit that courts took most seriously in choosing law—the place of the underlying events—was a place that in a large fraction of conflicts cases had no interest at all in having its law applied.” Weinberg, *supra* note 386, at 1640.

394. Robert A. Leflar, *Choice-Influencing Considerations in Conflicts Law*, 41 N.Y.U. L. REV. 267, 282 (1966).

395. Brainerd Currie, *Survival of Actions: Adjudication Versus Automation in the Conflict of Laws*, 10 STAN. L. REV. 205, 215 (1958).

396. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 145(1) (1971) (applying the “most significant relationship” standard to tort cases); *id.* § 188(1) (applying the “most significant relationship” standard to contract cases).

397. Section 6(2) of the *Restatement (Second)* provides as follows:

When there is no [statutory] directive, the factors relevant to the choice of the applicable rule of law include

- (a) the needs of the interstate and international systems,
- (b) the relevant policies of the forum,
- (c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue,
- (d) the protection of justified expectations,
- (e) the basic policies underlying the particular field of law,
- (f) certainty, predictability and uniformity of result, and
- (g) ease in the determination and application of the law to be applied.

Id. § 6(2).

398. Roosevelt, *supra* note 386, at 1667–68. Other criticisms of the *Restatement (Second)* appear in Weinberg, *supra* note 386, at 1644 n.39. Failing to make these hard choices rendered the *Restatement (Second)* “mush,” according to Laycock. Douglas Laycock, *Equal Citizens of Equal and Territorial States: The Constitutional Foundations of Choice of Law*, 92 COLUM. L. REV. 249, 253 (1992).

what result you want to reach,” Lea Brilmayer has argued, “the [*Restatement (Second)*] provides support.”³⁹⁹

If conflicts analysis provides more than just a metaphor, the *Restatement (Second)* suggests that bankruptcy courts should at least presumptively choose ordinary bankruptcy law in these cases unaltered by canon law. Consider the second element, the relevant policies of the forum. As discussed above, bankruptcy courts in Chapter 11 reorganizations are chiefly concerned with adjusting the debtor-creditor relationship in order to maximize recoveries and/or preserve the going concern. It is difficult to imagine that any policy of the “other” sovereign’s law, canon law, would be relevant in the context of the diocesan cases. If a “relevant policy” could even be determined under canon law, it would almost certainly not be analogous to that of bankruptcy law.

Similarly, applying bankruptcy law would promote the sixth factor, which seeks certainty, predictability, and uniformity of result. If the current cases are to produce rules that can be generalized to other cases in which religious organizations seek bankruptcy court protection, courts cannot lightly choose the religious rule. There is no reason to expect rules to be similar across religions. Canon law may, for example, produce different results on matters of property and governance than, say, Jewish or Islamic law, and favoring the rules of individual religions over the uniform Bankruptcy Code will reduce certainty and predictability. Indeed, the Court has articulated a strong reluctance to promote the interests of a particular sect over others.⁴⁰⁰

The fourth and seventh elements, the protection of “justified expectations” and “ease in the determination and application” of the law, are more ambiguous. Tort creditors’ justified expectations would be that bankruptcy law applies, especially because the dioceses themselves chose to declare bankruptcy. The parishioners, however, probably have different expectations, formed by their articulated views of “their” parish property and perhaps the force of religious liberty jurisprudence. Although neither choice would be easy, it would seem that applying bankruptcy law in full would be more difficult, given the intrusive and normatively troublesome implications of liquidating or commandeering dioceses.

Perhaps the best argument for applying bankruptcy law under a conflicts analysis is that the dioceses in effect chose it by filing for

399. See BRILMAYER, *supra* note 384, § 2.2.3, at 75.

400. See, e.g., *Larson v. Valente*, 456 U.S. 228, 244 (1982) (“The clearest command of the Establishment Clause is that one religious denomination cannot be officially preferred over another.”).

bankruptcy. Ordinarily, there are policy concerns about applying forum law simply because the plaintiff chose the forum.⁴⁰¹ For example, mechanical application of forum law might promote forum shopping. These concerns about forum shopping should not apply here. They may have force in the classic litigation dynamic, where plaintiffs commence suit in their preferred courts to establish defendants' liability. Here, however, the party choosing the forum—the diocese—is not a “plaintiff” in the traditional sense. Strictly speaking, it was the defendant in the underlying tort litigation, and has sought bankruptcy protection only because it has already lost in that capacity in state court.

If the diocese is viewed as the plaintiff in the bankruptcy court, then the general argument against forum-based choice of law should apply, but with a twist: the bankruptcy courts should apply their own law, and not canon law, precisely *because* the dioceses have chosen that forum. Debtors should not be permitted to pick and choose applicable law. Either ordinary bankruptcy law applies unaffected by religious law, or it does not apply at all. And if it does not, then the dioceses have no business being in bankruptcy.⁴⁰²

The dioceses may respond that in choosing the law of the forum, they selected bankruptcy law not in its ordinary formulation, but instead as modified by their interpretations of the corporation sole and other religious entity statutes, and the religious liberty concerns expressed in the Constitution, RFRA, the church property cases, and so forth. The weakness of such a position, however, is the indeterminacy of the precedent on which it depends. It is true, as discussed in Part IV.A.3, above, that *Young* found an exemption from the Bankruptcy Code, and that there are a variety of other plausible religious liberty claims that the diocese (or, perhaps more appropriately, the parishioners) could assert. But it is also true that *Smith* remains the law of the land, and that religious liberty jurisprudence seems highly susceptible to judicial manipulation. More importantly, it is hard to escape the fact that at least some third parties—tort claimants who are not parishioners—will be harmed by choosing anything but ordinary bankruptcy law. As Dane observes, the metaphorical territory of the religious entity should end at the point at which its foreign law touches

401. Despite this, courts more often than not appear to choose their own law. See BRILMAYER, *supra* note 384, § 2.2.2, at 71 (observing that “[c]ourts typically assume their own law to be the better one”).

402. This was, in fact, a position suggested by the courts in both the Portland and Spokane cases. See *supra* note 217.

others who have not chosen its rules.⁴⁰³ It is possible, but improbable, that the dioceses reasonably believed that they were choosing canon law when they filed for protection in U.S. bankruptcy court.

Does this mean that bankruptcy courts should dismiss religious liberty claims, whether raised by the dioceses or the parishioners? Not necessarily. A basic choice-of-law tenet is that forum law always governs “procedure.”⁴⁰⁴ As with many issues in conflict of laws, the characterization of a disputed point as procedural or substantive may itself be a disputed point.⁴⁰⁵ Nevertheless, there is reasonably strong support for the idea that presumptions and burdens of proof are “procedural, especially in bankruptcy.”⁴⁰⁶ In this context, it would seem appropriate that bankruptcy courts should apply their own rules on setting presumptions and burdens of proof, if for no other reason than that canon law would appear to supply no alternative.

Bankruptcy courts could use the power to set presumptions and burdens of proof to create a principled way to solve and/or settle some of the property and governance problems these cases raise. In the case of presumptions, the bankruptcy court would treat bankruptcy law as presumptively controlling. Parishioners and the diocese would bear the initial burden to show that ordinary bankruptcy law imposes a “substantial burden,” and tort or other creditors would bear the burden to show that the law was supported by a compelling state interest. If the Portland property decision is to be believed, then we know that the Bankruptcy Code presents no compelling state interest, so the only question left is the burden on the parishioners.⁴⁰⁷

403. Dane, *supra* note 24, at 368.

404. RESTATEMENT (FIRST) OF CONFLICT OF LAWS § 585 (1934) (stating that “[a]ll matters of procedure are governed by the law of the forum”); Little, *supra* note 386, at 932–33.

405. See Little, *supra* note 386, at 933.

406. United Airlines, Inc. v. HSBC Bank USA, N.A., 416 F.3d 609, 615 (7th Cir. 2005) (“Burdens of proof and persuasion are supplied by the forum, not by the source of substantive law. Bankruptcy law uses the preponderance standard.”). See also Sampson v. Channell, 110 F.2d 754 (1st Cir. 1940) (distinguishing between the procedural and substantive uses of burdens of proof).

407. See Tort Claimants Comm. v. Roman Catholic Archbishop (*In re Roman Catholic Archbishop*) (*Portland Property Decision*), 335 B.R. 842, 864 (Bankr. D. Or. 2005) (“The interests advanced by the bankruptcy system are not compelling under the RFRA.” (quoting *Christians v. Crystal Evangelical Free Church* (*In re Young*), 82 F.3d 1407, 1420 (8th Cir. 1996), *cert. granted*, *vacated by* 521 U.S. 1114 (1997))).

As a general matter, the diocese, as the debtor in possession, has the initial, *prima facie* burden of showing that the debtor has an ownership interest in some piece of property. Thereafter, the burden of proving that the property is removed from the ambit of the estate under section 541(d) of the Bankruptcy Code is on the party claiming the equitable interest. See *First Fed. v. Barrow*, 878 F.2d 912, 915 (6th Cir. 1989) (explaining that “having asserted a constructive trust of which they were

Here, by reserving procedural control in the forum court, conflict-of-laws doctrine may help the parties—and the court. The court may, under this inherent procedural power, set different burdens depending on the judge’s good faith view of the role that particular items of property play in the religious life of parishioners. If, for example, she believes a church is important to worship, she may place a low burden on the parishioners; if she is more skeptical, she might place a higher burden. Tort creditors would then have to respond to the arguments made by parishioners under these varying burdens of proof and persuasion. They may be able to rebut parishioners’ claims, but their ability to do so will be constrained and channeled by the weight of the burden set by the judge. This would, in many respects, parallel the distribution of burdens of proof and persuasion that already occurs when third parties claim that trust property should be excluded from the estate.⁴⁰⁸ But it has the added advantage of taking subtle account of the unique issues created by the legitimate religious liberty concerns of parishioners.

A similar approach might aid a court confronting governance challenges. As discussed in Part III.B.2, above, if all else fails, a court may be asked to appoint a Chapter 11 trustee for a diocesan estate. A court would be understandably reluctant to do so, for the religious liberty reasons discussed in Part IV. Yet, in the same way that inherent control of procedure may give the court the power to link property questions to religious claims, governance disputes could be resolved in a more discrete and sensitive way than ordinary bankruptcy law would contemplate. The court could, for example, place a very high burden on tort claimants seeking to remove a bishop entirely. But if tort claimants sought more modest change—for the appointment of a trustee with powers limited to collecting and liquidating identified items of property, for example—the

beneficiaries, the appellants assumed the burden of identifying the sums of their entitlements”); *Daly v. Radulesco* (*In re Carrozzella & Richardson*), 247 B.R. 595, 602 (B.A.P. 2d Cir. 2000) (“Once the Trustee established that the Debtor had control of the Account . . . then the burden of proof shifted to the Defendants to prove (1) that the Debtor had only legal title to the Defendants’ money”); *Pare v. Campopiano* (*In re Campopiano*), No. 92-11669, 1994 Bankr. LEXIS 1849, at *9 (Bankr. D.R.I. Nov. 23, 1994) (holding that a prima facie showing was made that insurance proceeds were property of the estate when a draft for fire loss damages was made payable to the debtor); *Davis v. Moon* (*In re Usery*), 158 B.R. 470, 472 (Bankr. W.D. Mo. 1993) (holding that in a turnover action, the trustee bears the initial burden of proof to establish a prima facie case that the subject of the turnover action is property of the estate). *See also* *Miller v. Rose*, 532 S.E.2d 228, 234 (N.C. Ct. App. 2000) (“[T]he party seeking to establish a trust has the burden of proving its existence by ‘clear, strong, and convincing evidence.’” (quoting *Keistler v. Keistler*, 522 S.E.2d 338, 340 (N.C. Ct. App. 1999))). Here, of course, the problem is complicated by the fact that the diocese is effectively disclaiming an interest in property.

408. *See, e.g., In re Marsh*, 116 F. 396, 399 (D. Conn. 1902) (placing the burden of proof on the creditors to “trace the proceeds into the estate coming into the hands of the trustee”).

burden on the movants might be lighter. Parishioners and the diocese would have to respond, but their response would be constrained and channeled by the nature of the burden imposed by the court.

The advantage of a conflict-of-laws analysis will lie chiefly in the flexibility it gives to judges to induce settlements. If properly used, it will enable courts to force the parties to flesh out their positions by making substantive claims about the relationship between what is essentially disputed property and religious liberty. It is similar, but superior to, the approach Judge Perris has indicated she would take in the Portland cases.⁴⁰⁹ It is similar because it creates a way to break the doctrinal and constitutional dilemmas created by these cases. But it is superior because it creates a principled basis for compelling the parties to establish the boundaries of the actual religious territory in dispute while at the same time insulating the judge from becoming too entangled in these difficult decisions.

B. PURPOSIVE EQUITY AND ITS LIMITS

Creative use of procedural law may not solve all of the problems that would arise in religious entity bankruptcies. Bankruptcy courts may not, for example, feel that they have the power to investigate the debtor's assets and determine whether they are "core" religious assets. They may believe, with some reason, that they must inexorably apply ordinary bankruptcy law, even though it may harm parishioners. They may, therefore, wish to provide some minimal protections to parishioners.

Equity may help here. The role of equity in bankruptcy is both overdiscussed and undertheorized. While courts frequently characterize bankruptcy as an equitable process and bankruptcy courts as courts of equity,⁴¹⁰ the truth is that no one knows if either statement is true and, if so,

409. As discussed in Parts II.A and IV.A.3, Judge Perris held that, while parish property was property of the Portland diocese's estate, it may nevertheless—to some undefined extent—be exempt from sale under RFRA. *See Portland Property Decision*, 335 B.R. at 853 n.9. Unfortunately, her decisions leave many questions about the role that RFRA plays.

410. *See, e.g., Young v. United States*, 535 U.S. 43, 50 (2002) (asserting that "bankruptcy courts . . . are courts of equity and 'appl[y] the principles and rules of equity jurisprudence'" (quoting *Pepper v. Litton*, 308 U.S. 295, 304 (1939))); *United States v. Energy Res. Co.*, 495 U.S. 545, 549 (1990) (explaining that "bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships"); *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988); *Local Loan Co. v. Hunt*, 292 U.S. 234, 240 (1934) (stating that "courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity").

what that might mean. Platitudes and “maxims”⁴¹¹ are plentiful. Precision, however, is in short supply. Nevertheless, equity directed to the purposes of bankruptcy reorganization, which I call “purposive equity,” may help courts wrestling with diocesan dilemmas.⁴¹²

Equity has roots in both constitutional and bankruptcy jurisprudence. Constitutional equity is typically associated with *Brown v. Board of Education*,⁴¹³ which Peter Hoffer characterized as the “greatest ‘equity’ suit in our country’s history, perhaps in the history of equity.”⁴¹⁴ According to Hoffer, the equitable principles enunciated in *Brown*, which led to the conclusion that federal courts should ensure school desegregation with “all deliberate speed,”⁴¹⁵ teach that “equity [is] an approach to law, including constitutional law, based on doing justice for all concerned.”⁴¹⁶

Since there are few who openly advocate overturning *Brown*, it is curious that we increasingly question the viability of equity. Nevertheless, since the Supreme Court’s decision in *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*,⁴¹⁷ commentators frequently ask whether equity survives in any meaningful sense.⁴¹⁸ In *Grupo Mexicano*, a majority of the Supreme Court held that a U.S. district court lacked the equitable power to issue a temporary injunction restraining a debtor from conveying assets in a way that would obviously harm its creditors, because federal courts are limited to the equitable powers that existed in 1789, when the Judiciary Act was enacted.⁴¹⁹

411. Judge Kreiger refers to them as “mantras.” Marcia S. Krieger, “*The Bankruptcy Court Is a Court of Equity*”: *What Does That Mean?*, 50 S.C. L. REV. 275, 276 (1999).

412. See *supra* note 28.

413. *Brown v. Bd. of Educ.*, 349 U.S. 294 (1955).

414. PETER CHARLES HOFFER, *THE LAW’S CONSCIENCE: EQUITABLE CONSTITUTIONALISM IN AMERICA* 4 (1990).

415. *Brown*, 349 U.S. at 301.

416. HOFFER, *supra* note 414, at 7. Other scholars have hinted that equity may be appropriate in the religious liberty context. See Loewy, *supra* note 306, at 110 (1998) (“The number of relevant factors to be considered under a Constitution dedicated to protecting both equality and free exercise of religion is such that any fair effort to achieve a balanced result requires a court to act virtually as a court of equity.”).

417. *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308 (1999).

418. See, e.g., Judith Resnik, *Constricting Remedies: The Rehnquist Judiciary, Congress, and Federal Power*, 78 IND. L.J. 223, 252–53 (2003). See also *supra* Part III.B.1.b.

419. *Grupo Mexicano*, 527 U.S. at 319 (explaining that the equitable remedy of a creditor’s bill “could be brought only by a creditor who had already obtained a judgment establishing the debt”). The Court reasoned that a judgment on the debt was a necessary predicate to the injunction, as a restraint on judicial power. Given the factual posture of this particular case, however, the requirement was curious. The debtor readily admitted that it was dissipating assets, leading the Second Circuit Court of Appeals to view the debtor’s actions as “less than benign.” *Alliance Bond Fund, Inc. v. Grupo Mexicano de Desarrollo, S.A.*, 143 F.3d 688, 692, 697 (2d Cir. 1998), *rev’d*, 527 U.S. 308 (1999).

An extended discussion of *Grupo Mexicano* is beyond the scope of this Article. The facts were somewhat unusual, involving a foreign debtor versus an unsecured, subordinated lender seeking to restrain alienation of assets, and the majority's reasoning was curious.⁴²⁰ Nevertheless, the case has been cited as further evidence, if any were needed, that federal courts are constrained to those powers that were available to English Courts of Chancery in 1789. Arguably, the real issue in the case involved deciding the parameters of this constraint: are courts limited to the specific *remedies* that existed in 1789, or only, as the dissent would have it, the *principles* that governed courts at that time?⁴²¹ The majority, per Justice Scalia, chose the former.⁴²²

Justice Scalia reiterated this preference for constraining equity to its historic practices, rather than principles, in *Great-West Life & Annuity Insurance Co. v. Knudson*.⁴²³ There, a divided Court, in another Scalia opinion, held that the equitable relief authorized by the Employee Retirement Income Security Act of 1974 ("ERISA") does not include restitutionary claims for specific performance where the claimant essentially seeks damages.⁴²⁴ Justice Scalia opined that equitable relief

420. The case has led some to question the viability of a panoply of bankruptcy court equitable remedies—in particular, substantive consolidation. *See supra* Part III.B.1.b. *See also In re Am. Homepatient, Inc.*, 298 B.R. 152, 165 (Bankr. M.D. Tenn. 2003) (concluding that *Grupo Mexicano* does not bar substantive consolidation); *In re Stone & Webster, Inc.*, 286 B.R. 532 (Bankr. D. Del. 2002). The reasoning here is curious because Scalia's majority opinion appears to ignore some basic commercial law principles. For example, he conflated a judgment with a property interest. *See Grupo Mexicano*, 527 U.S. at 323 ("[T]he rule requiring a judgment was historically regarded as serving . . . the substantive end of giving the creditor an interest in the property which equity could then act upon."). Of course, it is well understood that a judgment, without more, merely establishes a debt and, by itself, creates no interest in a debtor's property. *See United States v. Ribadeneira*, 105 F.3d 833, 836 (2d Cir. 1997); *United States v. Fuchs*, 2005 WL 440429, No. 3:02-CR-369-P, at *2 (N.D. Tex. Feb. 23, 2005). More substantively, the *Grupo Mexicano* opinion makes the curious assertion that the case did not involve a fraudulent conveyance problem. *Grupo Mexicano*, 527 U.S. at 324 n.7 (explaining that "[b]ecause this case does not involve a claim of fraudulent conveyance, we express no opinion on [whether an unsecured creditor has an interest in a debtor's property]"). The heart of the creditor's cause of action was that the debtor was conveying assets with an intent to hinder or delay collection. That, of course, is the gravamen of a fraudulent conveyance cause of action. *See, e.g.*, 11 U.S.C. § 548 (2000 & Supp. 2005) (stating the elements of a fraudulent transfer cause of action under the Bankruptcy Code); UNIF. FRAUDULENT TRANSFER ACT §§ 4–5, 7A U.L.A. 652–58 (1985 & Supp. 1998) (stating the elements of a fraudulent transfer cause of action under state law); UNIF. FRAUDULENT CONVEYANCE ACT § 2, 7A U.L.A. 442 (1985) (same).

421. *See Resnik, supra* note 418, at 235–36.

422. *Grupo Mexicano*, 527 U.S. at 322 ("We do not question the proposition that equity is flexible; but in the federal system, at least, that flexibility is confined within the broad boundaries of traditional equitable relief.")

423. *See Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204 (2002).

424. *Id.* at 204. A civil action under ERISA may be brought "by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates . . . the terms of the plan, or (B) to obtain other

referred to “those categories of relief that were *typically* available in equity.”⁴²⁵ These, he wrote, were limited to an accounting for profits, an equitable lien, or a constructive trust on specific funds held by the defendant.⁴²⁶

Equity’s role in bankruptcy is also contested.⁴²⁷ Judge Krieger, for example, has observed that “[h]istory does not support the common characterization of the bankruptcy court as a court of equity.”⁴²⁸ Although it is not clear that *Grupo Mexicano* constrains bankruptcy courts,⁴²⁹ it is equally clear that nothing in the Bankruptcy Code or its jurisdictional statutes gives bankruptcy courts the broad equitable powers often attributed to them.⁴³⁰

The problem of equity in bankruptcy has two components. First, do bankruptcy courts have general equitable powers to do that which the statute does not explicitly authorize? Although the textualist tendency of the current Court might suggest limitations on bankruptcy equity, it is equally possible that bankruptcy’s inherently equitable features were implicitly incorporated into the current statute.⁴³¹ Given the result-driven

appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of . . . the terms of the plan.” 29 U.S.C. § 1132(a)(3) (2000).

425. *Great-West*, 534 U.S. at 210 (emphasis added) (quoting *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 256 (1993)).

426. *See id.* at 213. For criticism of Scalia’s reasoning in *Great-West*, see Tracy A. Thomas, *Justice Scalia Reinvents Restitution*, 36 LOY. L.A. L. REV. 1063, 1070 (2003). Tracy Thomas observes that *Great-West* reflected one of several flip-flops by Justice Scalia on the nature of equity.

427. *See* Krieger, *supra* note 411, at 276; Adam J. Levitin, *Toward a Federal Common Law of Bankruptcy: Reconciling Equity Powers with a Statutory Regime* (2005) (unpublished manuscript, on file with author).

428. Krieger, *supra* note 411, at 275. Rather, she notes, U.S. bankruptcy law “has always been a creature of statute, separate and distinct from traditional equity jurisprudence.” *Id.* at 276. This ignores the important, common-sense possibility that equity can coexist with statutory authority. Adam Levitin has observed that the common locus of equitable power in bankruptcy, section 105 of the Bankruptcy Code, probably provides no basis for viewing bankruptcy courts as courts of equity. *See* Levitin, *supra* note 427, at 24–30. Section 105, unlike many other sections of the Bankruptcy Code, does not use the words “equity” or “equitable,” or language of that sort. *Id.* at 24–25. Rather, section 105 merely provides that bankruptcy courts have the power to make orders “necessary or appropriate to carry out the provisions” of the Bankruptcy Code. *Id.* at 25.

429. *See* Resnik, *supra* note 418, at 266 (arguing that *Grupo Mexicano* might not apply to bankruptcy courts). *See also supra* Part III.B.2.

430. *See* Levitin, *supra* note 427, at 3, 23–30.

431. *See id.* at 24 (“As a matter of statutory interpretation, the support for section 105(a) as authorizing bankruptcy equity powers is weak.”). Judge Krieger’s claim that bankruptcy courts have historically lacked broad equitable powers depends for its vitality on what is meant by “bankruptcy courts.” It is true that U.S. bankruptcy court power has largely been created and circumscribed by statute. It is, however, equally true that judicial resolutions of financial distress, from equity receiverships to corporate dissolutions, have long been equitable proceedings in which courts have had broad powers. How broad these powers are is, of course, a fair question. But unless Congress wanted

nature of the current Court's equity jurisprudence, it is easily possible that bankruptcy courts would have some equitable powers, at least those that might have existed in courts of equity in 1789.

Thus, the second question is likely to be more important: what are the limits to a bankruptcy court's equitable powers? It is tempting to say that there are many. For every claim that bankruptcy courts have equitable powers is another claim that courts cannot run wild with those powers. "The fact that a proceeding is equitable," Judge Posner observed in the oft-cited decision, *In re Chicago, Milwaukee, St. Paul & Pacific Railroad Co.*, "does not give the judge a free-floating discretion to redistribute rights in accordance with his personal views of justice and fairness, however enlightened those views may be."⁴³² Perhaps more important is the Supreme Court's view in *Norwest Bank Worthington v. Ahlers* that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code."⁴³³

Although equity may not be the most popular candidate for ensuring just results in the diocesan cases, it warrants more serious consideration than it has received thus far.⁴³⁴ Even within the constraints imposed, equity may address the harms that parishioners would suffer from the undifferentiated application of ordinary bankruptcy law, while maximizing the legitimate claims of creditors.

The best way to understand equity in this context, whether derived from text or otherwise, is as purposive equity. In *NLRB v. Bildisco & Bildisco*, the Supreme Court offered a good idea of what purposive equity might sound like:

bankruptcy courts to have fewer powers than other courts resolving financial distress, which is an unlikely supposition, then bankruptcy courts must have some inherent equitable powers.

432. *In re Chi., Milwaukee, St. Paul & Pac. R.R.*, 791 F.2d 524, 528 (7th Cir. 1986).

433. *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988). The Supreme Court observed in *Butner v. U.S.* that "[t]he equity powers of the bankruptcy court play an important part in the administration of bankrupt estates[,] . . . [b]ut undefined considerations of equity provide no basis for adoption of a uniform federal rule affording mortgagees an automatic interest in . . . rents as soon as the mortgagor is declared bankrupt." *Butner v. U.S.*, 440 U.S. 48, 55-56 (1979).

434. See Roundtable Discussion, *Religious Organizations Filing for Bankruptcy*, 13 AM. BANKR. INST. L. REV. 25, 46 (2005) ("[Bankruptcy] is not a roving commission to do equity. Sure, it's a court of equity. You can't rewrite the statute."). See also *Mirant Corp. v. Potomac Elec. Power Co.* (*In re Mirant Corp.*), 378 F.3d 511, 523 (5th Cir. 2004) ("A court's powers under § 105(a) are not unlimited as that section only 'authorizes bankruptcy courts to fashion such orders as are necessary to further the substantive provisions of the Code,' and does not permit those courts to 'act as roving commission[s] to do equity.'" (quoting *Southmark Corp. v. Grosz* (*In re Southmark Corp.*), 49 F.3d 1111, 1116 (5th Cir. 1995))).

The Bankruptcy Court is a court of equity, and in making this determination it is in a very real sense balancing the equities, as the Court of Appeals suggested. Nevertheless, the Bankruptcy Court must focus on the ultimate goal of Chapter 11 when considering these equities. The Bankruptcy Code does not authorize freewheeling consideration of every conceivable equity, but rather only how the equities relate to the success of the reorganization. The Bankruptcy Court's inquiry is of necessity speculative, and it must have great latitude to consider any type of evidence relevant to this issue.⁴³⁵

In *Bildisco*, the Court was asked to consider whether a debtor could reject a collective bargaining agreement as an executory contract under section 365 of the Bankruptcy Code.⁴³⁶ The Court, per Justice Rehnquist, reasoned that a collective bargaining agreement was an executory contract for bankruptcy purposes, and that the debtor in possession had made the requisite showing to reject its ongoing obligations under that agreement.⁴³⁷

The *Bildisco* opinion illustrates three important features of purposive equity. First, equitable powers in Chapter 11 should be limited to furthering the success of reorganization. It is not the “chancellor’s foot”⁴³⁸ that would determine the scope of equity, but instead the policies and practices that Congress and the courts have articulated over the years in determining what constitutes a successful reorganization. Maximizing recoveries for legitimate creditors, while preserving the going concern, in this case the parishes, are generally seen as fairly noncontroversial goals of bankruptcy reorganization.

Second, purposive equity, as envisioned by *Bildisco*, must embrace “balancing.” The harm to employees of rejecting a collective bargaining agreement should be weighed against the harm to the debtor’s estate—and

435. NLRB v. *Bildisco & Bildisco*, 465 U.S. 513, 527 (1984).

436. 11 U.S.C. § 365(a) (2000 & Supp. 2005). This section of the Bankruptcy Code permits the bankruptcy trustee (DIP), “subject to the court’s approval,” to “assume or reject any executory contract or unexpired lease.” *Id.*

437. *Bildisco*, 465 U.S. at 526 (“[T]he Bankruptcy Court should permit rejection of a collective-bargaining agreement . . . if the debtor [in possession] can show that the collective-bargaining agreement burdens the estate, and that after careful scrutiny, the equities balance in favor of rejecting the labor contract.”). Collective bargaining agreements can no longer be treated under section 365 of the Bankruptcy Code. Rather, section 1113 of the Bankruptcy Code now governs the assumption or rejection of such contracts. 11 U.S.C. § 1113 (2000 & Supp. 2005).

438. The idea that equity is a largely arbitrary and subjective undertaking is associated with John Selden’s comment that “[e]quity is according to [the] conscience of him [that] is Chancellor, and as [that] is larger or narrower so[] is equity. Tis all one as if they should make [the] Standard for [the] measure we[] call A foot, to be [the] Chancellor’s foot.” JOHN SELDEN, TABLE TALK OF JOHN SELDEN 43 (Frederick Pollock ed., 1927).

its ability to reorganize—of assuming the contract.⁴³⁹ By analogy, this would suggest that bankruptcy courts should weigh the harm to parishioners of general application of ordinary bankruptcy law against the harm to creditors of creating exceptions to that law.

Third, in order to balance the equities with some intelligence, purposive equity envisions a careful and thorough factual investigation, one which may be deeper and more intrusive than religious liberty advocates generally tolerate. Bankruptcy courts should approve rejection of a collective bargaining agreement, the *Bildisco* Court observed, only “after careful scrutiny.”⁴⁴⁰ I have argued elsewhere that one of the signal virtues of equity lies in the power it gives courts to determine whether an activity is an exercise of religion, and therefore perhaps protected from otherwise applicable law, or something else.⁴⁴¹

Here, this would mean that bankruptcy courts should not accept at face value diocesan or parishioner claims that all items of property, as determined in their discretion, should be excluded from the estate. Nor, conversely, should they accept without question tort creditors’ claims that we must suffer the demise of a diocese under ordinary bankruptcy law. Rather, bankruptcy courts should be viewed as having the equitable power, coupled with the power to control presumptions and burdens of proof discussed above, to determine independently the merits of competing claims about estate property and governance and burdens on religious exercise.

Moreover, even the narrowest vision of equity (for example, Justice Scalia’s) should acknowledge that equity provides specific remedies that would promote substantial justice. In the *Great-West* opinion, for example, Justice Scalia observed that remedies like the equitable lien and constructive trust should be available, at least in the restitution context.⁴⁴² Traditional grounds for these remedies likely do not exist in the diocesan cases. There is no claim that creditors would be “unjustly enriched” in a traditional sense if all church property was made part of the estate and liquidated. Nevertheless, there is a long tradition of applying these

439. See *Bildisco*, 465 U.S. at 526.

440. *Id.*

441. See Lipson, *On Balance*, *supra* note 27, at 665–70.

442. *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 213 (2002) (“[A] plaintiff could seek restitution *in equity*, ordinarily in the form of a constructive trust or an equitable lien, where money or property identified as belonging in good conscience to the plaintiff could clearly be traced to particular funds or property in the defendant’s possession.”).

equitable remedies to uniquely difficult problems that doctrine alone appears to be incapable of solving.

Here, for example, the equitable lien⁴⁴³ or constructive or resulting trust⁴⁴⁴ may preserve parishioners' ongoing access to churches, while assuring creditors that that excess value—the “equity,” so to speak—would inure to their benefit. As a doctrinal matter, of course, the court in the Portland case roundly rejected the parishioners' claim that some sort of trust had been formed in their favor, even though not recorded.⁴⁴⁵ It is undoubtedly correct as a legal matter that a bankruptcy trustee can avoid most unrecorded trust interests involving real property.⁴⁴⁶ But Judge Perris did not appear to have considered the deeper equitable issues that these cases present. Nor did she recognize that equity may be the vehicle by which she could provide the protection that she hinted might be appropriate if there were an attempt to sell all diocesan assets.

Equity does, or at least should, have limits. While equity can heal, it can also harm.⁴⁴⁷ Recall, for example, the LDS cases.⁴⁴⁸ As discussed above, equity played an important role in those decisions, in which a receiver in equity was appointed to seize and liquidate Mormon church property in order to force the Mormons to renounce polygamy.⁴⁴⁹ The LDS cases reflect an assertion of raw power in response to a religious practice

443. Currently, the elements required to establish an equitable lien are: a debt, duty, or obligation owed by one person to another; an identified thing described with “reasonable certainty” to which the obligation fastens; an intent the property will serve as security for the debt or obligation; and the court must be satisfied that in equity and good conscience the lienor is entitled to a lien and has no adequate remedy at law. 51 AM. JUR. 2D *Liens* § 34 (2005).

444. The constructive trust restores to the plaintiff an asset that rightly belongs to it. *See Consulting Overseas Mgmt., Ltd. v. Shtikel*, 18 P.3d 1144 (Wash. Ct. App. 2001). A resulting trust is imposed where parties intended to create a trust, but failed to do so for some reason. *See, e.g., Thor v. McDearmid*, 817 P.2d 1380, 1388 (Wash. Ct. App. 1991).

445. *Tort Claimants Comm. v. Roman Catholic Archbishop (In re Roman Catholic Archbishop) (Portland Avoidance Decision)*, 335 B.R. 868, 888 (Bankr. D. Or. 2005).

446. *See id.* at 877 (citing *Chbat v. Tleel (In re Tleel)*, 876 F.2d 769, 771–72 (9th Cir. 1989)). *See also Torres v. Eastlick (In re N. Am. Coin & Currency, Ltd.)*, 767 F.2d 1573, 1575 (9th Cir. 1985); *Airwork Corp. v. Markair Express, Inc. (In re Markair, Inc.)*, 172 B.R. 638, 642 (B.A.P. 9th Cir. 1994) (arguing that if a constructive trust “remains inchoate post-petition, . . . it is subordinate to the trustee’s strong-arm power”).

447. This would appear especially true in bankruptcy. Under early Roman law, creditors apparently had the power to seize the debtor’s assets, and then to “cut up his body and divide the pieces or leave him alive and sell him into slavery.” JAMES WM. MOORE & WALTER RAY PHILLIPS, *DEBTORS’ AND CREDITORS’ RIGHTS* 1 (4th ed. 1975).

448. *See Late Corp. of the Church of Jesus Christ of Latter-Day Saints v. United States*, 136 U.S. 1 (1890). *See also supra* Part IV.A.1.

449. *Latter-Day Saints*, 136 U.S. at 7.

that the Court found repugnant for largely sectarian reasons.⁴⁵⁰ Although it involved quite different matters, *Bush v. Gore*⁴⁵¹ is also an equity decision that many question. Tracy Thomas has argued that “the unguided and unprecedented adoption of the prophylactic remedy in *Bush v. Gore* demonstrates an abuse of the Court’s equitable power.”⁴⁵²

Purposive equity should present fewer problems. As limited by the purposes of reorganization under Chapter 11, this would be equity that addresses the unique problems presented by the diocesan cases, constrained by the goals of reorganization under Chapter 11 of the Bankruptcy Code.

How far should bankruptcy courts be able to go? It is tempting to suggest that they deploy their equitable powers to address some of the more difficult, noneconomic problems presented in these cases. It may be, for example, that a truth-and-reconciliation-type process would yield more positive results than distributional adjustments under a plan of reorganization or liquidation.⁴⁵³ As in South Africa after apartheid or Tulsa, Oklahoma after Jim Crow, we might feel better about these cases if we knew that they would produce the truth about the underlying wrongs and a mechanism for reconciliation in the light of that knowledge. Sincere apologies, sincerely accepted, would probably have greater value in these cases than almost any others in bankruptcy, where cash (or plausible substitutes) are about the best the parties can hope for.

450. See *id.* at 49 (stating that polygamy “is contrary to the spirit of Christianity, and of the civilization which Christianity has produced in the Western world”).

451. In *Bush v. Gore*, the Court ordered (1) the adoption of adequate statewide standards for determining what constitutes a “legal vote” after opportunity for argument, (2) practicable procedures to implement the standards, (3) orderly judicial review of any disputed matters, and (4) evaluation of the accuracy of vote tabulation equipment by the Florida Secretary of State. *Bush v. Gore*, 531 U.S. 98, 110 (2000) (per curiam). See also the discussion of the LDS cases in Part III.A, *supra*.

452. See Tracy A. Thomas, *Understanding Prophylactic Remedies Through the Looking Glass of Bush v. Gore*, 11 WM. & MARY BILL RTS. J. 343, 398 (2002).

453. Although beyond the scope of this Article, one model might involve the creation of truth and reconciliation commissions, akin to those used in South Africa. Truth and Reconciliation Commission Home Page, <http://www.doj.gov.za/trc/> (last visited Feb. 5, 2006). More than thirty nations, including Peru, Ghana, East Timor, and Sierra Leone, have utilized the truth commission model during the past three decades. Wikipedia, List of Truth and Reconciliation Commissions, http://en.wikipedia.org/wiki/List_of_truth_and_reconciliation_commissions (last visited Feb. 5, 2006). In the United States, truth and reconciliation commissions have been employed to address racially motivated atrocities in Greensboro, North Carolina, see *What Is Truth and Reconciliation?*, http://www.greensborotrc.org/truth_reconciliation.php (last visited Feb 5, 2006), Wilmington, North Carolina, see *1898 Wilmington Race Riot Commission*, <http://www.ah.dcr.state.nc.us/1898-wrrc/> (last visited Feb. 5, 2006), and Tulsa, Oklahoma, see *Tulsa Race Riot Final Report*, <http://www.ok-history.mus.ok.us/trrc/freport.htm> (last visited Feb. 5, 2006).

Yet, bankruptcy courts doubtless lack the power—whether in equity, under the Constitution, or by virtue of simple human limitations—to order the dioceses to say they are sorry, or to order the victims to accept such apologies. Nor is it clear that bankruptcy courts can (or should) appoint examiners or trustees to rifle through diocesan records in hopes of ferreting out information that might ultimately lead victims to know the truth of the church's behavior.

Yet, bankruptcy courts can achieve a second-best result, which would be settlements that incorporate these, or other, elements, as selected by the parties. This may be the true value of purposive equity, for an accepted—indeed, vital—purpose of bankruptcy is to induce settlements wherever possible.⁴⁵⁴ Here, the purpose of equity would be to encourage parties to negotiate solutions that avoid the offensive results of any of the doctrinal or constitutional choices and which may, ideally, lead to broader reconciliations than dollars alone could provide.

In one sense, using conflict of laws and equity to promote settlement represents a blunting or dulling of the doctrinal weapons ordinarily deployed in bankruptcy. If the Spokane and Portland cases are any indication, the received use of established doctrine is unlikely to produce much but more litigation there, or in other cases. The disputes between the dioceses and the tort creditors appear to be deep and volatile. The fact that five Catholics now sit on the Supreme Court,⁴⁵⁵ coupled with the risk of losing everything, might inspire the parishioners and dioceses to take their cases all the way to the Supreme Court, if they can. Thus, finding ways to promote broadly consensual settlements may be the best that courts can do in these cases.

454. See *supra* Part III.A.

455. Samuel Alito recently became the fifth Catholic member, the others being Kennedy, Roberts, Scalia, and Thomas. See Religion of the Supreme Court, http://www.adherents.com/adh_sc.html (last visited Feb. 5, 2006). Gregory Sisk, Michael Heise, and Andrew Morriss have recently published a study indicating that under certain circumstances, Catholic judges may be more inclined than others to grant religious liberty exemptions. As the study noted,

In the particular context of education, Catholic judges were significantly more likely both to respond favorably to religious claimants seeking exemption from governmental rules or regulations (that is, more approving of Free Exercise Clause objections to government controls) and to resist challenges to governmental acknowledgment of religion or interaction with religious institutions (that is, less approving of Establishment Clause claims).

Gregory C. Sisk, Michael Heise & Andrew P. Morriss, *Searching for the Soul of Judicial Decisionmaking: An Empirical Study of Religious Freedom Decisions*, 65 OHIO ST. L.J. 491, 502 (2004).

VI. CONCLUSION

The diocesan bankruptcy cases present no easy solutions. Their dilemmas will challenge bankruptcy and other courts to develop creative solutions in order to do substantial justice.

This Article has suggested two sources of rules and norms that might help to produce negotiated, consensual results. First, conflict-of-laws doctrine establishes that bankruptcy law should presumptively control. But that body of law also empowers courts to adjust jurisprudential burdens in order to determine the appropriate reach of ordinary bankruptcy law in these unusual cases. Second, courts should have the power to use “purposive equity,” which would enable them to balance harms and apply long-recognized remedies that would protect parishioners, including equitable liens and constructive trusts. While these (or other) creative uses of doctrine may not solve the diocesan dilemmas, per se, they should give judges more and better ways to encourage the parties to resolve, rather than litigate, these difficult disputes.

Cases like the diocesan bankruptcies are likely to become more common in the future. Many dioceses and other religious organizations face potentially unmanageable liability for the sexual misconduct of their agents. More generally, religious entities are becoming increasingly prominent commercial actors. As they incur debts in these undertakings, some will, like other debtors, find that bankruptcy reorganization is the only viable path to survival.

In these and similar cases, courts will have to step out of the comparatively narrow doctrinal paths along which bankruptcy and constitutional law have developed. In order to manage these extremely difficult cases, both the bankruptcy and constitutional systems must, and will, stretch to accommodate one another. Churches may fail, but the legal system in which they find themselves need not.