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COMMENTS

The Costly Exercise of Religion: Issues on Diocesan Bankruptcy Estate Formation and First Amendment Implications

I. Introduction

The scope of religious freedom has historically been a contentious legal matter in the United States. Contemporary litigation is no exception. Recently the Supreme Court held in *Burwell v. Hobby Lobby Stores, Inc.* that the Affordable Care Act's requirement that employers grant its female employees access to no-cost contraceptives violated the religious freedom of closely held corporations.¹ Just this past year the Court held in *E.E.O.C. v. Abercrombie & Fitch Stores, Inc.* that a prospective employer must accommodate a religious practice, such as the requirement to wear a headscarf, whether or not the employer has actual knowledge of the religious need.² Issues of contraception and workplace discrimination, however, are almost commonplace in the ongoing national debate on religious freedom. But another, often overlooked religious freedom issue needs to be addressed: What happens when a Catholic diocese files for bankruptcy in order to manage sex-abuse claims?

Due to the overwhelming amount of clergy abuse claims that have arisen in the past several years, numerous dioceses of the Roman Catholic Church have found it necessary to file for Chapter 11 bankruptcy. The values of the damages awarded to the abused claimants have been so extensive that many dioceses have found the only way in which they may continue ministerial operations and adequately satisfy the judgement obligations to the victims is to utilize bankruptcy protection. At the outset of the abuse scandal, the following dioceses all filed for bankruptcy in response to the litigation damages owed to tort claimants: Portland, OR; Spokane, WA; and Tucson, AZ.³ Subsequently, many other dioceses followed this recourse in order to

1. 134 S. Ct. 2751, 2785 (2014).

2. 135 S. Ct. 2028, 2034 (2015).

3. See *In re Roman Catholic Church of the Diocese of Tucson*, No. 4-04-bk-04721-JMM, 2007 WL 3124445, at *1 (Bankr. D. Ariz. Oct. 23, 2007); *Tort Claimants Comm. v. Roman Catholic Archbishop of Portland in Or.* (*In re Roman Catholic Archbishop of Portland in Or.*), 335 B.R. 868, 876 (Bankr. D. Or. 2005); *Comm. Of Tort Litigants v. Catholic Diocese of Spokane* (*In re Catholic Bishop of Spokane*), 329 B.R. 304, 310 (Bankr. E.D. Wash. 2005), *aff'd in part*, 2006 WL 211792 (E.D. Wash. 2006) and *rev'd in part*, 364 B.R. 81 (E.D. Wash. 2006).

pay their own judgment creditors and maintain church operations.⁴ The scope of the diocesan bankruptcies has reached as high as \$198 million⁵ and the extent of the property involved has been vast.⁶ Furthermore, because Catholic dioceses only began seeking bankruptcy protection in 2004,⁷ many of the issues presented provide entirely new categories of bankruptcy litigation and issues on the Bankruptcy Code's effect on religious freedom.

Chapter 11 bankruptcy provides the means for a diocese to reorganize its assets and distribute from a settlement repayment plan to the victims of the abuse while still performing its ministerial functions.⁸ However, the corporate structure of a Catholic diocese, the rules of Chapter 11 bankruptcy, and the U.S. Constitution create several impediments in ensuring the tort claimants receive adequate damages while still protecting the religious and corporate interests of the church.⁹ These issues are important because they display a clear legal conflict between the United States' historical emphasis on religious freedom and the rigid requirements of modern bankruptcy law. One of the most contentious and litigated points in the diocesan bankruptcies is to what extent the individual church parishes' property must be subject to the bankruptcy proceedings of their

4. See *Archdiocese of Milwaukee v. Doe (In re Archdiocese of Milwaukee)*, 482 B.R. 792 (Bankr. E.D. Wis. 2012); *In re Roman Catholic Church of the Diocese of Gallup*, 513 B.R. 761 (Bankr. D. N.M. 2014); *Official Comm. of Unsecured Creditors v. Catholic Diocese of Wilmington, Inc. (In re Catholic Diocese of Wilmington)*, 432 B.R. 135 (Bankr. D. Del. 2010); *In re Roman Catholic Bishop of San Diego*, 374 B.R. 756 (Bankr. S.D. Cal. 2007); *Voluntary Petition at 1, In re Archdiocese of Saint Paul and Minneapolis*, Case No. 15-30125 (Bankr. D. Minn. Jan. 16, 2015); *Voluntary Petition at 1, In re Roman Catholic Bishop of Helena, Mont.*, Case No. 14-60074 (Bankr. D. Mont. Mar. 5, 2015); *Voluntary Petition at 1, In re the Roman Catholic Bishop of Stockton*, Case No. 4-20371 (Bankr. E.D. Cal. Jan. 16, 2014); *Voluntary Petition at 1, In re Catholic Bishop of Northern Alaska*, Case No. 08-00110 (Bankr. D. Alaska May 17, 2010); *Voluntary Petition at 1, In re Diocese of Davenport*, Case No. 06-02229 (Bankr. D. Iowa May 1, 2006).

5. Amy Julia Harris, *Catholic Dioceses Declare Bankruptcy on the Eve of Sexual Abuse Trials*, REVEAL (Feb. 2, 2015), <https://www.revealnews.org/article/Catholic-dioceses-declare-bankruptcy-on-eve-of-sexual-abuse-trials/>.

6. See Joseph A. Rohner IV, *Catholic Diocese Sexual Abuse Suits, Bankruptcy, and Property of the Bankruptcy Estate: Is the "Pot of Gold" Really Empty?*, 84 OR. L. REV. 1181, 1182 (2005) (citation omitted).

7. *Id.* at 1181.

8. See 1 COLLIER ON BANKRUPTCY ¶ 1.07(3) (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2013).

9. See Felicia Anne Nadborny, *"Leap of Faith" Into Bankruptcy: An Examination of the Issues Surrounding the Valuation of a Catholic Diocese's Bankruptcy Estate*, 13 AM. BANKR. INST. L. REV. 839, 850-51 (2005); Rohner, *supra* note 6, at 1194.

governing diocese.¹⁰ Under the provisions of the Bankruptcy Code, if the individual parishes' assets are owned by the parishes themselves then the property is not subject to the diocese's bankruptcy.¹¹ However, if the property is considered to be owned by the diocese, it must be included in the bankruptcy estate.¹² Because the most significant and valuable property within the diocese is primarily the property of the individual parishes, the valuation of the bankruptcy estate is considerably affected by whether that property is included or excluded.¹³

There is a distinct set of issues on the forced inclusion of parish property in diocesan bankruptcy estates that has been frequently litigated. The first of these issues is whether the corporate structure of each Catholic diocese allows the bishop to exclude assets of the individual parishes from the bankruptcy estate.¹⁴ Several dioceses have argued that the structure of the diocese itself requires that parish assets be excluded under the provisions of the Bankruptcy Code and its exceptions.¹⁵ The Code of Canon Law, the system of laws and principles that act as the internal order and direction of the Catholic Church, clearly defines a distinction between the diocese as one entity and each individual parish as their own.¹⁶ However, this Comment concludes that unless each individual parish is actually separately incorporated within the applicable state, the corporate structure of a diocese does not afford such protection to the parishes.

The second issue looks at whether there exists a sufficient trust relationship between the diocese and the parishes that allows exclusion of parish assets.¹⁷ If the diocese and the bishop are acting as trustees in a trust relationship with each parish then the diocese has no equitable interest in the property of the parishes.¹⁸ This is important because property merely

10. See, e.g., *Tort Claimants Comm. v. Roman Catholic Archbishop of Portland in Or.* (*In re Roman Catholic Archbishop of Portland in Or.*), 335 B.R. 868, 875-76 (Bankr. D. Or. 2005); *Comm. Of Tort Litigants v. Catholic Diocese of Spokane* (*In re Catholic Bishop of Spokane*), 329 B.R. 304, 309-10 (Bankr. E.D. Wash. 2005), *aff'd in part*, 2006 WL 211792 (E.D. Wash. 2006) and *rev'd in part*, 364 B.R. 81 (E.D. Wash. 2006).

11. See 11 U.S.C. § 541(a) (2012) (stating that it is property of the *debtor* that goes into the estate); see also Rohner, *supra* note 6, at 1184.

12. See 11 U.S.C. § 541(a).

13. See Rohner, *supra* note 6, at 1189-90.

14. See *Roman Catholic Archbishop of Portland*, 335 B.R. at 855.

15. See, e.g., *id.*; *Catholic Bishop of Spokane*, 329 B.R. at 330.

16. 1983 CODE c.116, § 1, c.515, § 3.

17. See *Roman Catholic Archbishop of Portland*, 335 B.R. at 867; *Catholic Bishop of Spokane*, 329 B.R. at 327-28.

18. 11 U.S.C. § 541(d) (2012).

held in trust by a debtor is not to be included in the bankruptcy estate.¹⁹ The bankruptcy courts have analyzed whether an express trust exists between the dioceses and its parishes or whether a constructive or resulting trust exists, both causing the same effect on the bankruptcy estate.²⁰ In viewing the bankruptcy courts' analyses of this argument, this Comment argues that a trust-like relationship can protect some property but fails as a general exclusionary rule for all parish assets.

Finally, there is the issue of whether the First Amendment of the U.S. Constitution and the Religious Freedom Restoration Act ("RFRA") provide constitutional protection by barring the creditors and bankruptcy courts from requiring inclusion of parish assets in the bankruptcy estate. The dioceses have argued that forcing the inclusion of parish property in the estate substantially burdens their free exercise of religion.²¹ Two of the current issues regarding parish assets in a diocesan bankruptcy, and the primary purpose for which I have written this Comment, are (1) whether the creditors in these proceedings constitute government actors, and therefore, whether the RFRA may apply at all,²² and (2) whether the Bankruptcy Code itself constitutes a compelling governmental interest, and therefore, if the RFRA does apply, whether it provides any protection from forced inclusion of parish assets in the bankruptcy estate.²³ Several circuit courts are split on these issues and their resolutions are paramount for understanding the constitutional implications of the diocesan bankruptcy proceedings.²⁴ This Comment argues that because of the private nature of the creditors' interests,²⁵ the creditors do not constitute government actors, and therefore the RFRA does not apply. Furthermore, because of the private nature of creditors' interests, courts should reject the notion that the Bankruptcy Code and its provisions can be deemed compelling governmental interests.

19. *Id.*; see also *Catholic Bishop of Spokane*, 329 B.R. at 325.

20. *Catholic Bishop of Spokane*, 329 B.R. at 327-30.

21. See, e.g., *Listecki ex rel. Archdiocese of Milwaukee Catholic Cemetery Perpetual Care Trust v. Official Comm. of Unsecured Creditors (In re Archdiocese of Milwaukee)*, 485 B.R. 385, 387 (Bankr. E.D. Wis.) (*Listecki I*), *rev'd*, 496 B.R. 905 (E.D. Wis. 2013) (*Listecki II*), *aff'd in part, rev'd in part*, 780 F.3d 731 (7th Cir. 2015) (*Listecki III*); *Roman Catholic Archbishop of Portland*, 335 B.R. at 888.

22. See *Listecki III*, 780 F.3d at 737 (citing 42 U.S.C. § 2000bb-2(1)).

23. See *id.* at 745-46.

24. See *id.* at 741; *Christians v. Crystal Evangelical Free Church (In re Young)*, 82 F.3d 1407, 1419 (8th Cir. 1996), *vacated*, 521 U.S. 1114 (1997), *reinstated by* 141 F.3d 854 (8th Cir. 1998).

25. See *Listecki III*, 780 F.3d at 741.

The structure of this Comment is as follows: Part II discusses the basic legal background regarding bankruptcy law and the formation of the bankruptcy estate, particularly focusing on Chapter 11 reorganization. Part III looks at the application of bankruptcy law to the particular nature of the Catholic dioceses and discusses some of the major issues that have arisen from this application by presenting several holdings of the bankruptcy and circuit courts. Part IV discusses the current state of these issues and how the courts are likely to proceed. Part IV also presents some considerations for the dioceses to best obtain the protection they seek for their parishes. Finally, Part V presents a conclusion on these issues and arguments.

II. Legal Background

Bankruptcy provides a rigid set of federal laws that a debtor suffering from “financial failure” must follow to satisfy the applicable chapter of bankruptcy and to provide adequate payment to any unsecured creditors.²⁶ This includes a valuation of the debtor’s assets and liabilities, identification of applicable creditors, and formation of a bankruptcy estate.²⁷ The two primary purposes of the Bankruptcy Code are to provide a fresh start to the debtor via statutory discharge²⁸ and to protect the interests of the creditors in the most equitable way possible.²⁹ Chapter 11 bankruptcy provides a means for a debtor to reorganize the entity in a manner that allows payment to creditors while maintaining operation of its business or function. Under Chapter 11 reorganization, the interests of the debtor further switch from chiefly focusing on the discharge of debts to preventing the business from going into liquidation.³⁰ Although Chapter 11 bankruptcy is primarily geared toward businesses, other entities not actively engaged in business may file for reorganization under the Bankruptcy Code.³¹

The Bankruptcy Code provides two specific forms of relief: liquidation and rehabilitation.³² Liquidation requires a sale of all the debtor’s nonexempt assets, the proceeds of which are distributed to the creditors.³³

26. 1 COLLIER ON BANKRUPTCY, *supra* note 8, ¶ 1.01(1).

27. *See id.*

28. 11 U.S.C. § 727(a) (2012); *see also* Marrama v. Citizens Bank of Mass., 549 U.S. 365, 367 (2007); 1 COLLIER ON BANKRUPTCY, *supra* note 8, ¶ 1.01(1).

29. *See* 1 COLLIER ON BANKRUPTCY, *supra* note 8, ¶ 1.01(1) (citing Katchen v. Landy, 382 U.S. 323, 328 (1966)).

30. *See id.* (citing NLRB v. Bildisco & Bildisco, 465 U.S. 513, 528 (1984)).

31. Toibb v. Radloff, 501 U.S. 157, 177 (1991); *see also* 11 U.S.C. § 109.

32. 1 COLLIER ON BANKRUPTCY, *supra* note 8, ¶ 1.01(1).

33. *See also* 6 *id.* ¶ 700.01.

Liquidation bankruptcy is controlled by Chapter 7 of the Bankruptcy Code.³⁴ Rehabilitation, on the other hand, allows the debtor to hold the property subject to an eventual workout of payments under an agreement known as a “plan.”³⁵ Chapter 11, one of the several forms of rehabilitation bankruptcy, “provides an opportunity for a debtor to reorganize its business or financial affairs or to engage in an orderly liquidation of its property either as a going concern or otherwise.”³⁶ The primary policy behind a Chapter 11 bankruptcy is that it enables a business debtor to maintain operation as opposed to a complete liquidation.³⁷ An important requirement under rehabilitation is that the repayment plan must have a total value equal to what the creditors would have received under liquidation.³⁸ In the attempt to operate as functionally as possible during and after the bankruptcy proceedings, a Chapter 11 debtor often aims to exclude assets from the bankruptcy estate.

Upon filing the bankruptcy petition and commencing bankruptcy proceedings, two immediate legal consequences take effect. First, an automatic stay of all pending and future litigation against the debtor and the debtor’s property is enacted.³⁹ The automatic stay provides the debtor protection from additional creditors attempting collection of their debts and allows for an adequate assessment of the debtor’s assets and liabilities.⁴⁰ Second, a bankruptcy estate is formed in which all the debtor’s pre-petition property is included.⁴¹ Commencement of the bankruptcy case alone is sufficient to instantaneously create the bankruptcy estate.⁴² Under the terms of the Bankruptcy Code, the estate is to include all of the debtor’s legal and equitable interests.⁴³ However, any property the debtor owns in legal title alone, and not in equitable title, may be included in the estate and accessed by creditors “only to the extent of the debtor’s legal title . . . but not to the extent of any equitable interest.”⁴⁴ Furthermore, property held in trust by the debtor and for the benefit of a non-debtor will be excluded from the

34. *Id.* ¶ 700.01.

35. *See 7 id.* ¶ 1100.01. That is not to say that the assets themselves are safe from the bankruptcy proceedings in its entirety.

36. *Id.*

37. *Id.*

38. 11 U.S.C. § 1129(a)(7) (2012).

39. 11 U.S.C. § 362(a).

40. 1 COLLIER ON BANKRUPTCY, *supra* note 8, ¶ 1.01(2)(a).

41. 11 U.S.C. § 541(a).

42. *Id.*; *see also* Towers v. Wu (*In re Wu*), 173 B.R. 411, 413 (B.A.P. 9th Cir. 1994).

43. 11 U.S.C. § 541(a)(1)-(6).

44. *Id.* § 541(d).

estate.⁴⁵ Therefore, a central determination for any entity litigating a bankruptcy case is the extent to which assets must be included in the bankruptcy estate and which assets may be excluded.

An important characteristic of Chapter 11 reorganization over other forms of bankruptcy is that the debtor will actually remain in possession of the business's assets after filing the bankruptcy petition, which makes the debtor known as a "debtor-in-possession."⁴⁶ A creditor, however, can require that an independent trustee be appointed if there exist facts indicating the debtor is no longer suited to manage the business and its reorganization.⁴⁷ This aspect of Chapter 11 highlights that there is some flexibility for the debtor under Chapter 11 proceedings, giving the debtor both great control over the continuing operation of the business and the bankruptcy estate itself.⁴⁸ Furthermore, this characteristic creates an increased possibility for litigation on what property must be included in the bankruptcy estate.

III. Bankruptcy Code Applied to Dioceses and Issues Raised

From the outset of the clergy abuse litigation, twelve dioceses of the Catholic Church and two Jesuit orders⁴⁹ have filed for Chapter 11 bankruptcy.⁵⁰ To date, the settlements have ranged from \$9.8 million to more than \$198 million.⁵¹ The number of claimants involved in each case has ranged from about 50 to 362.⁵² The earliest of the bankruptcy filings came in 2004 from the Archdiocese of Portland, and the most recent filing came in early 2015 from the Archdiocese of Saint Paul and Minneapolis.⁵³ The majority of the proceedings took more than a year to reach a confirmed payment plan, and many of the cases have yet to reach that point.⁵⁴ These basic numbers display that the scope of these proceedings is extensive and

45. *Begier v. I.R.S.*, 496 U.S. 53, 59 (1990).

46. 11 U.S.C. §§ 1101(1), 1107-1108; *see also* 7 COLLIER ON BANKRUPTCY, *supra* note 8, ¶ 1100.01.

47. 11 U.S.C. § 1104(a).

48. 7 COLLIER ON BANKRUPTCY, *supra* note 8, ¶ 1100.01.

49. Jesuit orders are individual organizations within the Society of Jesus, a Catholic order of priests and brothers founded in the sixteenth century. *See The Jesuits*, JESUITS, jesuits.org/aboutus (last visited May 13, 2017). Although organizations of a subset of the Catholic Church, Jesuit orders are structurally similar to dioceses. *See id.*

50. *See supra* text accompanying notes 3-4.

51. Harris, *supra* note 5.

52. *Id.*

53. *Id.*

54. *Id.*

that the bankruptcy estates at issue are dealing with large sums of valuable property.

In understanding the issues that have arisen from the diocesan bankruptcies, it is helpful to understand the basic organization of the Catholic Church. The Catholic Church is a hierarchical church system.⁵⁵ The Holy See sits at the top of the hierarchy, led by the Pope and the Vatican City.⁵⁶ Connecting the Holy See and the many dioceses of the United States are the Papal Nuncio, the U.S. Conference of Catholic Bishops, and the Cardinals, which assist the Pope in running the U.S. Catholic Church on a national level.⁵⁷ The 195 U.S. Catholic dioceses and archdioceses⁵⁸ control the regional level of the church and each diocese contains numerous individual parishes within its control.⁵⁹ Each individual church parish contains various parcels of real property, from the church proper itself to schools, cemeteries, and administrative buildings.⁶⁰ The structure of the ownership of this property, which raises the issues set forth in this Comment, is that the bishop (or archbishop in the case of an archdiocese) actually holds the property of each parish in legal title.⁶¹ All of the internal structuring of the church and the orders and directives for every level are set out in the Code of Canon Law.⁶²

The structure of a Catholic diocese creates several issues regarding the formation of the bankruptcy estate. The corporate structure of the Church itself raises an issue on the nature of the ownership of diocesan assets. The dioceses' "trust-like" relationships with the parishes raise further problems regarding which property belongs in the estates. The individual parishes and the constitutional protections provided to religious institutions all create

55. Allison Walsh Smith, Comment, *Chapter 11 Bankruptcy: A New Battleground in the Ongoing Conflict Between Catholic Dioceses and Sex-Abuse Claimants*, 84 N.C. L. REV. 282, 319 (2005).

56. See Nadborny, *supra* note 9, at 845 (citing Yasmin Abdullah, *The Holy See at United Nations Conferences: State or Church?*, 96 COLUM. L. REV. 1835, 1837 (1996)); Paul Lewis, *At the U.N. Activists Vie with Vatican over Abortion*, THE N.Y. TIMES, Apr. 4, 1999, at 1-3.

57. See Nadborny, *supra* note 9, at 846 (citation omitted).

58. *Bishops and Dioceses*, U.S. CONFERENCE OF CATHOLIC BISHOPS (June 2016), <http://www.usccb.org/about/bishops-and-dioceses/>.

59. See Rohner, *supra* note 6, at 1183.

60. See *id.*

61. See *id.* The author notes that the bishop owns the property in legal title "as well as cash or liquid financial assets that also ostensibly belong to each parish. In addition, each diocese or archdiocese owns specific real and personal property for its own uses." *Id.*

62. See generally 1983 CODE.

a difficult environment for forming a diocesan bankruptcy estate. These varying issues have been addressed in many of the bankruptcy proceedings. Additionally, the holdings on similar issues have been decided in various ways. A common focus of these issues is the question of which assets must be included in the diocesan bankruptcy estate and which assets may be excluded.

A. Corporate Structure

Most jurisdictions allow a church diocese to incorporate as a corporation sole.⁶³ The corporation sole “lacks traditional shareholders and traditional internal corporate structures.”⁶⁴ A corporation sole is a legal entity “consisting of one incorporated office filled by one person and administered without a board of directors.”⁶⁵ In terms of the Catholic Church, the bishop of the diocese (or the archbishop of the archdiocese) generally holds this office. Technically, the single office of a corporation sole holds all assets in legal title. However, the equitable title of most diocesan assets is actually held by the individual entities (parishes, schools, cemeteries, etc.). Under the Supreme Court’s holding in *Begier v. I.R.S.*⁶⁶ that assets for which the debtor holds no equitable title are not property of the estate,⁶⁷ many dioceses have argued that no parish assets are to be included in the estate.⁶⁸

Under the provisions of Chapter 11, all of the debtor’s property is to be included within the bankruptcy estate.⁶⁹ One position held by the dioceses regarding this requirement is that the property of the individual parishes, schools, and other entities are not to be included in the estate because they constitute separate legal entities.⁷⁰ Under the provisions of Canon Law, each parish constitutes its own “juridic person,”⁷¹ or separate legal entity,

63. See *Tort Claimants Comm. v. Roman Catholic Archbishop of Portland in Or.* (*In re Roman Catholic Archbishop of Portland in Or.*), 335 B.R. 868, 876 (Bankr. D. Or. 2005).

64. Theresa J. Pulley Radwan, *Keeping the Faith: The Rights of Parishioners in Church Reorganizations*, 82 WASH. L. REV. 75, 89 (2007).

65. *Sole Corporation*, BLACK’S LAW DICTIONARY (10th ed. 2014).

66. 496 U.S. 53, 67 (1990).

67. 11 U.S.C. § 541(d) (2012).

68. See *Roman Catholic Archbishop of Portland*, 335 B.R. at 860; *Comm. Of Tort Litigants v. Catholic Diocese of Spokane* (*In re Catholic Bishop of Spokane*), 329 B.R. 304, 321 (Bankr. E.D. Wash. 2005), *aff’d in part*, 2006 WL 211792 (E.D. Wash. 2006) and *rev’d in part*, 364 B.R. 81 (E.D. Wash. 2006).

69. 11 U.S.C. § 541(a).

70. See, e.g., *Roman Catholic Archbishop of Portland*, 335 B.R. at 853; *Catholic Bishop of Spokane*, 329 B.R. at 312.

71. 1983 CODE c.116, § 1, c.515, § 3.

under the canons of Catholic law.⁷² As a corporation sole, the bishop (or archbishop) encompasses the civil body of the diocese, but the parishes, as individual juridic persons, encompass their own.⁷³ Under this view, the diocese does not envelop every parish within its legal identity, but rather “the Bishop merely has supervisory duties and oversight of all the juridic entities in the Diocese.”⁷⁴ Furthermore, as juridic persons, parishes “are ‘subjects of obligations and rights’ under Canon Law,” and included in “these recognized rights is property ownership.”⁷⁵ As a separate legal entity and a non-debtor in the diocese’s bankruptcy, a parish need not include its property in the bankruptcy estate.⁷⁶ However, many creditors object by arguing that as a corporation sole, the diocese actually encompasses all its parishes in a single corporate body.⁷⁷ The creditors argue that as a single corporate unit, all the assets held by the bishop in any capacity must be included in the estate.⁷⁸ The courts have addressed the question of how the corporate structure of a diocese affects the bankruptcy estate in several ways.

In the bankruptcy proceedings for the Archdiocese of Portland, the bankruptcy court held that the assets of individual parishes be included in the bankruptcy estate of the archdiocese.⁷⁹ Although Canon Law provides that a parish is its own juridic person, the Archdiocese of Portland itself has acknowledged that a juridic person is not necessarily an identity recognized by civil law.⁸⁰ The separation between a diocese and the individual parishes constitutes merely an internal structure, not distinct legal entities capable of holding separate title to property.⁸¹ Although later overturned, the bankruptcy court for the Diocese of Spokane similarly held that all parish assets must be included in the estate based upon the structure of the diocese and the effect excluding the assets would have on the creditors.⁸² The

72. Edward L. Buelt & Charles Goldberg, *Canon Law & Civil Law Interface: Diocesan Corporations*, 36 CATH. LAW. 69, 71-73 (1995).

73. *Catholic Bishop of Spokane*, 329 B.R. at 321.

74. *Id.*

75. Smith, *supra* note 55, at 319 (quoting 1983 CODE c.113, § 2).

76. *See* 11 U.S.C. § 541 (2012).

77. *See, e.g.*, Tort Claim. Comm. v. Roman Catholic Archbishop of Portland in Or. (*In re Roman Catholic Archbishop of Portland in Or.*), 335 B.R. 842, 867 (Bankr. D. Or. 2005); *Catholic Bishop of Spokane*, 329 B.R. at 330.

78. *Catholic Bishop of Spokane*, 329 B.R. at 311.

79. *Roman Catholic Archbishop of Portland*, 335 B.R. at 868.

80. *Id.* at 866; *see also* 1983 CODE c.116, § 1, c.515, § 3, c.1256.

81. *See Roman Catholic Archbishop of Portland*, 335 B.R. at 868.

82. *Catholic Bishop of Spokane*, 329 B.R. at 333.

bankruptcy court noted that “[r]eligious organizations do not exist on some ethereal plane far removed from society.”⁸³ The bankruptcy court in *Portland*, along with the lower court holding in *Spokane*, held that corporate law applied, rather than the internal structuring of the Church under the Catholic Code, and therefore, the Catholic Code’s designation of each parish as a separate juridic person does not provide a means for the diocese to exclude parish properties from the bankruptcy estate.⁸⁴

In a contrary decision, the court in the bankruptcy proceedings for the Diocese of Tucson acknowledged the individual parishes as independent legal entities, and therefore, held that the assets of each parish were immune from the diocesan estate.⁸⁵ The bankruptcy court confirmed the reorganization plan of the diocese, which expressly stated that each individual parish within its control was a separate juridic person, and therefore, the assets of each parish belong solely to the parish. Similarly, the reorganization plan for the Diocese of Northern Alaska excluded parish property and separated the parishes as independent juridic persons.⁸⁶ Both of the reorganization plans stated that parish property was held by the diocese in only legal title and that all equitable interests were held by the individual parishes.⁸⁷ Although the litigants never disputed the matter of excluding parish assets, the courts’ confirmations of the reorganization plans expressly stated that the structure of the dioceses allowed exclusion, implying the courts recognized the notion.

In litigation over the estate for the Archdiocese of Milwaukee, the court also aligned with the court in *Tucson* and held that the individual parishes constitute independent legal entities.⁸⁸ The diocese is a non-stock corporation and the parishes constitute their own independent civil corporations by the nature of their property ownership and daily activities.⁸⁹ The court expanded on the *Tucson* holding by denying the creditors’

83. *Id.* at 324.

84. *Id.* at 325; *Roman Catholic Archbishop of Portland*, 335 B.R. at 854.

85. Third Amended and Restated Disclosure Statement Regarding Plan of Reorganization at 18-19, *In re* The Roman Catholic Church of the Diocese of Tucson, 2015 WL 1978432 (Bankr. D. Ariz. 2005) (No. 4-bk-04-0471-JMM).

86. Debtor’s Plan of Reorganization for Catholic Bishop of Northern Alaska at 34, *In re* Catholic Bishop of N. Alaska, 2008 WL 8652366 (Bankr. D. Alaska 2008) (No. 08-00110-DMD).

87. *Id.*; Third Amended and Restated Disclosure Statement Regarding Plan of Reorganization, *supra* note 85, at 18-19.

88. *In re* Archdiocese of Milwaukee, 483 B.R. 693, 699 (Bankr. E.D. Wis. 2012) (*Archdiocese of Milwaukee I*).

89. *Id.*

attempts to utilize either an alter ego theory or a substantive consolidation claim to access the assets of the parishes.⁹⁰ In order to pierce the corporate veil, one of the necessary elements is the superior entity's complete domination of the lower entity.⁹¹ The court held that there was not sufficient evidence to show such domination in respect to a diocese over the parishes because the parishes conducted business with a large degree of autonomy.⁹² Furthermore, the court held that there was not sufficient entanglement for substantive consolidation to offset potential harm to the creditors, a necessary element for application of the theory.⁹³

Although the dioceses discussed have similar corporate structures, the bankruptcy courts have ruled quite differently on how this affects the identity of the individual parishes and whether parish assets are to be included in the diocesan bankruptcy estate.⁹⁴ The question of whether the parish assets are to be included in the diocesan estate based upon the corporate structure of the diocese depends greatly on the jurisdiction in which it is litigated, but most importantly, there is little direction in understanding how the courts will address this issue.

B. Trust-Like Relationship Between the Diocese and Parishes

Another argument utilized by the dioceses is based upon the "trust-like" relationship between the diocese and the parishes. As previously discussed, if a debtor owns only the legal title and not an equitable interest in property then a creditor may only receive the legal title from the bankruptcy estate.⁹⁵ The possessor of the equitable interest, if a non-debtor in the bankruptcy, will retain ownership through the proceedings.⁹⁶ In fact, the United States Supreme Court held that property in which the debtor does not own an equitable interest, but rather holds in trust for the benefit of another, will not be included in the debtor's bankruptcy estate.⁹⁷ Bankruptcy courts have also held that, even in the absence of an express trust, the property held by a

90. *Id.* at 699-700.

91. *Id.* at 698 (citing *Consumer's Co-op. v. Olsen*, 419 N.W.2d 211, 217-18 (Wis. 1988)).

92. *Id.* at 699.

93. *Id.* at 699-700 (citing *In re Augie/Restivo Baking Co.*, 860 F.2d 515, 518 (2nd Cir. 1988)).

94. *See, e.g., id.* at 699; *Comm. Of Tort Litigants v. Catholic Diocese of Spokane (In re Catholic Bishop of Spokane)*, 329 B.R. 304, 333 (Bankr. E.D. Wash. 2005), *aff'd in part*, 2006 WL 211792 (E.D. Wash. 2006) and *rev'd in part*, 364 B.R. 81 (E.D. Wash. 2006).

95. 11 U.S.C. § 541(d) (2012).

96. *Id.*

97. *Begier v. I.R.S.*, 496 U.S. 53, 59 (1990).

debtor in a constructive or resulting trust as trustee will not be included in the estate.⁹⁸

Several dioceses have argued that the nature of the relationship between the diocese and the individual parishes is a “trust-like” relationship.⁹⁹ The dioceses claim that the relationship puts the parishes as the beneficiaries of a trust for which the bishop is the trustee, thus precluding inclusion of parish assets under the provisions of the Bankruptcy Code.¹⁰⁰ If a court recognizes that the diocese owns only the legal title and the bishop is acting as a trustee while the parishes possess the equitable interest as beneficiaries then the parish assets must be excluded from the diocesan bankruptcy estate.¹⁰¹ The holdings on this issue have not been unanimous.¹⁰² Thus, the issue arises whether a trust-like relationship between the diocese and its parishes can function as a means to exclude parish property from the diocesan estate.

Generally, a trust arises by statute, either expressly or by judicial imposition of a constructive or resulting trust.¹⁰³ Although later reversed, the bankruptcy court in the *Spokane* proceedings held that the bishop acts as a trustee for the diocese as a whole under an express trust.¹⁰⁴ The diocese’s articles of incorporation expressly states that the bishop acts as a trustee of all property of the diocese. However, there is no such express provision regarding the diocese’s relationship over the property of the parishes and other entities.¹⁰⁵ Although no form of express statute or written agreement between the diocese and parishes exists, an implied trust may be formed via judicial imposition as a constructive or resulting trust.¹⁰⁶ The court noted that as a corporation sole, the bishop may hold the property in trust under a

98. *Foothill Capital Corp. v. Clare's Food Mkt., Inc. (In re Coupon Clearing Service, Inc.)*, 113 F.3d 1091, 1099 (9th Cir. 1997).

99. *See, e.g., Archdiocese of Milwaukee I*, 483 B.R. at 696; Official Comm. of Unsecured Creditors v. Catholic Diocese of Wilmington (*In re Catholic Diocese of Wilmington, Inc.*), 432 B.R. 135, 140-43 (Bankr. D. Del. 2010); Tort Claimants Comm. v. Roman Catholic Archbishop of Portland in Or. (*In re Roman Catholic Archbishop of Portland in Or.*), 335 B.R. 842, 867 (Bankr. D. Or. 2005); *Catholic Bishop of Spokane*, 329 B.R. at 325-29.

100. *See* 11 U.S.C. § 541(d); *Roman Catholic Archbishop of Portland*, 335 B.R. at 848.

101. *See Catholic Bishop of Spokane*, 329 B.R. at 325 (citing *Dewsnup v. Timm*, 502 U.S. 410, 432 (1992)).

102. *See, e.g., id.* at 333; *Archdiocese of Milwaukee I*, 483 B.R. at 700.

103. *See Catholic Bishop of Spokane*, 329 B.R. at 325; RESTATEMENT (SECOND) OF TRUSTS § 17 (AM. LAW INST. 1959).

104. *Catholic Bishop of Spokane*, 329 B.R. at 328.

105. *Id.*

106. *Id.* at 328-29.

constructive or resulting trust.¹⁰⁷ In its determination of whether such a trust existed for the Spokane diocese, the court held that either a constructive or resulting trust “requires that the underlying facts and circumstances regarding the relationship and course of dealing between the parties must demonstrate that it would be inequitable to allow the titleholder to retain the beneficial interest in the property.”¹⁰⁸

In analyzing the facts underlying the property at issue, the court noted that all the deeds to the disputed property reflect a fee simple absolute in the diocese, and therefore, creditors “would have no reason to believe nor any notice that the property was not an asset of the debtor.”¹⁰⁹ There is no notice of any constructive or resulting trust or intent to create one therein because the evidence does not demonstrate that it would be inequitable to allow the titleholder to retain the beneficial interest.¹¹⁰ Due to the lack of any sufficient evidence to support the claim that a constructive or resulting trust existed between the diocese and the parishes, the court held that no such trust existed.¹¹¹ The court explained that, “[a]s to resulting trusts under state law, no such trust exists until created by judicial act” and then recognized that no such event had occurred.¹¹² Therefore, the property of each parish could not be excluded from the estate based upon the “trust-like” relationship because no express, constructive, or resulting trust existed between the diocese and its individual parishes.¹¹³

In a more constraining holding, the court for the bankruptcy proceedings for the Diocese of Portland held that, because each parish is a unit of the diocese, the diocese could not legally hold property in trust for a parish.¹¹⁴ The bankruptcy court noted that a corporation that “has the capacity to take and hold legal title to property also has the capacity to be a beneficiary of a trust of such property.”¹¹⁵ Furthermore, the court recognized that an unincorporated association may be the beneficiary of a trust.¹¹⁶ However, the court held that there is no such authority that provides a means to “allow a division of a corporation or a unit or part of a legal entity to be a

107. *Id.* at 325.

108. *Id.* at 329.

109. *Id.* at 333.

110. *Id.*

111. *Id.* at 331, 333.

112. *Id.* at 332.

113. *Id.* at 332-33; *see also* 11 U.S.C § 544(a)(3) (2012).

114. *Tort Claimants Comm. v. Roman Catholic Archbishop of Portland in Or. (In re Roman Catholic Archbishop of Portland in Or.)*, 335 B.R. 842, 866-67 (Bankr. D. Or. 2005).

115. *Id.* at 867 (quoting 76 AM. JUR. 2D *Trusts* § 240 (2005)).

116. *Id.* (citing RESTATEMENT (SECOND) OF TRUSTS § 119 (AM. LAW INST. 1959)).

beneficiary of a trust.”¹¹⁷ The diocese is organized as a corporation sole and did not separately incorporate the individual parishes, and therefore, the diocese did not provide the parishes with the legal protections and powers of an independent corporation.¹¹⁸ The parishes are merely units of the diocese, and due to this, the diocese cannot hold assets of the parishes in trust for the parishes.¹¹⁹ Ultimately, the court in the Diocese of Portland proceedings held that the diocese could not exclude parish assets based on the trust argument.¹²⁰

The bankruptcy proceedings for the Diocese of Wilmington raised a similar question of whether a trust relationship existed between the diocese and the parishes.¹²¹ Specifically, the court analyzed whether a pooled investment program operated by the diocese and participated in by the individual parishes was property of the diocese or a beneficial interest of the parishes from a trust.¹²² Each parish transferred funds to the diocese, which then deposited the funds into the pooled investment program, and the diocese then invested those funds on behalf of the parishes.¹²³ The bankruptcy court noted that a resulting trust arises when a disposition of property is made with the inference that the person holding the property does not acquire the beneficial interest.¹²⁴ The court held that this investment program constituted a resulting trust because it was the intent of the parishes to have the diocese invest the transferred funds on their behalf and not to convey their beneficial interest.¹²⁵ However, the court concluded that the assets within this fund were commingled and indistinguishable with the diocese’s own funds in the program to the extent that it was too difficult to trace individual funds back to the respective parishes.¹²⁶ Although the court acknowledged that an enforceable trust relationship existed in regard to the investment program, the entire worth of the program was included in the estate because it was far too difficult to trace funds back to the individual parishes.¹²⁷ Therefore, under this analysis it is clear that a parish

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.*

121. Official Comm. of Unsecured Creditors v. Catholic Diocese of Wilmington, Inc. (*In re* Catholic Diocese of Wilmington, Inc.), 432 B.R. 135, 139 (Bankr. D. Del. 2010).

122. *Id.*

123. *Id.* at 142-44.

124. *Id.* at 149 (citing RESTATEMENT (FIRST) OF TRUSTS § 404 (AM. LAW. INST. 1935)).

125. *Id.*

126. *Id.* at 161.

127. *Id.* (citing 11 U.S.C. § 541(a) (2006)).

fund can be protected from inclusion in the bankruptcy estate. However, it will be included in the estate if the parish funds become commingled with the diocese's funds and cannot be traced.¹²⁸

Citing the decision in *In re Catholic Diocese of Wilmington, Inc.*, the court in the bankruptcy proceedings for the Archdiocese of Milwaukee held that the assets in the Parish Deposit Fund were not included in the archdiocese's bankruptcy estate.¹²⁹ Similar to the investment fund in *Wilmington*, the deposit fund included funds transferred by the parishes to be invested by the diocese on behalf of the parishes.¹³⁰ The court held that the archdiocese used the funds on behalf of the parishes and this constituted a resulting trust relationship.¹³¹ Distinguishing this holding from the *Wilmington* proceedings, the court noted that the funds were deposited into one segregated bank account and clearly traceable back to the parishes.¹³² The funds did not become commingled with those of the archdiocese or other parishes, and therefore, were clearly identifiable as property of the parishes.¹³³ The court concluded that the archdiocese was acting as a trustee for the transferred funds on behalf of the parishes, the diocese did not hold any equitable or beneficial interest in those funds, and therefore, the funds were not included in the diocesan estate.¹³⁴

In the bankruptcy proceedings for the Diocese of Helena, the court confirmed the Second Amended Plan of Reorganization, which appears to have excluded parish assets from the diocese's bankruptcy estate.¹³⁵ The First Amended Plan of Reorganization expressly stated that property belonging to the individual parishes and programs within the diocese—totaling over \$41 million in assets—was held in trust and would not be included in the bankruptcy estate.¹³⁶ The diocese claimed that the assets

128. *Id.*

129. *In re* Archdiocese of Milwaukee, 483 B.R. 855, 869 (Bankr. E.D. Wis. 2012) (*Archdiocese of Milwaukee II*) (citing *Catholic Diocese of Wilmington, Inc.*, 432 B.R. 135).

130. *Id.* at 868.

131. *Id.*

132. *Id.* at 869.

133. *Id.*

134. *Id.*

135. Second Amended Joint Chapter 11 Plan of Reorganization Proposed by The Roman Catholic Bishop of Helena, Montana and the Official Committee of Unsecured Creditors, *In re* Roman Catholic Bishop of Helena, Mont., No. 14-60074 (Bankr. D. Mont. Mar. 5, 2015).

136. Disclosure Statement for First Amended Joint Chapter 11 Plan of Reorganization Proposed by the Roman Catholic Bishop of Helena, Montana and The Official Committee of Unsecured Creditors at 29, *In re* Roman Catholic Bishop of Helena Mont., No. 14-60074 (Bankr. D. Mont. Jan. 13, 2015).

included were held in legal title by the diocese but held in trust for the benefit of the individual parishes, schools, and other entities.¹³⁷ Furthermore, the committee of creditors reserved the right to dispute this claim, but the “[p]lan represent[ed] a settlement of any dispute that could be raised regarding ownership.”¹³⁸ The Second Amended Plan of Reorganization does not include this express provision regarding the parish property.¹³⁹ However, the confirmed Second Amended Plan does not contradict the provision in the First Amended Plan of Reorganization and it does not include the parish assets in the ultimate bankruptcy estate.¹⁴⁰ Therefore, while the reasoning behind excluding the parish assets may not have necessarily been accepted by the court, the court did allow the exclusion of parish assets from the diocesan bankruptcy estate by confirming the plan.

The different holdings by these bankruptcy courts on whether or not the trust-like relationship between a diocese and its parishes may protect the parishes from forced inclusion of property into the bankruptcy estate further highlight the confusing nature of a diocesan bankruptcy. The relationship between a diocese and individual parishes is unlike most corporate structures. The extent of autonomy of the parishes in their day-to-day practices supports the theory that the relationship is closer to a trust-like relationship rather than a single legal body.¹⁴¹ The fact that the diocese generally holds legal title for all of the disputed property in fee simple absolute, however, conflicts with this theory.¹⁴² Therefore, the current state of the diocesan bankruptcies lacks a unified resolution to the issue of whether the trust-like relationship between the diocese and its parishes allows exclusion of parish assets from the bankruptcy estate.

C. Constitutional Protection of Religious Institutions

Bankruptcy proceedings of religious entities create several constitutional issues. The estate requirements in the Bankruptcy Code appear to cause an entanglement between the government and the church that could be deemed

137. *Id.*

138. *Id.* at 25.

139. *See* Second Amended Joint Chapter 11 Plan of Reorganization Proposed by the Roman Catholic Bishop of Helena, Montana and the Official Committee of Unsecured Creditors, *supra* note 135.

140. *Id.* at 14-15.

141. *See Archdiocese of Milwaukee I*, 483 B.R. 693, 699 (Bankr. E.D. Wis. 2012).

142. *See* Comm. Of Tort Litigants v. Catholic Diocese of Spokane (*In re* Catholic Bishop of Spokane), 329 B.R. 304, 331 (Bankr. E.D. Wash. 2005), *aff'd in part*, 2006 WL 211792 (E.D. Wash. 2006) and *rev'd in part*, 364 B.R. 81 (E.D. Wash. 2006).

unconstitutional under the Establishment Clause of the First Amendment.¹⁴³ Furthermore, the effects and burdens that arise from the application of the provisions of the Bankruptcy Code on a Catholic diocese appear to violate the Free Exercise Clause of the First Amendment under the constitutional standards set by Congress in the RFRA.¹⁴⁴ Specifically, several dioceses argued that including the parish assets in the estate violated the free exercise protection under the RFRA.¹⁴⁵ There are currently two major circuit splits regarding the issue of the diocesan estate formation and First Amendment implications.¹⁴⁶

1. The Establishment Clause

Including the property of individual parishes and entities in the diocesan bankruptcy estate creates a possible constitutional issue between the estate requirements per section 541 of the Bankruptcy Code and the Establishment Clause of the First Amendment. The Establishment Clause states that “Congress shall make no law respecting an establishment of religion.”¹⁴⁷ Diocesan debtors have unsuccessfully claimed that, by including all the assets of the parishes in the estate under section 541, the court violated this separation between government and religious entities.¹⁴⁸

Under constitutional analysis, a statute violates the Establishment Clause if (1) the statute has a secular purpose, (2) the principal or primary effect of the statute advances or inhibits religion, and (3) the statute creates an excessive entanglement between government and religion.¹⁴⁹ It has further been recognized that the third prong of this test constitutes the primary focus for Establishment Clause analysis.¹⁵⁰ An argument utilized by

143. See, e.g., *Tort Claimants Comm. v. Roman Catholic Archbishop of Portland in Or.* (*In re Roman Catholic Archbishop of Portland in Or.*), 335 B.R. 842, 859 (Bankr. D. Or. 2005).

144. 42 U.S.C. § 2000bb (2012). This statute was held unconstitutional as applied to states, but as to bankruptcy proceedings, a matter of federal law, the RFRA is still applicable. See *City of Boerne v. Flores*, 521 U.S. 507, 536 (1997).

145. See, e.g., *Roman Catholic Archbishop of Portland*, 335 B.R. at 859.

146. See *Listecki III*, 780 F.3d 731, 736 (7th Cir. 2015); *Hankins v. Lyght*, 441 F.3d 96, 104 (2d Cir. 2006); *Christians v. Crystal Evangelical Free Church (In re Young)*, 82 F.3d 1407, 1417 (8th Cir. 1996), *vacated*, 521 U.S. 1114 (1997), *reinstated by* 141 F.3d 854 (8th Cir. 1998).

147. U.S. CONST. amend. I.

148. See, e.g., 11 U.S.C. § 541 (2012); *Roman Catholic Archbishop of Portland*, 335 B.R. at 859, 862.

149. *Lemon v. Kurtzman*, 403 U.S. 602, 612-13 (1971).

150. *Grutka v. Barbour*, 549 F.2d 5, 8 (7th Cir. 1977); see also *Nadborny*, *supra* note 9, at 871.

dioceses is that, by including parish assets in the bankruptcy estate, the Bankruptcy Code fails this third prong.¹⁵¹ In essence, the dioceses argue that the Bankruptcy Code, judicial proceedings, and forcing specific assets into the estate constitutes excessive entanglement.¹⁵² The creditors, however, argue that such entanglement fails to reach the level of excessive because it was the church's voluntary acts that created the entanglement.

The Archdiocese of Portland raised the defense that the adjudication of whether parish property is to be included in the diocesan estate entangled the Bankruptcy Code with religious matters in violation of the Establishment Clause.¹⁵³ The court noted that, in resolving disputes regarding church property, it has been held that a court may apply "neutral 'secular principles of property,'" such as state or federal statutes, without violating the First Amendment.¹⁵⁴ This allows the court to rely on objective and well-established concepts of law, providing a flexible approach that can apply to all forms of religion.¹⁵⁵ The applicable, neutral secular law in any bankruptcy proceeding is the Bankruptcy Code, and therefore, applying the provisions and court interpretations thereof does not violate the First Amendment due to excessive entanglement.¹⁵⁶ Furthermore, the court held that applying the principles of the Catholic Code for formation of the bankruptcy estate would negate the neutral requirement.¹⁵⁷ The Supreme Court has expressly held that the application of neutral law that affects a religious property will not violate the Establishment Clause as long as it is generally a secular principle.¹⁵⁸ Although the diocese may be operated under internal church law, the Canon Law does not govern church property ownership in the secular world.¹⁵⁹ Therefore, the court held that the sole reliance on the Bankruptcy Code in resolving the parish property dispute did not constitute an excessive entanglement between the government and religion in violation of the Establishment Clause.¹⁶⁰

151. *Roman Catholic Archbishop of Portland*, 335 B.R. at 853; *see also Grutka*, 549 F.2d at 8; *Nadborny*, *supra* note 9, at 871-72.

152. *Roman Catholic Archbishop of Portland*, 335 B.R. at 853.

153. *Id.*

154. *Id.* at 854 (citing *Maktab Tarighe Oveyssi Shah Maghsoudi, Inc. v. Kianfar*, 179 F.3d 1244, 1249 (9th Cir. 1999)).

155. *Id.* (citing *Jones v. Wolf*, 443 U.S. 595, 603 (1979)).

156. *Id.*; *see also Nadborny*, *supra* note 9, at 871-72.

157. *Roman Catholic Archbishop of Portland*, 335 B.R. at 854.

158. *Jones*, 443 U.S. at 603; *Kianfar*, 179 F.3d at 1249.

159. *Roman Catholic Archbishop of Portland*, 335 B.R. at 859.

160. *Id.* at 853.

2. Free Exercise Under the Religious Freedom Restoration Act

An additional constitutional issue arises from the Free Exercise Clause of the First Amendment and the RFRA.¹⁶¹ The Free Exercise Clause provides that “Congress shall make no law . . . prohibiting the free exercise” of religion.¹⁶² Modern analysis of the Free Exercise Clause began as a balancing test of whether the challenged law constituted a substantial burden on one’s practice of religion.¹⁶³ If a court determined the law imposed a substantial burden on the practice of religion, the statute in dispute would be required to further a compelling governmental interest to avoid invalidation.¹⁶⁴ In *Employment Division, Department of Human Resources of Oregon v. Smith*, however, the Supreme Court rejected this balancing test, fearing that the test “would open the prospect of constitutionally required religious exemptions from civic obligations of almost every conceivable kind.”¹⁶⁵ Therefore, the Court held that “neutral, generally applicable laws may be applied to religious practices even when not supported by a compelling governmental interest.”¹⁶⁶ The shift in *Smith* allotted much weaker protection for religious entities: any law that did not directly target religion would not be required to satisfy the compelling interest standard of strict scrutiny.¹⁶⁷

In response to the Court’s decision in *Smith*, Congress enacted the Religious Freedom Restoration Act in 1993.¹⁶⁸ The RFRA was intended to provide broad protection for religious freedom¹⁶⁹ in acknowledging that “laws ‘neutral’ toward religion may burden religious exercise as surely as laws intended to interfere with religious exercise.”¹⁷⁰ The RFRA provides that, if a federal law creates a substantial burden on the exercise of religion, the statute must satisfy the strict scrutiny standard to be held in compliance with the Free Exercise Clause of the Constitution.¹⁷¹ Therefore, any statute

161. See *Listecki II*, 496 B.R. 905 (E.D. Wis. 2013), *aff’d in part, rev’d in part*, 780 F.3d 731 (7th Cir. 2015).

162. U.S. CONST. amend. I.

163. See *Wisconsin v. Yoder*, 406 U.S. 205 (1972); *Sherbert v. Verner*, 374 U.S. 398 (1963).

164. See *Yoder*, 406 U.S. at 215; *Sherbert*, 374 U.S. at 403, 406.

165. 494 U.S. 872, 888 (1990).

166. *City of Boerne v. Flores*, 521 U.S. 507, 514 (1997).

167. *Smith*, 494 U.S. at 878.

168. 42 U.S.C. § 2000bb (2012).

169. *Id.* § 2000bb(b); see also *Burwell v. Hobby Lobby Stores, Inc.*, 134 S. Ct. 2751, 2760 (2014).

170. 42 U.S.C. § 2000bb(a)(2).

171. *Id.* § 2000bb-1.

that creates a substantial burden on the free exercise of religion must further a compelling governmental interest and do so by the least restrictive means possible.¹⁷² This is a standard that will rarely be met and will likely lead to the overturning of the statute by the courts.

There are two major circuit splits regarding the application of the RFRA to the diocesan bankruptcies. The first split pertains to the scope of the RFRA and whether the creditors to the diocese constitute a government actor necessary to trigger the RFRA's protection.¹⁷³ The Seventh Circuit held that the creditors were acting purely from self-interest, and therefore were only private actors.¹⁷⁴ The Eighth Circuit, however, expressly held that the RFRA was an appropriate defense in bankruptcy proceedings.¹⁷⁵ The second split is on the issue of whether the Bankruptcy Code constitutes a compelling governmental interest, which is a necessary element for satisfying the strict scrutiny standard once a statute is found to have substantially burdened religious practice.¹⁷⁶ The Seventh Circuit again rejected the RFRA claim by holding that the Bankruptcy Code does not constitute a compelling governmental interest;¹⁷⁷ conversely, the Eighth Circuit held it does not.¹⁷⁸ These two circuit splits represent the most pressing issues regarding the diocesan bankruptcies in their current state, and their resolutions are essential to understanding religious freedom in regard to bankruptcy proceedings.

a) Determination of a Government Actor Under the RFRA

In order for a diocese to obtain constitutional protection under the RFRA from including parish property in the bankruptcy estate, inclusion must constitute a substantial burden on the church. Generally, a substantial burden on religious exercise "is one that necessarily bears direct, primary, and fundamental responsibility for rendering religious exercise—including

172. *Id.* § 2000bb-1(b).

173. *Listecki III*, 780 F.3d 731, 736 (7th Cir. 2015); *Christians v. Crystal Evangelical Free Church (In re Young)*, 82 F.3d 1407, 1417 (8th Cir. 1996), *vacated*, 521 U.S. 1114 (1997), *reinstated by* 141 F.3d 854 (8th Cir. 1998).

174. *Listecki III*, 780 F.3d at 736-37.

175. *Christians*, 82 F.3d at 1417; *see also* *Hankins v. Lyght*, 441 F.3d 96, 104 (2d Cir. 2006) (holding that a federal statute substantially burdening free exercise may be asserted as a defense in "any action"); *EEOC v. Catholic Univ. of Am.*, 83 F.3d 455 (D.C. Cir. 1996) (applying the RFRA to a private plaintiff in a gender discrimination claim against a religious employer).

176. *Listecki III*, 780 F.3d at 746; *Christians*, 82 F.3d at 1419.

177. *Listecki III*, 780 F.3d at 746.

178. *Christians*, 82 F.3d at 1420.

the use of real property for the purpose thereof within the regulated jurisdiction—effectively impracticable.”¹⁷⁹ Requiring each individual parish to include its property in the estate of the diocese may constitute a substantial burden on the parish’s free exercise because application of the Bankruptcy Code could leave the parishioners and children with no place to worship or study.¹⁸⁰ Therefore, another central issue with the diocesan bankruptcy estate is whether the inclusion of parish assets violates the Free Exercise Clause under the standards of the RFRA.

The Archdiocese of Portland argued that, under the RFRA, the parish assets must be excluded from the bankruptcy estate because inclusion would substantially burden the free exercise of their religious practices.¹⁸¹ This argument was founded on Canon Law, which states that the parishes—not the diocese—own parish property.¹⁸² The archdiocese further argued that inclusion of the parish assets in the estate would greatly constrain the parishioners’ ability to practice and study religious materials.¹⁸³ The court noted that if the inclusion of parish assets constituted a substantial burden, the burden would most certainly fail to satisfy the strict scrutiny standard as “the interests advanced by the bankruptcy system are not compelling under the RFRA.”¹⁸⁴ However, the court ultimately held that the determinations under section 541 estate formation are merely on the status of property ownership and is, therefore, incapable of imposing actual burden on the exercise of religion.¹⁸⁵ The court concluded that the inclusion of parish assets is not a substantial burden, and the protection provided under the RFRA is inapplicable to the diocese’s bankruptcy proceedings.

A similar argument arose in the bankruptcy proceedings for the Archdiocese of Milwaukee, in which the archdiocese claimed that being forced to include the Cemetery Perpetual Case Trust, a \$55 million fund used to maintain all Catholic cemeteries within the archdiocese, would

179. *Listecki II*, 496 B.R. 905, 920 (E.D. Wis. 2013) (quoting *Civil Liberties for Urban Believers v. City of Chi.*, 343 F.3d 752, 761 (7th Cir. 2003)), *aff’d in part, rev’d in part*, 780 F.3d 731 (7th Cir. 2015).

180. See Radwan, *supra* note 64, at 110.

181. See *Tort Claimants Comm. v. Roman Catholic Archbishop of Portland in Or. (In re Roman Catholic Archbishop of Portland in Or.)*, 335 B.R. 842, 859 (Bankr. D. Or. 2005).

182. *Id.*; 1983 CODE c.1256.

183. *Roman Catholic Archbishop of Portland*, 335 B.R. at 864; see also Radwan, *supra* note 64, at 110.

184. *Roman Catholic Archbishop of Portland*, 335 B.R. at 864 (quoting *Christians v. Crystal Evangelical Free Church (In re Young)*, 82 F.3d 1407, 1420 (8th Cir. 1996), *vacated*, 521 U.S. 1114 (1997), *reinstated by* 141 F.3d 854 (8th Cir. 1998)).

185. *Id.* at 861; see also 11 U.S.C. § 541 (2012).

substantially burden the church.¹⁸⁶ The diocese argued that the loss of the fund would eliminate the church's ability to bury its members in accordance with religious doctrine.¹⁸⁷ Furthermore, general upkeep of the archdiocese's cemeteries would be greatly hindered without access to this fund.¹⁸⁸ The focus of the court's analysis centered on whether the trust could even apply under the RFRA, as the act only applies to actions of the government.¹⁸⁹ Although the creditors, and not the state, moved to have the cemetery fund included in the bankruptcy estate, they were doing so under color of law of the Bankruptcy Code and performing a public function.¹⁹⁰ The bankruptcy court held that by acting under color of law, the actions of the creditors were "fairly attributable to the government."¹⁹¹ Furthermore, the bankruptcy court held that because the diocese would lose the ability to maintain its cemeteries and bury its members, requiring the cemetery fund be included in the estate constitutes a substantial burden.¹⁹² The creditors further claimed that even if requiring the fund be included in the estate constitutes a substantial burden, the interest of preserving the bankruptcy system is a sufficiently compelling interest and would thus satisfy the strict scrutiny standard.¹⁹³ The bankruptcy court, however, held that preservation of bankruptcy failed to reach the importance of a compelling interest and that forcing inclusion of the cemetery fund into the diocesan estate violated the diocese's free exercise under the RFRA.¹⁹⁴

The Court of Appeals for the Seventh Circuit recently reversed this holding. The central issue addressed by the circuit court was whether the creditors did in fact constitute the "government" in order for the RFRA to apply.¹⁹⁵ The distinguishing point arises in the argument that the committee of creditors constitutes the "government" because it performs a public function under color of law of the Bankruptcy Code.¹⁹⁶ Although there are some overlapping functions, a "governmental entity is to act as an impartial supervisor of the bankruptcy process [t]he Committee [of creditors],

186. *Listecki II*, 496 B.R. 905, 909-10 (E.D. Wis. 2013), *aff'd in part, rev'd in part*, 780 F.3d 731 (7th Cir. 2015).

187. *Id.* at 911.

188. *Id.*

189. *Id.* at 915.

190. *Id.* at 919.

191. *Id.*

192. *Id.* at 920-21.

193. *See id.* at 922.

194. *Id.*

195. *Listecki III*, 780 F.3d 731, 737 (7th Cir. 2015).

196. *Id.* at 737-40.

however, is far from impartial.”¹⁹⁷ The committee members became creditors through their own private transactions with the debtor and each is a private, individual creditor.¹⁹⁸ The circuit court notes that to act under color of law and to act as a government actor are interchangeable terms,¹⁹⁹ but acting out of self-interest contradicts the notion of acting under color of law for a public function.²⁰⁰ The decision that the RFRA precludes the inclusion of the cemetery fund into the diocesan bankruptcy estate was thereby reversed.²⁰¹

The Seventh Circuit’s reasoning in *Listecki* starkly conflicts with the holdings by several other circuit courts.²⁰² The Seventh Circuit held that the RFRA does not apply because the creditors are not government actors,²⁰³ and yet other circuit courts have held that the RFRA would apply even if the offending party was not a government actor.²⁰⁴ The Eighth Circuit held that the RFRA is an actionable defense in bankruptcy proceedings against the bankruptcy trustee.²⁰⁵ The Second Circuit held that the RFRA applies to “any action” of a “federal statute [that] substantially burdens the exercise of their religion.”²⁰⁶ Finally, the D.C. Circuit held that the RFRA applied to a private plaintiff’s discrimination claim against a religious employer.²⁰⁷ These cases held that the RFRA applied in a situation firmly rejected by the Seventh Circuit, creating a clear circuit split on whether the RFRA applies in the diocesan bankruptcy proceedings. An appeal on this issue was petitioned for writ of certiorari in the Supreme Court by the Archdiocese in

197. *Id.*

198. *Id.* at 738.

199. *Id.* (citing *Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 935 (1982)).

200. *Id.* at 740-41.

201. *Id.* at 749-50.

202. *Hankins v. Lyght*, 441 F.3d 96, 104 (2d Cir. 2006); *EEOC v. Catholic Univ. of Am.*, 83 F.3d 455, 469 (D.C. Cir. 1996); *Christians v. Crystal Evangelical Free Church (In re Young)*, 82 F.3d 1407, 1417 (8th Cir. 1996), *vacated*, 521 U.S. 1114 (1997), *reinstated by* 141 F.3d 854 (8th Cir. 1998).

203. *Listecki III*, 780 F.3d at 737-38.

204. *Hankins*, 441 F.3d at 109; *Catholic Univ. of Am.*, 83 F.3d at 455; *Christians*, 82 F.3d at 1417.

205. *Christians*, 82 F.3d at 1420.

206. *Hankins*, 441 F.3d at 104.

207. *Catholic Univ. of Am.*, 83 F.3d at 455.

the proceedings for the Archdiocese of Milwaukee,²⁰⁸ but the parties later settled,²⁰⁹ leaving the issue unanswered and the circuit split in place.

b) Strict Scrutiny Standard and the Bankruptcy Code

Circuit courts are additionally split over the issue of whether the interests of the Bankruptcy Code constitute a compelling governmental interest. As noted above, if a court determines that a statutory requirement imposes a substantial burden on the free exercise of religion, then the interest furthered by that statute must be of a compelling governmental interest and applied in the least restrictive means to satisfy the requirements under the RFRA.²¹⁰ If a court finds that applying a provision of the Bankruptcy Code constitutes a substantial burden on a church or religious entity, it then must be determined whether the Bankruptcy Code itself furthers a compelling governmental interest.²¹¹ Otherwise, the burden fails the strict scrutiny standard of the RFRA and violates the Free Exercise Clause of the First Amendment.²¹²

In the bankruptcy proceedings for the Archdiocese of Milwaukee, the Seventh Circuit additionally analyzed “whether there is a compelling governmental interest in the [c]hallenged [p]rovisions” of the Bankruptcy Code.²¹³ The circuit court acknowledged that there is no bright-line definition of a compelling governmental interest, but, similar to other courts that have decided on the interests of the Bankruptcy Code, noted that it must be an interest “of the highest order.”²¹⁴ In offering examples of such interests, the court referenced several Supreme Court cases that held interests such as the tax system,²¹⁵ social security,²¹⁶ and public safety/national security²¹⁷ satisfied the heightened requirements of strict

208. Petition for Writ of Certiorari, *Listecki ex rel. Archdiocese of Milwaukee Catholic Cemetery Perpetual Care Trust v. Official Comm. Of Unsecured Creditors*, 136 S. Ct. 581 (2015) (Mem.) (No. 15-28), 2015 WL 4100301.

209. See Brendan O’Brien, *Federal Judge Approves Milwaukee Archdiocese Bankruptcy Plan*, REUTERS (Nov. 9, 2015), <http://www.reuters.com/article/us-wisconsin-archdiocese-idUSKCN0SY27L20151109>.

210. 42 U.S.C. § 2000bb-1(b) (2012).

211. See *id.* § 2000bb-1(b)(1).

212. See *id.*

213. *Listecki III*, 780 F.3d 731, 745 (7th Cir. 2015).

214. *Id.* (quoting *Church of the Lukumi Babalu Aye, Inc. v. City of Hialeah*, 508 U.S. 520, 546 (1993)).

215. *Hernandez v. C.I.R.*, 490 U.S. 680, 699-700 (1989).

216. *United States v. Lee*, 455 U.S. 252, 258-59 (1982).

217. *Gillette v. United States*, 401 U.S. 437, 462 (1971).

scrutiny. The Committee of Unsecured Creditors in *Listecki III* argued that the protection of the creditors and their interest was the compelling governmental interest under the Bankruptcy Code.²¹⁸

The Seventh Circuit, agreeing with the creditors, held that the Bankruptcy Code constitutes a compelling governmental interest because the nature of the interests that are furthered aligned with those of the social security system.²¹⁹ Analyzing the Bankruptcy Code similar to the Supreme Court in *United States v. Lee*, the court here noted that the “broad scope and remedial nature of the [c]ode are akin to those interests the Court has held are compelling this test, *e.g.*, the social security system.”²²⁰ Similar to the Bankruptcy Code, the “social security system ‘serves the public interest by providing a comprehensive . . . system with a variety of benefits available to all participants’ nationwide.”²²¹ The social security system supports all of those who have either reached sixty-five years of age or have some form of disability.²²² The Bankruptcy Code, like the social security system, aids all of those burdened by a certain financial condition by safely allowing them to repay their debts and still contribute to society as an individual or business entity.²²³ Analogizing the interests of the Bankruptcy Code with those of the social security system, the circuit court held that the specific provisions challenged by the Committee of Unsecured Creditors and the Bankruptcy Code as a whole furthered a compelling governmental interest.²²⁴ Therefore, the circuit court held that even if requiring the Archdiocese to include the Cemetery Fund in the diocesan bankruptcy estate did constitute a substantial burden under the RFRA, the requirements of the Bankruptcy Code would satisfy the strict scrutiny standard as furthering a compelling governmental interest.²²⁵ Furthermore, the Seventh Circuit held that generally, “the protection of creditors . . . is a compelling governmental interest that can overcome a burden on the free exercise of religion.”²²⁶

Conflicting with the Seventh Circuit’s decision, several courts have held that the application of the Bankruptcy Code does not constitute a

218. *Listecki III*, 780 F.3d at 745.

219. *Id.* at 746-47.

220. *Id.* at 746.

221. *Id.* (quoting *United States v. Lee*, 455 U.S. 252, 258 (1982)).

222. *Id.*

223. *Id.* (citing *United States v. Whiting Pools*, 462 U.S. 198, 203 (1983)).

224. *Id.* at 746-47.

225. *Id.* at 749-50.

226. *Id.* at 745-46.

compelling government interest.²²⁷ The Eighth Circuit in *Christians* analyzed the issue of whether the Bankruptcy Code itself constituted a compelling governmental interest and ultimately held that it failed to reach this standard.²²⁸ The court noted that the “RFRA does not define ‘compelling governmental interest’” but that “[c]ompelling governmental interest[s] have been described . . . as ‘interests of the highest order.’”²²⁹ In applying this standard, the court viewed other interests that had been previously held to be compelling governmental interests:²³⁰ interests such as public safety and national security.²³¹ The primary interests of the Bankruptcy Code are to provide the debtor with a fresh start while simultaneously protecting the interests of all the creditors.²³² The Eighth Circuit held that these interests, while important, “fell ‘short of direct national security and public safety concerns.’”²³³ The circuit court found that the interests of the Bankruptcy Code were too localized to reach such a level of import.²³⁴ Therefore, the circuit court held that the Bankruptcy Code and its provisions failed to satisfy the standard of a compelling governmental interest under the RFRA.²³⁵

Concurring with the Eighth Circuit in *Christians*, the bankruptcy court in the proceedings for the Archdiocese of Portland held that the provisions of the Bankruptcy Code also fail to reach the importance of a compelling governmental interest.²³⁶ The court noted that the purpose of the provisions in question is meant to “maximize the bankruptcy estate and thereby

227. See *Christians v. Crystal Evangelical Free Church (In re Young)*, 82 F.3d 1407, 1420 (8th Cir. 1996), *vacated*, 521 U.S. 1114 (1997), *reinstated by* 141 F.3d 854 (8th Cir. 1998); *Listecki II*, 496 B.R. 905, 921-22 (E.D. Wis. 2013), *aff’d in part, rev’d in part*, 780 F.3d 731 (7th Cir. 2015); *Tort Claimants Comm. v. Roman Catholic Archbishop of Portland in Or. (In re Archbishop of Portland in Or.)*, 335 B.R. 842, 864 (Bankr. D. Or. 2005); *Fitzgerald v. Magic Valley Evangelical Free Church, Inc. (In re Hodge)*, 200 B.R. 884, 898 (Bankr. D. Idaho 1996); *In re Tessier*, 190 B.R. 396, 405 (Bankr. D. Mont. 1995).

228. *Christians*, 82 F.3d at 1420.

229. *Id.* at 1419 (quoting *Church of the Lukumi Babalu Aye, Inc. v. City of Hialeah*, 508 U.S. 520, 546 (1993)).

230. *Id.* at 1420.

231. *Id.* (citing *Tessier*, 190 B.R. at 405).

232. *Id.*; see also Julian Ellis & David M. Hyams, *RFRA: Circuits Split on “Compelling Government Interest”*, 34 AM. BANKR. INST. J., Nov. 2015, at 36, 37; 1 COLLIER ON BANKRUPTCY, *supra* note 8, ¶ 1.01(1).

233. *Christians*, 82 F.3d at 1420 (quoting *Tessier*, 190 B.R. at 405).

234. *Id.*

235. *Id.*

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

maximize the recovery for creditors,” and yet many exceptions to this purpose exist within the Code itself.²³⁷ Furthermore, the court noted that there are exceptions to providing the debtor with a fresh start upon completion of the bankruptcy proceedings, which, as noted above, is one of the two central interests advanced by the Code.²³⁸ The court highlighted these exceptions to raise the point that “the Bankruptcy Code itself provides for exceptions that do not further the policies of the Code.”²³⁹ The claim that an interest furthered by a statute is of the highest order appears problematic if exceptions to that very same interest are provided within its own provisions.²⁴⁰

The Seventh Circuit directly held in a diocesan bankruptcy case that the Bankruptcy Code in general constitutes a compelling governmental interest.²⁴¹ The Eighth Circuit, along with four other courts,²⁴² conversely held that the Bankruptcy Code fails to reach the level of import as a compelling governmental interest.²⁴³ These conflicting decisions have established a circuit split on whether the Bankruptcy Code constitutes a compelling governmental interest.²⁴⁴ As dioceses continue to file bankruptcy over mounting litigation awards to clergy abuse claimants, a unified doctrine is required on this question.

IV. Analysis of the Diocesan Bankruptcy Issues

Issues or elements of the issues discussed are still unresolved based on the past court decisions. Although there are different state bankruptcy courts deciding these issues, the Bankruptcy Code is a federal code. Interpretation of property is largely a state issue, but determinations of

237. *Id.*

238. *Id.*; see also 11 U.S.C. § 523(a) (2012) (statutorily provided exceptions to debtor discharge).

239. *Roman Catholic Archbishop of Portland*, 335 B.R. at 864.

240. See *Church of the Lukumi Babalu Aye, Inc. v. Hialeah*, 508 U.S. 520, 547 (1993); *Florida Star v. B.J.F.*, 491 U.S. 524, 541-42 (1989) (Scalia J., concurring in part and concurring in judgment).

241. *Listecki III*, 780 F.3d 731, 746 (7th Cir. 2015).

242. *Listecki II*, 496 B.R. 905, 921-22 (E.D. Wis. 2013), *aff'd in part, rev'd in part*, 780 F.3d 731; *Tort Claimants Comm. v. Roman Catholic Archbishop of Portland in Or.* (*In re Roman Catholic Archbishop of Portland*), 335 B.R. 842, 864 (Bankr. D. Or. 2005); *Fitzgerald v. Magic Valley Evangelical Free Church, Inc.* (*In re Hodge*), 200 B.R. 884, 898 (Bankr. D. Idaho 1996); *In re Tessier*, 190 B.R. 396, 466 (Bankr. D. Mont. 1995).

243. *Christians v. Crystal Evangelical Free Church* (*In re Young*), 82 F.3d 1407, 1417 (8th Cir. 1996), *vacated*, 521 U.S. 1114 (1997), *reinstated by* 141 F.3d 854 (8th Cir. 1998).

244. See *Ellis & Hyams*, *supra* note 232, at 36.

whether specific property belongs in the bankruptcy estate is a matter of federal law.²⁴⁵ However, because church litigation on this scale is ever increasing, the issues on how the dioceses must form their estates are increasingly important, and therefore, a degree of unification will be required. Therefore, it is necessary to analyze the issues to find the strongest resolutions in order for both the courts and the Church to understand how to proceed in future bankruptcy cases.

A. The Corporate Structure of the Diocese

As the debtor-in-possession, the bishop must keep the interests of the creditors in mind during the bankruptcy proceedings because the debtor-in-possession owes a fiduciary duty to the creditors.²⁴⁶ Although the tenets of the Catholic hierarchy and Canon Law dictate the bishop protect the interests of the parishes and ability of parishioners to practice, the Bankruptcy Code legally requires the bishop to subordinate those interests to those of its creditors.²⁴⁷ This creates a significant issue for the diocese because the best interest of the creditors would require the inclusion of parish assets in the estate to ensure maximum relief. However, if courts acknowledge the parishes as separate legal entities per the Canon Code,²⁴⁸ the bishop could avoid the fiduciary duty to include parish property in the bankruptcy estate in order to maximize repayment plan to creditors. There is a significant conflict of interest here, and therefore, the corporate structure of the church has important effects on the formation of the estate.

Although some courts have excluded parish assets based on the corporate structure of a Catholic diocese, courts should not uphold this practice.²⁴⁹ The dioceses' central argument is that the Catholic Code's definition of each parish as a separate juridic person allows the state to identify each parish as a separate civil entity.²⁵⁰ Although the diocese alone is generally the actual civil entity incorporated with the respective secretary of state,²⁵¹ the corporate structure from within the organization, under Canon Law, clearly separates the diocese and its individual parishes as distinct juridic persons.²⁵² The weakness of this argument is fairly clear on its face: state

245. Board of Trade of Chi. v. Johnson, 264 U.S. 1, 10 (1924).

246. Radwan, *supra* note 64, at 117.

247. *Id.* at 118-20.

248. 1983 CODE c.116, § 1, c.515, § 3.

249. *Archdiocese of Milwaukee I*, 483 B.R. 693, 699-700 (Bankr. E.D. Wis. 2012).

250. *See* 1983 CODE c.116, § 1, c.515, § 3.

251. *See* Radwan, *supra* note 64, at 89.

252. 1983 CODE c.116, § 1, c.515, § 3.

law governs what is a distinct civil entity and not corporate articles of incorporation, bylaws, or other internal governing documents.²⁵³ A diocese structured as a corporation sole is just that, a corporation with a sole, overseeing office that is the legally recognized entity and all other individual entities within are under its legal control.²⁵⁴

To avoid the preemption of state law over the intended structure of Canon Law, a diocese would likely need to individually incorporate each parish as a separate legal entity.²⁵⁵ The bankruptcy court in the proceedings for the Diocese of Tucson accepted this as a viable strategy to protect the assets of each parish from the diocesan bankruptcy estate.²⁵⁶ The Diocese of Tucson's reorganization plan allowed for each individual parish to hold legal title of its property, and therefore, allowed exclusion of the property from the diocese's bankruptcy estate.²⁵⁷ A previous author writing on this issue noted that incorporating every individual parish "would not harm parishioners" and "would begin to resolve the property disputes."²⁵⁸ Therefore, although the clear application of the law bars the use of the Catholic Code as a means to avoid including parish assets in the bankruptcy estate, a diocese could anticipate these issues by individually incorporating each parish.

The important point to take from the diocesan bankruptcy proceedings is that the defense that the corporate structure of the diocese *alone* does not protect parish assets from the estate.²⁵⁹ States recognize the diocese as a

253. Tort Claimants Comm. v. Roman Catholic Archbishop of Portland in Or. (*In re* Roman Catholic Bishop of Portland in Or.), 335 B.R. 842, 866 (Bankr. D. Or. 2005) (applying Oregon corporation law to the issue as opposed to the diocese's internal rules); see Radwan, *supra* note 64, at 88.

254. See *Sole Corporation*, BLACK'S LAW DICTIONARY (10th ed. 2014).

255. See Radwan, *supra* note 64, at 119-20.

256. Order Confirming the Third Amended and Restated Plan of Reorganization, *In re* The Catholic Church of the Diocese of Tucson, No. 4-bk-04-0471-JMM (Bankr. D. Ariz. May 25, 2005); see also Debtor's Third Amended and Restated Plan or Reorganization at 77, *In re* The Catholic Church of the Diocese of Tucson, No. 4-bk-04-0471-JMM (Bankr. D. Ariz. May 25, 2005).

257. Order Confirming the Third Amended and Restated Plan of Reorganization, *supra* note 256; see also Debtor's Third Amended and Restated Plan or Reorganization, *supra* note 256, at 77.

258. Radwan, *supra* note 64, at 120.

259. See Tort Claimants Comm. v. Roman Catholic Archbishop of Portland in Or. (*In re* Roman Catholic Archbishop of Portland in Or.), 335 B.R. 842, 868 (Bankr. D. Or. 2005); Comm. Of Tort Litigants v. Catholic Diocese of Spokane (*In re* Catholic Bishop of Spokane), 329 B.R. 304, 333 (Bankr. E.D. Wash. 2005), *aff'd in part*, 2006 WL 211792 (E.D. Wash. 2006) and *rev'd in part*, 364 B.R. 81 (E.D. Wash. 2006).

corporate sole, and under the provisions of the Bankruptcy Code, all assets held by that office are subject to the bankruptcy proceedings.²⁶⁰ The internal Catholic Code may separate each parish as a distinct juridic person,²⁶¹ but this should carry few legal consequences from the perspective of the states and the bankruptcy courts.²⁶² The states' corporate laws will preempt the internal Canon Law, whether in a bankruptcy interpretation or under constitutional scrutiny.

B. "Trust-Like" Relationship Between the Diocese and Parishes

The trust-like relationship between a diocese and its individual entities can provide some protection for parishes and other entities, but cannot be extended to generally exclude all parish assets from the diocesan estate. Although the relationship between the diocese and each parish in its entirety may not protect the parishes from including assets in the bankruptcy, certain funds and investment programs can be protected.²⁶³ In *Wilmington*, the court held that an investment program constituted a resulting trust because it was the intent of the parishes to have the diocese invest the transferred funds on their behalf and not to convey their beneficial interest.²⁶⁴ If the structure of the fund ensures that each individual parish's investment remains traceable back to the parish and does not become commingled with the funds of the diocese or the entire fund, then the resulting trust provides protection from including those funds in the diocese's bankruptcy estate.²⁶⁵

Other authors have argued that including the parish assets held in a traceable resulting trust in the bankruptcy estate not only violates bankruptcy law, but would infringe on the free exercise rights of the dioceses and parishes.²⁶⁶ The Bankruptcy Code itself expressly states that recognized trust property is to be excluded from the bankruptcy estate,²⁶⁷

260. See 11 U.S.C. § 541(a)(2) (2012).

261. 1983 CODE c.116, § 1, c.515, § 3.

262. See *Roman Catholic Archbishop of Portland*, 335 B.R. at 868; *Catholic Bishop of Spokane*, 329 B.R. at 333.

263. See *Archdiocese of Milwaukee II*, 483 B.R. 855, 869 (Bankr. E.D. Wis. 2012); *Official Comm. of Unsecured Creditors v. Catholic Diocese of Wilmington (In re Catholic Diocese of Wilmington, Inc.)*, 432 B.R. 135, 139 (Bankr. D. Del. 2010).

264. *Catholic Diocese of Wilmington, Inc.*, 432 B.R. at 148-49.

265. *Archdiocese of Milwaukee II*, 483 B.R. at 869; see 11 U.S.C. § 541(d).

266. See Daniel J. Marcinak, *Separation of Church and Estate: On Excluding Parish Assets from the Bankruptcy Estate of a Diocese Organized as a Corporation Sole*, 55 CATH. U. L. REV. 583, 633 (2006).

267. 11 U.S.C. § 541(d).

and there is now precedential case law acknowledging that such trusts can exist within the diocese-parish relationship.²⁶⁸ Applying this doctrine to all parish property, however, fails under the current understanding of how bankruptcy law applies to the diocese-parish relationship.²⁶⁹

One unanswered issue regarding exclusion of a traceable statutory or resulting trust for which the diocese acts as trustee is the extent of what property can be included in such a trust. The cases thus far have only applied to specific trusts created for a very specific purpose, viz. investment funds for the parishes.²⁷⁰ It's possible that instead of holding the legal title of all parish property under the laws of a corporation sole, the diocese could create individual trusts for each parish and its property. Although exceptionally tedious, such an express trust relationship could very well avoid the issues these dioceses have struggled with when reorganizing under Chapter 11 bankruptcy. What is clear is that all parish property will not be excluded merely based on the trust-like relationship.²⁷¹

C. Constitutional Protection

The bankruptcy proceedings of religious entities have also exposed several constitutional issues. The estate requirements in the Code appear to cause an entanglement between the government and the Church that could be deemed unconstitutional under the Establishment Clause of the First Amendment.²⁷² Furthermore, the effects and burdens that arise from the application of the Bankruptcy Code on a Catholic diocese appear to violate the Free Exercise Clause of the First Amendment under the constitutional standards set forth in the RFRA.²⁷³ Specifically, several dioceses argued that including the parish assets in the estate violated the free exercise protection under the RFRA.²⁷⁴ However, the circuit courts that have addressed this issue conflict on whether the RFRA may even apply in a diocesan bankruptcy.²⁷⁵ If the RFRA does apply, the circuit courts will

268. See *Archdiocese of Milwaukee II*, 483 B.R. at 869; *Catholic Diocese of Wilmington, Inc.*, 432 B.R. at 140-42.

269. *Comm. Of Tort Litigants v. Catholic Diocese of Spokane (In re Catholic Bishop of Spokane)*, 329 B.R. 304, 333 (Bankr. E.D. Wash. 2005), *aff'd in part*, 2006 WL 211792 (E.D. Wash. 2006) and *rev'd in part*, 364 B.R. 81 (E.D. Wash. 2006).

270. *E.g.*, *Archdiocese of Milwaukee II*, 483 B.R. at 869.

271. See *Catholic Bishop of Spokane*, 329 B.R. at 333.

272. See *Tort Claimants Comm. v. Roman Catholic Archbishop of Portland in Or. (In re Roman Catholic Archbishop of Portland in Or.)*, 335 B.R. 842, 850 (Bankr. D. Or. 2005).

273. 42 U.S.C. § 2000bb (2012).

274. *E.g.*, *Roman Catholic Archbishop of Portland*, 335 B.R. at 859.

275. *E.g.*, *Listecki III*, 780 F.3d 731, 741 (7th Cir. 2015).

continue to disagree on whether application of the Bankruptcy Code could pass muster under the standards of the RFRA.²⁷⁶ Both of these issues carry massive implications on the effects bankruptcy may have on religious freedom.

1. Are the Creditors Acting Under Color of Law?

The Church cannot utilize constitutional protection under the RFRA because the creditors, whether acting under a committee or not, are not acting under color of law for a public function. A committee of creditors' purpose is to ensure adequate compensation from private transactions. Although a diocese has argued (successfully in a bankruptcy court) that the committee of creditors is acting under the Bankruptcy Code, they are doing so to ensure payment of a private transaction.²⁷⁷ The dioceses argue that the creditors are acting under color of law of the Bankruptcy Code and performing a public function.²⁷⁸ This public function, as one diocese articulated it, is to pursue claims on behalf of the bankruptcy estate and ensure they receive equitable relief from the debtor.²⁷⁹ However, it is difficult to perceive this as a truly public function, as the central aim of the committee is to ensure private litigants receive adequate compensation from the damages suffered from clergy abuse. Although there are larger public implications that may arise from the clergy abuse litigation—and the sizeable damages that have been awarded thus from—these are not the goals of the creditors. Their central, overarching goal is to fulfill a transaction of money, albeit one dictated by the courts. Therefore, the fundamental requirement of the RFRA—that the party asserting the burden be a state actor²⁸⁰—is not satisfied.

In ascertaining whether actions were done under color of law, courts often look at the source of authority of the party asserting the statute and determine whether it exists purely by a grant from the state.²⁸¹ Generally, the Supreme Court has held that a private party acts under color of law when “there is a sufficiently close nexus” between the conduct of the private party and the government so that the private party’s actions “may be

276. *E.g., id.*

277. *Listecki II*, 496 B.R. 905, 919 (E.D. Wis. 2012), *aff'd in part, rev'd in part*, 780 F.3d 731.

278. *Id.*

279. *Id.* (citing *Jackson v. Metro. Edison Co.*, 419 U.S. 345, 352 (1974)).

280. 42 U.S.C. § 2000bb-1 (2012).

281. *See, e.g., Temple v. Albert*, 719 F. Supp. 265, 267 (S.D.N.Y. 1989).

fairly treated as that of the [government] itself.”²⁸² Clearly stated, the Court noted that the issue is “whether particular conduct is ‘private’ on the one hand, or ‘state action’ on the other.”²⁸³ As discussed, the committee of creditors is seeking payment from a transaction between private parties. The only substantial nexus between the creditors and the government is the Bankruptcy Code itself.²⁸⁴ The mere act of asserting compliance with a federal law is far from a nexus substantial enough to constitute state action. Therefore, their conduct in general is of a private nature.

An objection to this argument arises from the Second Circuit’s holding in *Hynkins v. Light*, in which the court noted that the language of the RFRA is broad enough to include actions of private citizens applying federal law.²⁸⁵ The circuit court first acknowledged the lack of case law on the question of whether the “RFRA applies to an action by a private party seeking relief under a federal statute against another private party who claims that the federal statute substantially burdens his or her exercise of religion.”²⁸⁶ The court then noted that the statutory language itself appears to include such an action by stating “that it ‘applies to all federal law, and the implementation of that law.’”²⁸⁷ Under this interpretation of the RFRA, it appears that the color of law argument posed by the Seventh Circuit is unnecessary. The creditors in a diocesan bankruptcy are seeking relief under the terms of the federal Bankruptcy Code, which the Church claims is substantially burdening their free exercise of religion. Because the application of a federal law is causing the substantial burden, under the Second Circuit’s view, the RFRA must apply.²⁸⁸

Although the Second Circuit’s argument is persuasive, the lack of precedential authority on applying the RFRA to disputes between two private parties weakens this claim. In her dissenting opinion, then Second Circuit Judge and current Supreme Court Justice Sonya Sotomayor argues that the RFRA “does not apply to disputes between private parties.”²⁸⁹ She points out that even the “majority concedes that it is unable to find a single

282. *Jackson v. Metro. Edison Co.*, 419 U.S. 345, 351 (1974).

283. *Id.* at 349-350 (citing *Burton v. Wilmington Parking Auth.*, 365 U.S. 715, 723 (1961)).

284. *See Listecki III*, 780 F.3d 731, 738-40 (7th Cir. 2015) (finding no nexus between the creditors and the government on the grounds of the committee’s makeup, or its public function).

285. 441 F.3d 96, 103 (2d Cir. 2006).

286. *Id.*

287. *Id.* (quoting 42 U.S.C. § 2000bb-3(a)).

288. *Id.*

289. *Id.* at 109 (Sotomayor, J. dissenting).

holding that contradicts . . . that the RFRA does not apply to suits between private parties.”²⁹⁰ Furthermore, Sotomayor notes that because the application of the RFRA to a dispute between private parties is not at dispute in the case before the Second Circuit, the majority’s conclusion on the issue is merely dicta.²⁹¹ Although the breadth of the language in the RFRA could be interpreted to allow application to private disputes, the complete lack of any additional precedential interpretation of the statute in this fashion highlights the weakness of this argument. Furthermore, the precedent holding otherwise is overwhelming.²⁹²

The RFRA requires state action in order for its strict scrutiny standard to apply to a federal law.²⁹³ The text of the statute itself states that the “[g]overnment shall not substantially burden a person’s exercise of religion.”²⁹⁴ Because the creditors, whether acting under a committee or not, are not acting under color of law for a public function, the Church cannot utilize constitutional protection under the RFRA to avoid the disputed provisions of the Bankruptcy Code.

2. Does the Bankruptcy Code Constitute a Compelling Governmental Interest?

For similar reasons, the Bankruptcy Code could not be held to constitute a compelling governmental interest. Although currently there is no uniformity in the issue of whether the creditors of a Catholic diocese constitute a government actor under color of law or whether the RFRA can apply to actions between private parties, the circuit split strict regarding the Bankruptcy Code as a compelling governmental interest also deserves analysis. The Seventh Circuit held that the Bankruptcy Code and its provisions constitute a compelling governmental interest,²⁹⁵ while the Eighth Circuit directly held otherwise.²⁹⁶ If the Supreme Court decided that the creditors under these circumstances do constitute a government actor, the issue of whether the application of the Code and its provisions could satisfy the scrutiny standard of the RFRA must be resolved. Not only is this

290. *Id.* at 114.

291. *Id.*

292. *See, e.g.*, *Gen. Conference Corp. of Seventh-Day Adventists v. McGill*, 617 F.3d 402, 410 (6th Cir. 2010); *Sutton v. Providence St. Joseph Medical Ctr.*, 192 F.3d 826, 834 (9th Cir. 1999).

293. 42 U.S.C. § 2000bb-1(b) (2012).

294. *Id.* § 2000bb-1(a) (emphasis added).

295. *Listecki III*, 780 F.3d 731, 745-46 (7th Cir. 2015).

296. *Christians v. Crystal Evangelical Free Church (In re Young)*, 82 F.3d 1407, 1417 (8th Cir. 1996), *vacated*, 521 U.S. 1114 (1997), *reinstated by* 141 F.3d 854 (8th Cir. 1998).

question unanswered by the Court, but it is an issue conversely decided on by many courts.²⁹⁷

The Supreme Court previously noted that the RFRA “requires the Government to demonstrate that the compelling interest test is satisfied through application of the challenged law ‘to the person’—the particular claimant whose sincere exercise of religion is being substantially burdened.”²⁹⁸ In analyzing the issues on diocesan bankruptcies, the Seventh Circuit held that the Bankruptcy Code does in fact further a compelling governmental interest.²⁹⁹ The circuit court found that the Bankruptcy Code, analogous to the social security system, has a “broad scope and remedial nature . . . akin to some of those interests the Court has held are compelling.”³⁰⁰ The Eighth Circuit contrarily held that “the interests advanced by the bankruptcy system are not compelling under the RFRA.”³⁰¹ It appears that the central disagreement between the two circuit courts is on the issue of whether the interests furthered by the Bankruptcy Code are furthering a public interest or merely a private one.³⁰² Therefore, the resolution of this split depends on whether the interests furthered by the Bankruptcy Code in a diocesan bankruptcy are a public or private interest.

Historically, the two primary purposes of the Bankruptcy Code are to provide a fresh start to the debtor via statutory discharge³⁰³ and to protect the interests of the creditors.³⁰⁴ Under Chapter 11 reorganization, the interests furthered by the Code to the debtor switch from chiefly focusing on the discharge of debts to preventing the business or organization from going into liquidation.³⁰⁵ The interests of the debtor are just that—only in place to further the *private* interests of that individual or entity. The

297. See, e.g., *Christians*, 82 F.3d 1407; *Listecki II*, 496 B.R. 905 (E.D. Wis. 2013), *aff'd in part, rev'd in part*, 780 F.3d 731; see also *Listecki III*, 780 F.3d at 744; *Tort Claimants Comm. v. Roman Catholic Archbishop of Portland in Or. (In re Roman Catholic Archbishop of Portland in Or.)*, 335 B.R. 842 (Bankr. D. Or. 2005); *Fitzgerald v. Magic Valley Evangelical Free Church (In re Hodge)*, 200 B.R. 884 (Bankr. D. Idaho 1996); *In re Tessier*, 190 B.R. 396 (Bankr. D. Mont. 1995).

298. *Gonzales v. O Centro Espirita Beneficente Uniao do Vegetal*, 546 U.S. 418, 430-31 (2006) (quoting 42 U.S.C. § 2000bb-1(b)).

299. *Listecki III*, 780 F.3d at 745-46.

300. *Id.* at 746.

301. *Christians*, 82 F.3d at 1420.

302. See *Petition for Writ of Certiorari*, *supra* note 208, at 27.

303. *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 367 (2007); 1 COLLIER ON BANKRUPTCY, *supra* note 8, ¶ 1.01(1); see also 11 U.S.C. § 727(a) (2012).

304. See 1 COLLIER ON BANKRUPTCY, *supra* note 8, ¶ 1.01(1) (citing *Katchen v. Landy*, 382 U.S. 323, 328 (1966)).

305. See *id.* (citing *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984)).

interests of the creditors, however, do not present as clear an understanding of whether these interests are of a public or private nature. Therefore, whether or not the Bankruptcy Code furthers any public interest depends on whether the interests of the creditors as acknowledged under the Bankruptcy Code are public interests. In the both circuit courts discussed, the holdings specifically referenced the interests of the creditors as the point of contention on the matter.³⁰⁶ The Seventh Circuit held in *Listecki* that the Bankruptcy Code in general, its particular provision, and primarily the interest in protecting creditors constitute compelling governmental interests.³⁰⁷ The Eighth Circuit, on the other hand, found that “protecting the interests of creditors is not comparable” to others deemed to reach the level of compelling.³⁰⁸

Although the Bankruptcy Code imposes public order by protecting creditors and ensuring fair treatment, the specific protection of these creditors remains a private interest. The Supreme Court held that the interests furthered by the social security system are of a compelling interests “[b]ecause the social security system is nationwide.”³⁰⁹ Furthermore, the Court noted that the “system is by far the largest domestic governmental program in the United States today.”³¹⁰ Like the decision in *United States v. Lee*, interests considered *compelling* have generally been on a massive scale.³¹¹ The limited scope of the interests of the creditors pales in comparison to the social security system. Specifically within the diocesan bankruptcies, the creditors in question amount to several hundred in the most extreme cases.³¹² Because of the limited scope of the actual interests furthered in favor of the creditors, the Seventh Circuit’s analogy to the social security system appears inherently flawed. Social Security reaches millions of Americans on a monthly basis.³¹³ Therefore, the Eighth Circuit’s holding regarding the interests furthered by the Bankruptcy Code follows the Supreme Court’s definition of a compelling governmental interest much more closely. Because of this, the resolution of this circuit split will likely lead to the rejection of the Seventh Circuit’s holding and a

306. *Listecki III*, 780 F.3d 731, 745-46 (7th Cir. 2015); *Christians*, 82 F.3d at 1420.

307. *Listecki III*, 780 F.3d at 745-46.

308. *Christians*, 82 F.3d at 1420.

309. *United States v. Lee*, 455 U.S. 252, 258 (1982).

310. *Id.* (noting that the social security system “distribut[es] approximately \$11 billion monthly to 36 million Americans”).

311. *See* Petition for Writ of Certiorari, *supra* note 208, at 27.

312. *See* Harris, *supra* note 5.

313. *Lee*, 455 U.S. at 258.

holding that protecting the interests of the creditors is not a compelling governmental interest.

It is important to note that the argument is not the dioceses attempting exemption from the Bankruptcy Code in its entirety, but rather to avoid the specific application of section 541 and requiring that individual parish property be included in the estate. As pointed out by other authors, the dioceses are purposely seeking the protection of the Bankruptcy Code.³¹⁴ The issue is that “certain Code provisions as applied to particular property or transactions” are substantially burdening their religious freedom.³¹⁵ Rejecting the Bankruptcy Code as a compelling governmental interest will not undermine the application of the Code in a general sense, but will only limit its application in a very particular case. In arguing that the Bankruptcy Code falls short of being a compelling interest, it is important to note that bankruptcy law is a significant body of law. Its significance, however, fails to reach the level that allows a federal law to substantially burden the free exercise of religion.

V. Conclusion

The corporate structure of the Catholic Church itself raises an issue on the nature of the ownership of diocesan assets, but absent individual incorporation of each parish, the structure affords little protection over parish property. The “trust-like” relationship between the diocese and parishes further raises problems regarding the property of the dioceses and whether the diocese simply acts as a trustee of several trusts for which the parishes are beneficiaries. Although the question is left open as to what types of trusts can protect parish and individual entities’ assets from the bankruptcy estate, it is now clear that only trusts which leave parish property clearly traceable back to each respective parish are afforded the protection under section 541(d). Once the funds or property become commingled with those of the other parishes or the diocese at large, the protection is lost. Furthermore, the individual parishes and the constitutional protection provided to religious institutions creates a difficult environment for forming a diocesan bankruptcy estate. Although the Bankruptcy Code is a vastly influential federal code, its provisions likely fall short of the strict scrutiny standard of a compelling governmental interest. The RFRA, which was created to apply to neutral, generally applicable laws such as the Bankruptcy Code, does not appear to apply to

314. See also Ellis & Hyams, *supra* note 232, at 66.

315. See *id.*

private disputes. The creditors in the Catholic diocesan litigation are seeking private recovery, and therefore do not constitute state actors. In its current state, the RFRA will only apply to laws being enforced upon religious entities by state actors or parties acting under color of law. Because the creditors in these cases have not satisfied this requirement, the dioceses cannot exclude parish assets through the RFRA.

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