Catholic Dioceses in Bankruptcy

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ABSTRACT

The Catholic Church is coping with mass tort liability for sexual abuse of children by priests. Since 2004, eighteen Catholic organizations have filed for relief in bankruptcy. Fifteen debtors emerged from bankruptcy after settling with sexual abuse claimants and insurers. During settlement negotiations, sexual abuse claimants and debtors clashed over the extent of the debtors' property and ability to pay claims. Although such disputes are common in chapter 11 plan negotiations, the Catholic cases required the parties and bankruptcy courts to account for unique religious attributes of Catholic debtors. This article reviews the arguments and outcomes on property issues based on reported decisions, pleadings, plans, and disclosure statements. It explains the key characteristics of Catholic dioceses under canon and secular organization law and the bankruptcy contexts in which these characteristics became hot button issues. It offers an analysis of the legacy of the Catholic cases for bankruptcy law, religious liberty, and for the relationships among entities within a Catholic diocese.

TABLE OF CONTENTS

I. Introduction. - 2 -
II. Catholic Dioceses as Debtors - 5 -
  A. Canon Law - 5 -
  B. Organizational Law. - 9 -
III. Parish Property as Property of the Estate. - 11 -
  A. Property of the Estate Basics. - 11 -
  B. Corporations Sole. - 14 -
  C. Religious Corporations with Separately Incorporated Parishes. - 18 -
    1. Transfer Avoidance. - 18 -
    2. Derivative Standing. - 19 -
    3. Substantive Consolidation. - 23 -
IV. Religious Liberty. - 24 -
  A. The First Amendment and the Religious Freedom Restoration Act. - 24 -
  B. The Bankruptcy Code as Neutral, Generally Applicable Law. - 25 -
  C. Substantial Burden on Free Exercise of Religion. - 25 -
  D. The Cemetery Trust Litigation. - 27 -

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1. Avoidance Actions as Action by the "Government" under RFRA. .... - 27 -
2. Compelling Governmental Interest. .... - 29 -
V. Competing Plans and Cram Down. .... - 33 -
VI. The Legacy of the Catholic Bankruptcy Cases. .... - 36 -
A. Organization under Canon Law. .... - 36 -
B. Contribution by Parishes and Parishioners. .... - 37 -
C. Religious Liberty for Debtors. .... - 40 -
VII. Conclusion. .... - 44 -

I. Introduction.

In January 2002, the Boston Globe reported that a former priest of the Roman Catholic Archdiocese of Boston, John J. Geoghan, had been accused by more than 130 people of sexually abusing children since the mid-1990s.[1] Boston Archbishop Cardinal Bernard Law and five other bishops knew of credible accusations against Geoghan but did nothing to warn the faithful or bar Geoghan from unsupervised access to children.[2] Six months after the story broke, the U.S. Conference of Catholic Bishops (USCCB) acknowledged responsibility for failure to protect children from clergy sexual abuse.[3] As it turned out, the problem was not limited to the Archdiocese of Boston.

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[1] *See* Michael Rezendes, *Church allowed abuse by priests for years*, BOSTON GLOBE, Jan. 6, 2002, http://www.bostonglobe.com/news/special-reports/2002/01/06/church-allowed-abuse-priest-for-years/cSHfGkTIrAT25qKGvBuDNM/story.html. *See Timeline of Spotlight report stories*, BOSTON GLOBE (Nov. 10, 2015), http://www.bostonglobe.com/2015/11/10/timeline-spotlight-report-stories/SGm67HGOQ7PolOSGZHxs8K/story.html. The Boston Globe investigative series won the 2003 Pulitzer Prize for Public Service. *See The 2003 Pulitzer Prize Winner in Public Service*, THE PULITZER PRIZES, http://www.pulitzer.org/winners/boston-globe-1 (last visited Aug. 6, 2018). The series became the basis of the 2015 film "Spotlight." *See generally*, SPOTLIGHT, http://spotlightthefilm.com/about.

[2] *See* DAVID FRANCE, OUR FATHERS: THE SECRET LIFE OF THE CATHOLIC CHURCH IN AN AGE OF SCANDAL 129–48 (2004). In 2002, Geoghan was convicted and sentenced to life in prison for indecent assault and battery against a 10-year-old boy that occurred in 1991. He was killed by a fellow inmate in prison 2004. *See Sex abuse priest killed in prison*, CNN, Feb. 23, 2004, http://www.cnn.com/2003/US/08/24/geoghan/index.html.

[3] *See, e.g.*, USCCB, CHARTER FOR THE PROTECTION OF CHILDREN AND YOUNG PEOPLE 1 (2002), http://www.bishop-accountability.org/resources/resource-files/churchdocs/DallasCharter.pdf ("[T]he ways in which we bishops addressed these crimes and sins, have caused enormous pain, anger, and confusion."); The Associated Press, *SCANDALS IN THE CHURCH; Statement by President of the U.S. Catholic Bishops on Sexual Abuse*, N.Y. TIMES, June 14, 2002, http://www.nytimes.com/2002/06/14/us/scandals-church-statement-president-us-catholic-bishops-sexual-abuse.html ("We did not go far enough to ensure that every child and minor was safe from sexual abuse. . . . Both what we have done or [sic] what we have failed to do contributed to the sexual abuse of children and young people by clergy and church personnel."). *See* Raymond C. O'Brien, *Clergy, Sex and the American Way*, 31 PEPP. L. REV. 363, 365-66 (Jan. 2004) ("It appeared as if the Church had isolated itself from the state's concern for children, an isolation which appeared arrogant and even sinister.").

In July 2004, after efforts to settle multiple sexual abuse claims collapsed, the Archdiocese of Portland, Oregon became the first Catholic organization to seek bankruptcy protection.[4] Elizabeth Warren (then a law professor) expressed surprise that a Catholic archbishop would be willing to undergo the loss of privacy and control required of debtors in bankruptcy.[5] In retrospect, however, the resort to bankruptcy by the Archdiocese of Portland and the seventeen Catholic diocese and religious institutes that have followed it into bankruptcy is not surprising. Clergy sexual abuse of children had become a mass tort problem for Catholic organizations. Chapter 11 was the obvious legal response.[6]

The Catholic bankruptcy cases put a legal spotlight on the secular and ecclesiastical relationships between a diocesan debtor and the parishes, schools, cemeteries, and other entities that operate within the diocese and under the bishop's authority. Although fights about the nature and value of a debtor's property are common in chapter 11 cases, Catholic dioceses are not ordinary debtors. Skirmishes between sexual abuse creditors and the debtors were unusually aggressive and public. Advocates for sexual abuse claimants stoked the media with plans to "go after… parish assets."[7] One attorney described the push to include parish assets as a "slugfest"

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[4] The Archdiocese of Portland filed for bankruptcy on the eve of jury selection in a civil sexual abuse trial based on its alleged negligent supervision of a priest accused of abusing more than 50 boys between 1950 and 1980. Four years earlier, the Archbishop of Portland, John Vlazny, had publicly apologized for sexual abuse of children by archdiocesan priests. *See* Jane Doe 130 v. Archdiocese of Portland in Oregon, 717 F.Supp.2d 1120, 1129-30 (D. Or. 2010). In the year before bankruptcy, the archdiocese paid more than $21 million to settle sexual abuse claims. *See Letter from John G. Vlazny to the faithful*, ARCHDIOCESE OF PORTLAND IN OREGON (July 6, 2004), http://www.bishop-accountability.org/ia-davenport/bankruptcy/2004-07-06-Vlazny-Letter.htm. *See also* Laurie Goodstein, *Oregon Archdiocese Files for Bankruptcy Protection*, N.Y. TIMES, July 7, 2004, http://www.nytimes.com/2004/07/07/us/oregon-archdiocese-files-for-bankruptcy-protection.html.

[5] *See* Michael Paulson, *Archdiocese Files for Bankruptcy*, BOSTON GLOBE, July 7, 2004, http://articles.sun-sentinel.com/2004-07-07/news/0407070083_1_diocese-bankruptcy-court. *See also* David A. Skeel, Jr., *Avoiding Moral Bankruptcy*, 44 B.C. L. REV. 1181, 1181 (2003) (noting that rumors that the Archdiocese of Boston might file for bankruptcy took him by surprise); Pam Belluck & Adam Liptak, *For Boston Archdiocese, Bankruptcy Would Have Drawbacks*, N.Y. TIMES, Dec. 3, 2002, http://www.nytimes.com/2002/12/03/us/for-boston-archdiocese-bankruptcy-would-have-drawbacks.html (quoting bankruptcy scholar Jay Westbrook noting that for the Archdiocese of Boston to file for bankruptcy would be "stunning"). A bankruptcy filing requires the debtor to open its books to creditors, the courts, and the public, and to be subject to court supervision and public scrutiny of its financial affairs and business operations. *See, e.g.*, 11 U.S.C. §§ 341, 343 (allowing creditors to question the debtor under oath and challenge the accuracy and completeness of the debtor's disclosure); 11 U.S.C. § 1112(b)(1), (4) (stating that failure to comply is grounds for dismissal of the case).

[6] By 2004, reorganization in bankruptcy was a common corporate response to mass tort liability. *See* Susan Chandler, *Oregon archdiocese takes a page from corporate playbook*, CHI. TRIB., Aug. 1, 2004, http://articles.chicagotribune.com/2004-08-01/business/0408010031_1_portland-archdiocese-portland-archbishop-john-vlazny-bankruptcy-judge-elizabeth-perris (analogizing sex abuse claims to asbestos claims). *See generally* Georgene Vairo, *Mass Tort Bankruptcies: The Who, The Why and The How*, 78 AM. BANKR. L.J. 93, 95 (2004) (noting that use of bankruptcy by companies with asbestos liability had become "routine" and predicting use of bankruptcy as response to non-asbestos mass tort issues); Francis E. McGovern, *The Tragedy of the Asbestos Commons*, 88 VA. L. REV. 1721, 1754 (2002) (noting that bankruptcy is the only way an asbestos defendant could achieve complete and final disposition of claims).

[7] *E.g.*, Annysa Johnson, *Parishes' assets targeted in archdiocese bankruptcy case*, J. SENTINEL, (Oct. 18, 2012), http://archive.jsonline.com/news/religion/parishes-assets-targeted-in-archdiocese-bankruptcy-case-tf79a59-174875991.html (reporting that lawyers for sexual abuse claimants "telegraphed that they intend to go after individual parish assets and proceeds from the archdiocese's $105 million Faith in Our Future campaign"); Laurie

that must occur "before people get serious" about settlement.[8] The Catholic debtors pushed back. They argued for protection from bankruptcy court adjudication of property of the estate on religious freedom grounds. They also argued that the property rights subject to their bankruptcy cases did not include property which they attributed to parishes and other diocesan affiliates under secular and religious law.

As of September 2018, of the eighteen organizations that filed for bankruptcy protection fourteen (seven dioceses, five archdioceses, and two religious institutes) have emerged from bankruptcy after confirming consensual plans.[9] The Archdiocese of San Diego settled with its creditors and dismissed its chapter 11 case about six months after filing. In June 2018, after a failed attempt at confirmation by cram down of competing plans, the Archdiocese of St. Paul and Minneapolis and its creditors reached a settlement, and confirmation of a consensual plan is pending [hearing scheduled for September 25].[10] Three other cases are pending, all in Minnesota.[11]

This article considers the arguments and outcomes on property issues in the Catholic bankruptcy cases. Part II explains the unique legal characteristics of Catholic dioceses as debtors in bankruptcy under canon law and secular organizational law. Part III explains the conflicts between advocates for sexual abuse creditors and the debtors over the nature and extent of the debtors' property. Part IV considers the contexts and outcomes of litigation about the debtors' right to religious liberty under the First Amendment and the Religious Freedom Restoration Act (RFRA). Part V looks briefly at the issues that arose in the battle of competing plans in the St. Paul and Minneapolis case. Part VI reflects on the legacy of the Catholic bankruptcy cases on

Goodstein, *Oregon Archdiocese Files for Bankruptcy Protection*, N.Y. TIMES, July 7, 2004, https://www.nytimes.com/2004/07/07/us/oregon-archdiocese-files-for-bankruptcy-protection.html (reporting that a lawyer for a sexual abuse claimant said the Archdiocese of Portland "controlled a half-billion dollars in assets", including parishes, schools, charities and trusts, and had "no grounds to plead poverty"); *Attorneys want Diocese to claim ownership*, SIOUX CITY J., Oct. 25, 2006, http://siouxcityjournal.com/news/state-and-regional/attorneys-want-diocese-to-claim-ownership/article_9b3d7893-3846-5949-8a5b-859e80ece7dd.html (reporting that a lawyer for sexual abuse claimants said that separately incorporated parishes should contribute their property to pay claims and "[w]e believe the bishop controls the parishes").

[8] *E.g.*, Donald L. Swanson, *Don't Let This Happen to You: Milwaukee Archdiocese Bankruptcy Part Three, The In-Court 'Slugfest,'*" MEDIATBANKRY (May 5, 2016), https://mediatbankry.com/2016/05/05/dont-let-this-happen-to-you-milwaukee-archdiocese-bankruptcy-part-three-the-in-court-slugfest/. *See also*, *In re* Archdiocese of Milwaukee, 496 B.R. 905, 912 (Bankr. E.D. Wis. 2013)(noting that decision regarding the fate of the Cemetery Trust litigation "will shape the course of future proceedings in bankruptcy").

[9] *See,* Marie T. Reilly & Rebecca A. Mattson, BANKRUPTCIES IN THE CATHOLIC CHURCH, Penn State Law E-Library, https://elibrary.law.psu.edu/bankruptcy/ (archive of plans, disclosure statements and other selected documents collected from public dockets in the Catholic bankruptcy cases)(hereinafter, BANKRUPTCY ARCHIVE).

[10] *Id.*

[11] *See* Marie T. Reilly, *Appendix A: Case Information*, PENN STATE LAW ELIBRARY (2018), https://elibrary.law.psu.edu/bankruptcy/37/ [hereinafter *Appendix A*] (the Diocese of Duluth, the Diocese of New Ulm and the Crosier Fathers and Brothers). In May 2013, Minnesota enacted the Minnesota Child Victims' Act, which opened a three-year time-barred claims revival window for sexual abuse claimants to assert otherwise time-barred claims for childhood sexual abuse. Minn. Stat. § 541.073 (LexisNexis 2018).

bankruptcy law, religious liberty and the relationships among entities within the hierarchy of the Church.

II. Catholic Dioceses as Debtors.

A. Canon Law.

Bankruptcy cases of non-profit religious organizations are not unusual.[12] However, the Catholic debtors are unique among non-profit organizations in bankruptcy because of their affiliation with the Catholic Church. The Catholic Church is a worldwide community established over two thousand years ago by Jesus Christ with about 1.25 billion members who hold a common religious creed.[13] The 1983 Code of Canon Law ("canon law") governs the conduct of all Catholics.[14] It establishes the internal organizational structure and procedures of the Catholic Church and the property rights and agency relationships of entities within the Church.[15]

Canon law describes the Catholic Church as a complete community.[16] Yet, the Church operates within a distinct secular community which is subject to secular law. Canon law acknowledges secular law and requires that Catholics must comply with it, except for secular laws that are contrary to divine law[17] or when canon law expressly supersedes it.[18] For example, canon law expressly supersedes civil law on the right of the Church to preach the Gospel and to "announce moral principles, even about the social order. . . ."[19] Conversely, canon law adopts secular law on certain matters, including "general and specific regulations on contracts and

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[12] *See* Pamela Foohey, *When Faith Falls Short: Bankruptcy Decisions of Churches*, 76 OHIO ST. L.J. 1319 (2015); Pamela Foohey, *When Churches Reorganize*, 88 AM. BANKR. L. J. 277 (2014).

[13] *See* Michael Lipka, *A Closer Look at Catholic America*, PEW RESEARCH CENTER (Sept. 14, 2015), http://www.pewresearch.org/fact-tank/2015/09/14/a-closer-look-at-catholic-america/. About 20% of adults residing in the United States report that their primary religious affiliation is Roman Catholic. *Id.*

[14] 1983 CODE C.11 (ecclesiastical law binding on all baptized Catholics over 7 years of age). Catholics are also bound by divine law, revealed in scripture or tradition. *Id.* at C.750. Catholics who follow the Eastern Rite follow the 1990 Code of Canons of the Eastern Churches. *See* CODE OF CANONS OF THE EASTERN CHURCHES, https://orthocath.files.wordpress.com/2010/01/1990_code_of_canons_of_the_eastern_churches.pdf.

[15] 1983 CODE C.96-144; *id.* at c.330-572*; id.* at c.1259-1310.

[16] Jacques Maritain, *The Catholic Church and Social Progress*, Foreign AFF., July 1939, https://www.foreignaffairs.com/articles/1939-07-01/catholic-church-and-social-progress.

[17] Divine law, also known as natural law is law enacted by God and made known to man through revelation. *See generally*, Jean Porter, Nicholas Wolterstoff, NATURAL AND DIVINE LAW: RECLAIMING THE TRADITION FOR CHRISTIAN ETHICS (1999); New Advent, *Moral Aspect of Divine Law*, CATHOLIC ENCYCLOPEDIA, www.newadvent.org/cathen/09071a.htm.

[18] 1983 CODE, C.22.

[19] *E.g., id.* at C.747 ("It is the obligation and inherent right of the Church, independent of any human authority, to preach the Gospel to all peoples….").

payments, subject to divine law or conflicting canon law.[20] As to most of the matters that secular law regulates, however, canon law is silent.[21] In particular, canon law has nothing to say about the rights of creditors of Catholic organizations against the organizations or their property.

The Catholic Church is not a universal, monolithic corporate organization. Nor is it a Pope-led kingdom with absolute, downward hierarchy, as many suppose. The Church operates through a central leader, the Pope, and through its "particular churches," regional entities including archdioceses, dioceses, parishes, and religious institutes.[22] Dioceses are geographic areas.[23] An archdiocese is a large diocese[24] in terms of the numbers of Catholics residing within it, and usually covers a large metropolitan area.[25] Residing and operating within the geographic boundaries of a diocese are communities of Catholic faithful known as parishes.[26] Religious institutes are groups of individuals (e.g., priests, nuns, brothers) who undertake certain vows and agree to live in community with other members under a common order or tradition.[27] A religious institute operates

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[20] *See, id.* at C.1290. The Catechism of the Catholic Church provides that Catholics are morally bound to observe legitimate secular laws but must disobey laws that are "contrary to the demands of the moral order, to the fundamental rights of persons or the teachings of the Gospel." UNITED STATES CONFERENCE OF BISHOPS, CATECHISM OF THE CATHOLIC CHURCH 541 c.2242 (2d ed. 2016); *see also* THE CANON LAW SOCIETY OF AMERICA, NEW COMMENTARY ON THE CODE OF CANON LAW 84 c.22 (John P. Beal et al. eds. 2000) [hereinafter NEW COMMENTARY ON CANON LAW].

[21] *Id.* at 85.

[22] 1983 CODE C.368-430. The most common form of a particular church is a diocese. NEW COMMENTARY ON CANNON LAW, *supra* note 20, at 506.

[23] 1983 CODE C.369 (a diocese is "a portion of the people of God which is entrusted for pastoral care to a bishop…."). *See* United States Conference of Catholic Bishops, *Diocese and Bishop Addresses*, www.usccb.org/about/bishops-and-dioceses/all-dioceses.cfm (listing of archdioceses and dioceses in the U.S.).

[24] Hereafter, unless the context indicates, diocese refers to archdiocese or diocese.

[25] An archdiocese may also be referred to as a "metropolitan see." A "see" is an ecclesiastical province that includes the archdiocese and "suffrage" dioceses within the ecclesiastical province that are also under the authority of the archbishop. An archbishop has authority over his own diocese and as the head of the metropolitan see has certain responsibilities to the suffrage dioceses within the see. 1983 Code c.473 §1. For example, the Roman Catholic Archdiocese of New York is the metropolitan see of the ecclesiastical province of New York which includes the suffrage dioceses of Albany, Brooklyn, Buffalo, Ogdensburg, Rochester, Rockville Centre and Syracuse. *See 2016 Financial Services Report*, ARCHDIOCESE OF NEW YORK (2016), http://www.archny.org/documents/2017/7/2016%20Financial%20Report-1.pdf. Each diocese is a "particular church" within the "universal church." 1983 CODE C.368; John J. Coughlin, CANON LAW: A COMPARATIVE STUDY WITH ANGLO-AMERICAN LEGAL THEORY 118 (0xford 2010). Along with dioceses, juridic entities such as territorial prelatures, abbacies, apostolic vicarates and prefactures are also "particular churches." *Id*. *See* Henri De Lubac, *Particular Churches in the Universal Church*, in THE MOTHERHOOD OF THE CHURCH 191-211 (Sergia Englund trans., Ignatiusa Press 1982).

[26] 1983 CODE C.515 (A parish is "a definite community of the Christian faithful established on a stable basis within a particular church."); *id.* at C.374 (every diocese is divided in to parishes).

[27] 1983 CODE C.607, § 2. *See generally* Cecilia Meighan, *Religious Institutes-Property and Tax Issues*, 33 THE CATHOLIC LAWYER 25 (2017). Some religious institutes are authorized by the pope (known as "pontifical right"

independently of a diocese, however, individual members are subject to the authority of the bishop of the diocese in which they reside on religious matters.[28]

Canon law recognizes corporate agency for entities distinct from the persons who comprise them.[29] Indeed, corporate agency as a legal construct may have originated in early Roman Catholic canon law.[30] Canon law calls entities with such agency juridic persons.[31] Dioceses, and diocesan-affiliated entities such as parishes, schools, cemeteries, special purpose trusts (hereafter referred to collectively as "parishes") are all public juridic persons with unique and distinct agency under canon law.[32]

With respect to property rights, canon law recognizes a distinction between ecclesiastical property (the Church's property) and non-ecclesiastical property. All property legitimately acquired by a public juridic person is ecclesiastical property, whereas property acquired by individual persons is not.[33] For example, a monetary contribution by an individual to his or her parish becomes ecclesiastical property once the parish, as juridic person, acquires it.[34]

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institutes) and thus are under the authority of the pope, and not the bishop of the geographic diocese in which the institute is located. *Id.* at 25-26.

[28] 1983 Code C.678, § 1. *See also id.* C.680 (providing for cooperation among institutes and between institute and diocesan clergy under the direction of the bishop).

[29] *See* NEW COMMENTARY ON CANON LAW, *supra* note 20, at 154-55.

[30] *See* John Dewey, *The Historic Background of Corporate Legal Personality*, 35 YALE L.J. 655, 665 (1926) (attributing the legal concept of *persona ficta* to Pope Innocent IV who used it to afford monasteries continuous and separate existence from the monks).

[31] 1983 CODE C.113, § 2 ("…[B]esides physical persons, there are also… juridic persons, that is, subjects in canon law of obligations and rights which correspond to their nature."). Juridic persons have the "innate right to acquire, retain, administer and alienate temporal goods . . . independently of civil power." *Id.* at c.1254, § 1. In contrast to a juridic person, a "moral person" is a group of individuals, or assets, with a common purpose but without a canonical legal personae distinct from the persons who comprise it. *See* NEW COMMENTARY ON CANON LAW, *supra* note 20, at 154-55. *See also* 1983 CODE C.310 (A private association not established as a juridic person has no agency of its own, but individual members of the association can "jointly contract obligations and can acquire and possess rights and goods as co-owners and co-possessors . . . ."). Goods held jointly by a private association are not "ecclesiastical goods" and are not subject to canonical norms regulating such goods. *See* NEW COMMENTARY ON CANON LAW, *supra* note 20, at 408; 1983 CODE C.1257; *id.* at C.515, § 3 (parishes); *id.* at C.373 (diocese); *id.* at C.634, § 1 (religious orders).

[32] *See id.* at C.116, § 1. A juridic person founded to serve the public good is a "public juridic person." *Id.* at c.116, § 1.

[33] *See* 1983 CODE C.1257, § 1 ("All temporal goods which belong to the Universal Church, the Apostolic See, or other public juridic persons in the Church are ecclesiastical goods and are governed by the following canons and their own statutes."). *See also id.* at c.1254-1310 (regulating the purchase, ownership, administration, and sale of Church property by juridic persons to whom it belongs).

[34] *See* 1983 CODE, C.1267, § 1 (offerings given to an administrator of a public juridic person are presumed to be offerings to the public juridic person the individual administers), § 3 (offerings given by the faithful can only be used for the purpose for which they were given).

"[O]wnership of goods belongs to that juridic person which has acquired them legitimately."[35] Property that belongs to one juridic person cannot simultaneously belong to another juridic person.[36]

A juridic person's "ownership" of property is limited by canon law which establishes a hierarchy of authority among juridic persons. The authority of juridic persons within the Church is generally, but not perfectly hierarchical. The Pope is the bishop of Rome, successor in that position to Saints Peter and Paul.[37] The Pope appoints bishops for each diocese.[38] The bishop has authority over each parish within the geographic boundaries of the diocese.[39] In turn, the bishop appoints a pastor, typically a priest, to manage a parish.[40]

As noted above, canon law recognizes ownership of property in the juridic person who acquired it.[41] At the same time, that property is typically "administered" by a juridic person senior in the hierarchy, for the benefit of the juridic person.[42] The Pope has plenary authority over all ecclesiastical goods.[43] The bishop is the administrator for property belonging to the diocese, the juridic person that the bishop administers.[44] The bishop does not administer parish property. Rather, a pastor (appointed by the bishop) "exercises direct power of governance" over the parish,[45] and administers the property belonging to the parish.[46] The bishop's role with respect to parish property is indirect through his authority over the pastor who administers it. The bishop

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[35] 1983 CODE C.1256.

[36] *See,* Adam J. Maida & Nicholas P. Cafardi, CHURCH PROPERTY, CHURCH FINANCES, AND CHURCH RELATED CORPORATIONS 26 (1983) ("[A]ll property is the property of one public juridic person or another.")

[37] *Roman Catholicism, Structure of the Church: Apostolic Succession*," ENCYCLOPÆDIA BRITANNICA https://www.britannica.com/topic/Roman-Catholicism/Structure-of-the-church (last visited Aug. 11, 2018).

[38] 1983 CODE C.377, § 1; Pope Paul VI, *Decree Concerning Pastoral Office of Bishops in the Church, Christus Dominus* 20 (Oct. 28, 1965), http://www.vatican.va/archive/hist_councils/ii_vatican_council/documents/vat-ii_decree_19651028_christus-dominus_en.html.

[39] 1983 CODE C.374, § 1.

[40] *Id*. at C.515, § 1 ("[P]astoral care is entrusted to a pastor . . . under the authority of the diocesan bishop."). *See also* NEW COMMENTARY ON CANON LAW, *supra* note 20, at 676 ("[T]he diocesan bishop . . . has authority over the pastor of each parish [within the diocese].").

[41] 1983 CODE C.1256.

[42] *Id.* at c.1279, § 1. *See also* NEW COMMENTARY ON CANON LAW, *supra* note 20, at 1474.

[43] The Pope is the "supreme administrator and steward of all ecclesiastical goods." 1983 CODE C.1273. *See also* 1983 CODE C.1276.

[44] NEW COMMENTARY ON CANON LAW, *supra* note 20, at 1477.

[45] 1983 CODE C.532.

[46] *Id*. at C.531, C.1276, C.532. *See also id*. at C.515, § 1; NEW COMMENTARY ON CANON LAW, *supra* note 20, at 1477.

is "to exercise careful vigilance over the administration of all goods which belong to public juridic persons subject to him…."[47]

The Catholic bankruptcy cases opened wide the obvious tension between the independence of parishes from the bishop and the bishop's indirect authority over parish property. One commentator described the question of whether parishes "own" property as an example of how extreme interpretations of canon law are either as "antinomian" or "legalistic" and concluded that to attempt the translation of canon law hierarchical ownership rights into secular terms "disrupt[s] the unity of law and theology" expressed in canon law.[48] Another commentator put the issue in much plainer terms. He asserted that under canon law, "parishes are not plums for the diocesan bishop to pick when he has debts to pay."[49]

B. Organizational Law.

All Catholic dioceses are not organized alike. The differences among them became key issues in their bankruptcy cases. State law varies on the corporate forms available to religious organizations.[50] Depending on state law, Catholic organizations may choose among corporate forms, including charitable trusts, unincorporated associations, corporation sole, religious non-profit corporations, or general non-profit corporations.[51]

In the late nineteenth and early twentieth centuries, legislatures extended special corporate sole charters for religious organizations including Catholic dioceses, which otherwise could not incorporate.[52] The corporation sole form places all the management control of the organization in a single person as agent for the corporation sole, *e.g.*, the bishop of a Catholic diocese and his

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[47] 1983 CODE C.1276, § 1. The bishop designates certain transactions involving parish property by type or size as extraordinary, for which the pastor must obtain the bishop's permission. 1983 CODE C.1281. Unlike parishes, religious institutes administer property outside the supervisory authority of the bishop of the diocese in which they are geographically located. *Id.* at C.586 (acknowledging "a just autonomy of life, especially of governance… for individual institutes"). However, members of a religious institute are subject to the bishop's authority "in those matters which regard the care of souls, the public exercise of divine worship, and other works of the apostolate." *Id.* at C.678, §1.

[48] *See* COUGHLIN, *supra* note 25, at 176-179.

[49] *See e.g.*, Nicholas P. Cafardi, *The Availability of Parish Assets for Diocesan Debts: A Canonical Analysis*, 29 SETON HALL LEGIS. J. 361, 368 (2005).

[50] Patty Gerstenblith, *Associational Structures of Religious Organizations*, 1995 B.Y.U. L. REV. 439 (1995).

[51] *Id*. at 441-42 (1995 survey research revealed that 87 percent of religious organizations chose the religious not-for-profit corporate form). For all non-profit corporations, to qualify for tax-exempt status, the corporation's organizing documents must ensure that the members, officers, and directors do not receive profit from the organization's operations. *Id*. at 442. This "nondistribution constraint" is also required for federal tax-exempt status under 26 U.S.C. § 501(c)(3). *See* Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L. J. 835,838 (1980).

[52] *E.g.*, Washington's corporation sole statute was enacted in 1915 to provide a means for religious organizations to hold title to property distinctly from their members and enjoy perpetual existence. *In re* Catholic Bishop of Spokane, 329 B.R. 304, 327 (Bankr. E.D. Wash. 2005).

successors.[53] Like the ordinary non-profit corporate form, it permits the survival of the corporation in perpetuity and continuous ownership of property.[54]

The corporate sole form is loosely consistent with the bishop's supervisory responsibility over parishes and other juridic persons within the diocese. It is inconsistent with recognition of parishes as juridic persons with the agency to own property distinct from the bishop.[55] After state corporation law evolved to accommodate non-profit religious corporations under general corporation laws, the question arose among canonists regarding the continued utility of the corporate sole form and whether parishes within corporation sole dioceses should separately incorporate and hold title to the property canon law attributed to them. Advocates for the status quo (diocese as corporation sole with centralized title to property) lauded it as an efficient means for the bishop to use parish property as collateral for diocesan or parish projects at capital costs more favorable than could be achieved by individual parishes borrowing against parish property.[56]

In 1983, just as the current Code of Canon Law took effect, two authors of a handbook on Church property and finance opined that a Catholic diocese could be organized variously as a corporation sole, a non-profit religious corporation, or as an entity without corporate form. They offered no guidance for a bishop to choose among these forms, or how the diocese and its parishes should hold title to property within the secular corporate structure he chose.[57] The authors opined blithely that secular law was irrelevant. Courts would apply canon law to supply the terms of those implied trusts "because it is that law which governs the use of these Church assets."[58] No doubt, the authors were unconcerned about the prospect of diocesan bankruptcy cases.

Today, in light of the clergy sexual abuse scandal, the financial advantages of bishop-centered control over title property have disappeared, swamped by the liability risk. In 2000, two years before the Archdiocesan of Boston scandal broke, canon law scholars noted that organization of a diocese as a corporation sole with centralized title to property, and without separate

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[53] Statutes typically provide that the sole manager of the corporation must have been duly elected or chosen and must act in accordance with the rules of the organization of which the manager is a part. MAIDA & CAFARDI, *supra* note 36 at 128. *See also In re* Roman Catholic Archbishop of Portland in Or., 345 B.R. 686, 697 (Bankr. D. Or. 2006) (finding a distinction between the Archdiocese of Portland and the "office of the Archbishop" for purposes of interpretation of an express trust; the former is the corporate entity, the latter is the ecclesiastical office of the Archbishop under Canon law). *See* Gerstenblith, supra note 50, at 454 (as of 1995, twenty-six states permitted incorporation of a religious organization as a corporation sole).

[54] Gerstenblith, supra note 50 at 455. *See, e.g.*, County of San Luis Obispo v. Ashurst, 194 Cal. Rptr. 5, 6-8 (Cal. Ct. App. 1983) ("The creditors of a corporation sole may not look to the assets of the individual holding office, nor may the creditors of the individual look to the assets held by the corporation sole.").

[55] NEW COMMENTARY ON CANON LAW, *supra* note 20, at 164, 1457.

[56] *See* R. Kealy, *Methods of Diocesan Incorporation,* CANON LAW SOCIETY OF AMERICA PROCEEDINGS 163-77 (1986). *See, e.g.*, Baxter v. McDonnell, 49 N.E. 667, 668 (N.Y. 1898) (where Catholic bishop held title to an unincorporated church in his name, the court found that "the purpose of this arrangement is to exclude the laity from that power of interference which they would have were the title vested in a corporation.")

[57] *See* Kealy, *supra* note 56, at 163-77. In any case, the bishop holds title to parish assets "in accordance with canon law… as civil law trustee for the parish . . . [under] an amalgam of these individual parish trusts." *Id.*

[58] *Id.* at 131 (citing 1983 CODE C. 1257).

incorporation of parishes, is "incompatible with the law of the Church" and "long ago disapproved by the Holy See."[59] Perhaps wryly, they noted that bishops and their finance officers and advisers "should make every effort to see that the laws of the Church… are faithfully followed."[60]

As Professors Hansmann and Kraakman have recognized, organizational law defines the pool of assets to which an organization's creditors have recourse and shields from those creditors other property not within that pool.[61] Unlike canon law, which governs rights and relationships *among* juridic persons, a bankruptcy proceeding reveals the effect of organizational law on the organization's creditors. In no other legal setting is scrutiny of organizational form, property rights and agency more energetically undertaken.

III. Parish Property as Property of the Estate.

A. Property of the Estate Basics.

Consider the importance of property of the estate issues in bankruptcy cases generally. In a chapter 7 case, the trustee for the estate marshals, liquidates, and distributes property of the estate to creditors in satisfaction of the debtor's pre-petition debts under the chapter 7 rules that govern payout.[62] In contrast, in a chapter 11 case, the debtor and creditors engage bankruptcy court-supervised negotiation towards a plan of reorganization that typically preserves at least some of the debtor's going concern value, settles creditors' claims, and provides for discharge of pre-petition debts.[63]

Property of the estate issues frame negotiation among the parties in a chapter 11 case.[64] Among other requirements, to confirm a plan of reorganization over the objection of a creditor, a chapter 11 plan of reorganization must provide payout to the objecting creditor with a present value at least equal to the payout that creditor would receive upon liquidation of property of the estate in a hypothetical chapter 7 case.[65] This confirmation requirement is called the "best interest test." It protects a dissenting creditor from the consequences of a chapter 11 plan if the plan payout

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[59] NEW COMMENTARY ON CANON LAW, *supra* note 20, at 164.

[60] *Id.* at 164, 1457.

[61] Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L. J. 387, 390 (2000) ("[T]he essential role of all forms of organizational law is to provide for the creation of a pattern of creditors' rights—a form of 'asset partitioning'—that could not practicably be established otherwise.").

[62] *See* 11 U.S.C. § 501 (claims allowance process); *id.* § 506 (secured claims); *id.* § 507 (priority among unsecured creditors); *id.* § 725 (distribution of property to holders of secured claims; *id.* § 726 (priority of distribution of property of the estate.).

[63] *See* UNITED STATES COURTS, CHAPTER 11-BANKRUPTCY BASICS http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics (last visited Aug. 15, 2018).

[64] To confirm a plan in a chapter 11 case, the plan must meet the requirements of section 1129. 11 U.S.C. § 1129. If the debtor is a non-profit corporation, any transfers of property under the plan must be made "in accordance with any applicable provisions of non-bankruptcy law that govern the transfer of property." 11 U.S.C. § 1129(a)(16).

[65] 11 U.S.C. § 1129(a)(7).

is not in its "best interest' relative to the alternative hypothetical chapter 7 liquidation payout.[66] To satisfy the requirement, the disclosure statement accompanying a plan must provide a hypothetical valuation of property of the estate so creditors can determine whether the plan satisfies the test.[67] Given the best interest test, the more property included within the estate and the greater its value, the more leverage for unsecured creditors in the chapter 11 plan negotiation.[68]

The legal contexts in which property of the estate issues arose in the Catholic bankruptcy cases differed depending on the debtor's organizational structure, the organizational structure of parishes within the diocese and subject to the bishop's canonical authority, and the respective rights of the debtors and parishes under secular law. The filing of a petition in bankruptcy creates an estate that includes, with certain exceptions, "all legal or equitable interests of the debtor in property as of the commencement of the case."[69] Section 541 defines "property of the estate;" state law defines what rights qualify for the status of "a legal or equitable interest of the debtor in property."[70]

Although the definition of property of the estate in section 541 is straightforward, application of section 541 is complicated because property rights are complicated. The general rule under bankruptcy law is that parties who hold rights in property of the estate maintain their rights notwithstanding the debtor's bankruptcy. For example, a creditor with a valid security interest in property of the estate with priority over the estate's interest in that property under state law is generally entitled to priority for its interest over the estate's interest in that property.[71] Similarly, a third party who holds a valid beneficial interest in property subject to a trust under which the debtor holds legal title maintains that beneficial interest in property notwithstanding the

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[66] *Id.* A chapter 11 plan proponent ordinarily must include a hypothetical liquidation analysis in the disclosure statement accompanying the plan so that creditors can determine if the proposed plan is in their best interest. 11 U.S.C. § 1125(b) (to solicit votes on a plan, the plan proponent must provide a disclosure statement containing "adequate information"). *See* Charles Jordan Tabb, THE LAW OF BANKRUPTCY 1123-24 (2d ed. 2009) (observing that most disclosure statements include a hypothetical liquidation analysis). *E.g.*, *In re* Roman Catholic Archbishop of Portland in Or., No. 04-37154-elpll, 2007 Bankr. LEXIS 1180 at *20 (Bankr. D. Or. Apr. 13, 2007) (the plan provided that the objecting creditors would be paid in full, so no hypothetical liquidation analysis was required).

[67] 11 U.S.C. § 1125.

[68] *See* Comm. of Tort Litigants v. Catholic Diocese of Spokane, 329 B.R. 304, 317 (Bankr. E.D. Wash. 2005) (noting that the more property included within the debtor's estate, the bigger the payout to tort claimants under the debtor's plan of reorganization).

[69] 11 U.S.C. § 541(a)(1) ("The commencement of a case . . . creates an estate . . . comprised of all of the following property wherever located and by whomever held: (1) [subject to certain exceptions] all legal or equitable interests of the debtor in property as of the commencement of the case."). The estate also includes property the trustee recovers by exercise of the statutory powers, § 541(a)(3), (4). Section 541(b) excludes certain of the debtor's property interests from the estate and thereby protects such interests from creditors' claims. 11 U.S.C. § 541(b). Hereafter, all references to section numbers refer to Chapter 11 of the United States Code, unless otherwise indicated.

[70] *See* 11 U.S.C. § 541(a); Butner v. United States, 440 U.S. 48, 55 (1979). *See, e.g.*, *In re* Roman Catholic Archbishop of Portland Oregon, 335 B.R. 842, 854 (Bankr. D. Or. 2005) (noting that section 541 defines property of the estate, but state law defines what is property).

[71] 11 U.S.C. § 507.

debtor's bankruptcy. Only the debtor's legal title to property becomes property of the estate; the third party's beneficial interest in the property does not.[72]

The Archdiocese of Portland and the Dioceses of Tucson, Spokane, San Diego, Fairbanks, Gallup, Stockton, Helena and Great Falls-Billings were organized as corporations sole at the time of their filings.[73] Except for parishes within the Diocese of Stockton, parishes were not separately incorporated.[74] The respective bishops, as the lone agent for the corporation sole, was the record title holder to all ecclesiastical property without differentiation as to whether it belonged to the diocese or to the parishes under canon law.

The Archdioceses of Milwaukee and St. Paul and Minneapolis, the Dioceses of Davenport, Wilmington, Stockton, Helena, Duluth, New Ulm and Great Falls-Billings were organized as non-profit or religious corporations at the time of filing.[75] Within these archdioceses and dioceses, parishes and other affiliated entities were separately incorporated and held record title to property.[76] The three religious institute debtors, (Oregon Province, Society of the Jesuits, Christian Brothers of Ireland, New York and Crosier Fathers and Brothers), were all organized as non-profit corporations. One of these debtors, The Oregon Province, Society of the Jesuits, was comprised of individual communities, many of which were not separately incorporated.[77]

For debtors organized as corporations sole with title to property centralized in the bishop, the debtors asserted that they held only legal title to certain property in trust for parishes, schools, cemeteries or other juridic persons whose separate interests the bishop must safeguard and respect under canon law. Sexual abuse claimants argued that state law and the bankruptcy code exclusively governed property rights, with the effect of stripping parishes of rights in property

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72 11 U.S.C. § 541(d) ("Property in which the debtor holds . . . only legal title . . . becomes property of the estate . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold."). *See, e.g.*, *In re* Parkview Hosp., 211 B.R. 619 (Bankr. N. D. Ohio 1997) (fund subject to a charitable trust excluded from debtor's estate).

73 *See Appendix A, supra* note 11 (listing corporate form for each debtor based on information provided by debtors in disclosure statements available in BANKRUPTCY ARCHIVE, *supra* note 9).

74 *Id.* Although the Diocese of Stockton was organized as a corporation sole, each of the parishes were also organized as separate corporations sole. Debtor's Disclosure Statement Regarding Plan of Reorganization, Oct. 26, 2016 at 12, in BANKRUPTCY ARCHIVE, *supra* note 9; *In re* Roman Catholic Bishop of Stockton, No. 14-20371 (Bankr. E.D. Cal. 2014). *E.g.*, *Archbishop of Portland*, 335 B.R. at 849; Comm. of Tort Litigants v. Catholic Diocese of Spokane, 329 B.R. 304, 310 (Bankr. E.D. Wash. 2005).

75 *See Appendix A, supra* note 11 (listing corporate form for each debtor based on information provided by debtors in disclosure statements available in BANKRUPTCY ARCHIVE, *supra* note 9).

76 *Id.* Parishes within the Diocese of Stockton held title to property separately from the diocese. Although the Diocese of Stockton was organized as a corporation sole, parishes within the diocese were organized separately as corporations sole yielding a decentralized property structure analogous to that in dioceses organized as religious corporations with separately incorporated parishes. *See Bishop of Stockton*, *supra* note 74.

77 *See* Amended Disclosure Statement, *In re* Society of Jesus, Oregon Province at 20-24, BANKRUPTCY ARCHIVES, *supra* note 9.

formally titled in the bishop's name, notwithstanding their "ownership" of property under canon law.

Sexual abuse creditors used a reverse strategy in cases of debtors organized as religious corporations with separately incorporated parishes with their own title legal title to property. In these cases, the debtors scheduled property titled in its name but did not include property held by and titled in the names of separately incorporated entities. In the bankruptcy cases, sexual abuse creditors tried to capture parish property into the debtors' estates using a variety of legal arguments, all of which would elevate the substance of the bishop's canonical authority over parishes and their property over parishes' formal separate title to property under secular law.

B. Corporations Sole.

Debtors organized as corporations sole listed in their schedules all property titled in the name of the bishop but asserted that the bishop's title to property attributed to parishes under canon law, for property of the estate purposes, was subject to a trust and thereby excluded from the estate under section 541(d).[78] For example, the Diocese of Tucson, a corporation sole, explained that under secular law, the closest analogy for the legal status of parishes within the diocese was unincorporated associations.[79] The diocese noted that Arizona law does not recognize legal agency for an unincorporated association to own property and for that reason, the diocese held title to parish property.[80] Even so, it asserted, "the Diocese does not have any equitable, beneficial or proprietary interest in the Parish Real Property."[81]

Unsecured creditors' committees representing sexual abuse claimants in both the Spokane and Portland cases objected to their respective debtor's trust theory regarding parish property.[82] In particular, they argued that the alleged trusts were invalid under state law and not entitled to respect under bankruptcy law.[83] The stakes were high. Attorneys for sexual abuse claimants in the

[78] *See In re* Roman Catholic Archbishop of Portland in Or., 335 B.R. 842, 848 (Bankr. D. Or. 2005) (debtor asserted that although it held legal title to about $98 million in cash deposits, investment accounts and real estate, most of the property is held in trust); *Spokane*, 329 B.R. at 310 (debtor asserted that with certain exceptions property listed on its schedules was held for the benefit of parishes, schools, cemeteries and other diocesan entities). The Diocese of Spokane explained in its Statement of Financial Affairs that the diocese "has no equitable beneficial or proprietary interest in this [parish] property, but, in some cases, holds mere legal title" and also that some property "is subject to a restriction imposed by the donor or grantor." *Id.*

[79] *In re* The Roman Catholic Church of the Diocese of Tucson, Disclosure Statement at 25 in BANKRUPTCY ARCHIVES, *supra* note 9.

[80] *Id.*

[81] *Id.*

[82] Comm. of Tort Litigants v. Catholic Diocese of Spokane, 2006 U.S. Dist. LEXIS 6025, at *3-4 (E.D. Wash. Jan. 24, 2006); *Archbishop of Portland*, 335 B.R. at 848. In the Spokane case, the district court affirmed the bankruptcy court's conclusion that the tort claimants' committee had standing to challenge by adversary action the debtor's characterization of property of the estate. *Comm. of Tort Litigants*, 2006 U.S. Dist. LEXIS 6025, at * 15.

[83] In the Portland case, the sexual abuse claimants' committee sought a declaration that property listed on the debtors' schedules as "held in trust" for parishes was property of the estate free of any third-party interests. *Archbishop of Portland*, 335 B.R. at 848. In the Spokane case, the committee challenged the debtors'

Portland case estimated that including property the debtor attributed to trusts in favor of 124 diocesan parishes and schools would yield an estate of about $500 million dollars compared to assets valued at about $19 million which debtor had scheduled as property of the estate.[84]

In both cases, the parishes organized into informal committees with standing to intervene in the adversary actions.[85] In the Spokane case, parishes contended that the diocese held the disputed property in a constructive trust for their benefit or for the benefit of individual parishioners.[86] The court rejected the contention that *parishioners* could hold a beneficial interest in parish property. Even though parishioners made gifts to their parishes with the understanding that the parish would use the gifts exclusively for the parish, the donor parishioners acquired no property interest in the gifted property.[87] As to whether *parishes* could be beneficiaries of a constructive trust, a threshold question was the legal status of parishes as entities distinct from the debtor. The bankruptcy court assumed without deciding that the parishes were distinct legal entities.[88]

The bankruptcy court held that the deeds that named the bishop as sole title holder were the exclusive source of evidence on the state of the title and declined to consider the affidavit evidence from pastors, parishioners and other benefactors in support of their asserted beneficial interest.[89] The bankruptcy court entered partial summary judgment in favor of the creditors' committee, finding that the disputed real property was property of the estate free of any trust.[90] Even if the parishes could establish a trust in their favor under Washington law, because constructive or resulting trusts are equitable remedies, the parishes' asserted interest was at best

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characterization of 22 parcels of real property as held in trust for parishes and moved for an order consolidating the non-debtor defendants with the debtor. *Bishop of Spokane*, 329 B.R. at 310-311.

[84] Steve Woodward, *Class Action Possible in Church Case*, THE OREGONIAN, May 26, 2005, http://www.bishop-accountability.org/news2005_01_06/2005_05_26_Woodward_ClassAction.htm. *See also*, Joe Feuerherd, *Portland Bankruptcy Seen As High-Risk Strategy*, NATIONAL CATHOLIC REPORTER (July 30, 2004) (noting that archdiocesan attorneys reported at a hearing $100 million in investment accounts, most held for the accounts of parishes and affiliated entities). In the Tucson case, the diocese was smaller (75 parishes) but the differential was proportionately large. Sexual abuse claimants estimated the value of property of the estate, including parish property, at $110 million dollars compared to $16 million listed by the diocese. Stephanie Innes, *Diocese Files Bankruptcy*, ARIZ. DAILY STAR, Sept. 21, 2004 at A1; Stephanie Innes, *Diocese Set to Split with Its Parishes*, ARIZ. DAILY STAR, Sept. http://www.bishop-accountability.org/news2004_07_12/2004_09_23_Innes_DioceseSet.htm.

[85] *Archbishop of Portland*, 335 B.R. at 848-49; *Bishop of Spokane*, 329 B.R. at 331. *See generally* Theresa J. Pulley Radwan, *Keeping the Faith: The Rights of Parishioners in Church Reorganizations*, 82 WASH. L. REV. 75, 91-110 (2007).

[86] *Bishop of Spokane*, 329 B.R. at 329, n.8.

[87] *Id.* at 330 (citing RESTATEMENT (SECOND) OF TRUSTS § 25, cmt. a, § 125 (AM. LAW INST. 2018)).

[88] *Id.* at 330-331. *See* Comm. of Tort Litigants v. Catholic Diocese of Spokane, 364 B.R. 81, 91 (E.D. Wash. 2006) (noting that the bankruptcy court's assumption was "correct" and that "the Parishes are unincorporated associations").

[89] *Bishop of Spokane*, 329 B.R. at 331; *Comm. of Tort Litigants*, 364 B.R. at 91 (noting that the bankruptcy court did not consider the affidavit testimony).

[90] *Bishop of Spokane*, 329 B.R. at 333.

an "inchoate right" as of the filing of the petition and not a beneficial interest in property distinct from the estate's interest.[91] Finally, even if under Washington law a constructive or resulting trust was a property interest, it was unrecorded and therefore subject to the trustee's power to avoid unrecorded interests under section 544(a)(3).[92] The decision was a stunning and significant setback for the Diocese of Spokane, and for Catholic dioceses with similarly centralized title to property.[93]

Ten months later, the district court, reviewing *de novo*, reversed.[94] It found issues of fact on the validity of a trust in favor of parishes under Washington law based on the distinction between constructive trust and a resulting trust.[95] A constructive trust arises as a remedy for fraud by the title holder on the constructive trust beneficiary.[96] In contrast, a *resulting* trust arises in favor of the person who paid to acquire property (the beneficiary) when a title to property is conveyed to a record title holder who is someone other than that person (the trustee).[97] Washington courts recognize a resulting trust based on the circumstances of the conveyance of title, and not exclusively based on the deed.[98] The district court came close to calling the bankruptcy court's disregard of the affidavit evidence the parishes had submitted absurd. If only the record of title is relevant on whether property is subject to a resulting trust, then no resulting trust would ever arise.[99]

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[91] *Id.* at 332 (citing *In re* Markair, Inc., 172 B.R. 638, 642 (B.A.P. 9th Cir. 1994)).

[92] *Id.* at 333 (recognizing that the debtor in possession can exercise the trustee's power to avoid unrecorded interests in real property and that the court could grant derivative standing to exercise that power to the creditors' committee); 11 U.S.C. § 544(a)(3). The trustee's strong arm power to avoid unperfected property interests in property reinforces state law that requires public notice of non-possessory property interests (for example real property recording laws, public filing requirements for personal property security interests. *See generally* David G. Carlson, *The Trustee's Strong Arm Power under the Bankruptcy Code*, 43 S.C. L. REV. 841 (1992).

[93] *See, e.g.*, Seattle Times Staff, *Bankruptcy judge rules parish assets available to victims*, THE SEATTLE TIMES, Aug. 26, 2005, https://www.seattletimes.com/seattle-news/bankruptcy-judge-rules-parish-assets-available-to-victims/ (reporting that Barbara Blaine, president of Survivors Network of those Abused by Priests (SNAP) said she hoped the decision "would prompt leaders of other dioceses to stop fighting victims."); Joe Feuerherd, *Diocesan bankruptcies raise church ownership issues*, NATIONAL CATHOLIC REPORTER (Sept. 9, 2005), www.natcath.org/NCR_Online/archives2/2005c/090905/090905a.php ("The settlement dollars just went up dramatically . . . and the claimants hold all the cards") (quoting Sam Gerdano, executive director of the American Bankruptcy Institute).

[94] *Comm of Tort Litigants*, 364 B.R. at 95.

[95] *Id.* at 95.

[96] *Id.* at 92-93 (citing Brown v. State of Washington, 924 P.2d 908 (Wash. 1996)).

[97] *See* RESTATEMENT (SECOND) OF THE LAW OF TRUSTS § 448 (describing circumstances in which a "resulting trust" arises).

[98] *Committee of Tort Litigants*, 364 B.R. at 91 (citing *Brown*, 924 P.2d at 911-12).

[99] *Id.* at 93, 95. Moreover, if a resulting trust arose, it could be a property interest (and not merely an inchoate right) at the time of filing. Under Washington law, a resulting trust arises at the time of the conveyance to the title holder

The district court further held that a resulting trust could survive the trustee's power to avoid unrecorded interests in real property under section 544(a)(3).[100] Under some states' laws, the circumstances that give rise to a resulting trust may amount to *constructive notice* of the beneficiary's interest, which as a matter of state law precludes the possibility of a bona fide purchaser.[101] Section 544(a)(3) relieves the trustee from the effect of *actual knowledge* of an unrecorded interest, but does not relieve the trustee of the effect of constructive notice.[102] The court held that summary judgment on this issue was inappropriate because of fact issues as to whether, under Washington law, the circumstances surrounding parishes' acquisition of parish property constituted constructive notice of the parishes' beneficial interest in it.[103]

Meanwhile, during the interval between the bankruptcy and district court opinions in the Spokane case, the Portland bankruptcy court considered the creditors' committee's request for a ruling that the parishes were legally indistinct from the debtor, and therefore could not be beneficiaries of an implied trust.[104] The bankruptcy court held that under Oregon law, unincorporated parishes had no capacity to sue, be sued, or hold title to real property.[105] However, it held that parishioners and other donors who contributed to the acquisition and maintenance of parish real property might have a beneficial interest in it.[106]

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and does not depend (like a constructive trust does) on a court order. *Id.* at 92 (citing BOGERT ON TRUSTS 327 (3d ed. 2005)).

[100] *Id.* at 93 (citing *In re* Torrez, 827 F.2d 1299 (9th Cir. 1987)).

[101] For example, under California law, there can be no bona fide purchaser of property from the holder of legal title of property held subject to a resulting trust if the beneficiary's possession of the property constitutes constructive notice of his equitable interest. *See, e.g.*, Robertson v. Peters, 5 F.3d 417, 420 (9th Cir. 1993) (under Cal. law, trustee takes free of actual knowledge but not constructive notice); *id. at* 420 (trustee's constructive knowledge of a prior interest precludes bona fide purchaser status); *In re* Bittner, Nos. 08-43037 ND, 08-4255, 2009 Bankr. LEXIS 2530 at * 12 (Bankr. N.D. Cal. June 9, 2009) (trustee had constructive notice of a resulting trust and thus lacked bona fide purchaser status under 11. U.S.C. § 544(a)(3).

[102] *E.g.*, *In re* Asher, 488 B.R. 58, 73 (Bankr. E.D.N.Y. 2013) (under New York law, the trustee's avoiding power under § 544(a)(3) is subject to constructive notice). A few courts have limited the trustee's avoiding power under section 544(a)(3) against the holder of an implied equitable lien based on the equities of the situation. *See, e.g.*, *In re* 28th Legislative Dist. Cmty. Dev. Corp., No. 10-14804, 2011 Bankr. LEXIS 4411 (Bankr. E.D. Tenn. 9, 2011) (debtor non-profit community development organization held properties purchased with grant funding in trust for grant providers under federal law, beneficial interests of trust beneficiaries not subject to avoidance under § 544(a)(3)); *In re* West Central Housing Development Org., 338 B.R. 482, 486 (Bankr. D. Colo. 2005) (same); *In re* Premier Airways, Inc., 303 B.R. 295 (Bankr. W.D.N.Y. 2003) (same).

[103] *Committee of Tort Litigants*, 364 B.R. at 95.

[104] *In re* Roman Catholic Archbishop of Portland in Or., 335 B.R. 842, 868 (Bankr. D. Or. 2005). The debtor argued only that the parishes were separate entities from the debtor and apparently conceded that schools were not separate entities. *Id* at 865.

[105] *Id.* at 866. In addition to Oregon court authority, the court cited *F.E.L. Publications, Ltd v. Catholic Bishop of Chicago*, 754 F.2d 216, 221 (7th Cir. 1985) (archbishop not liable for tortious interference in business relationship between parish and third party because parish was not legally distinct from archbishop).

[106] *Archbishop of Portland*, 335 B.R. at 862-63.

C. Religious Corporations with Separately Incorporated Parishes.

1. Transfer Avoidance.

Advocates for sexual abuse creditors in the cases of debtors organized as religious corporations with separately incorporated parishes sought to use tools available under bankruptcy law to capture property titled in separately incorporated parishes as part of property of the diocesan debtor's estate. The Bankruptcy Code includes statutory provisions known collectively as the "trustee's avoiding powers" under which the bankruptcy trustee, as agent for the estate, may avoid certain property interests of third parties, or reverse certain pre-petition transfers of property by the debtor to third parties.[107] By exercising an avoiding power, the trustee can capture a property interest from its holder and thereby augment the contents of the "property of the estate" available for unsecured creditors.[108] In the Catholic bankruptcy cases where the debtor was incorporated separately from parishes who held title to their own property, transfer avoidance litigation focused on the trustee's power to avoid fraudulent transfers under sections 544(b)(1) and 548.[109]

The onslaught of fraudulent transfer challenges in their bankruptcy cases could not have been a surprise to the debtors. Intense national media attention to the clergy sexual abuse scandal following the Boston Archdiocese scandal in 2002 provided Catholic bishops with powerful incentive to consider the organizational structure and property holdings of entities within the diocese and to take action to protect parish assets from diocesan creditors.[110] The media similarly shed light on dioceses' asset-protective transfers.[111] In the media and in court, the debtors explained the pre-petition transfers as benign acts to conform the parishes' formal title to property

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[107] *See generally* THE LAW OF BANKRUPTCY, *supra* note 76, at 465.

[108] *See generally id.* at 470 (noting that one of the purposes of the avoiding powers is to maximize the value of the estate available for distribution to all creditors); Thomas H. Jackson, *Avoiding Powers in Bankruptcy*, 36 STAN. L. REV. 725 (1984) (asserting that the avoiding powers fall into two categories, one that adjusts the rights of creditors relative to each other, and the other that adjusts the rights of creditors relative to the debtor).

[109] Section 548 provides a uniform federal fraudulent transfer avoiding power. 11 U.S.C. § 548. Section 544(b) gives the trustee the right to avoid a transfer that a creditor of the estate could avoid under state fraudulent transfer law. 11 U.S.C. § 544(b).

[110] *See*, Jill S. Manny, *Governance Issues for Non-Profit Religious Organizations*, 40 CATH. LAW. 1, 1 (2000) (recommending that corporation sole dioceses separately incorporate parishes, dioceses, and fund-raising entities that support them to protect such entities from diocesan liability).

[111] *See, e.g.*, Jean Hopfensperger and Jennifer Bjorhus, *Minn. Archdiocese transfer of assets may protect it from bankruptcy creditors*, STAR TRIBUNE, February 2, 2015, http://www.startribune.com/archdiocese-shifted-assets-before-filing-bankruptcy/290400991/; Laurie Goodstein, *Dolan Sought to Protect Church Assets, Files Show*, N.Y. TIMES, July 1, 2013, https://www.nytimes.com/2013/07/02/us/dolan-sought-vatican-permission-to-shield-assets.html; Jean Guccione, *Diocese Accused of Moving Assets to Avoid Paying Sex-Abuse Claims*, L.A. TIMES, August 18, 2004 at B6, articles.latimes.com/2004/aug/18/local/me-priests18 (reporting that several California dioceses transferred title to property held by the bishop to parishes to shield it from sexual abuse creditors); Frank Gibney, Jr., *Can a Church Go Broke?*, TIME, May 26, 2002, http://content.time.com/time/magazine/article/0,9171,250016,00.html ("[S]everal dioceses have persuaded plaintiffs to accept reduced settlements, on the grounds that they could not afford to pay more . . . [while] leaders divide church property among dozens if not hundreds of separate corporations.").

with their "ownership" right in such property under canon law.[112] In contrast, sexual abuse claimants' lawyers and the media characterized such transfers as malevolent schemes to defraud sexual abuse claimants.[113]

2. Derivative Standing.

Under the Bankruptcy Code, the power to avoid fraudulent transfers belongs to the bankruptcy trustee,[114] or in a chapter 11 case to the debtor in possession exercising the powers of the trustee.[115] Neither individual creditors nor a committee of creditors can assert the trustee's avoiding powers without the consent of the debtor in possession or a grant of derivative standing from the bankruptcy court.[116] Bankruptcy courts grant derivative standing if the particular avoidance action the committee wants to pursue is "colorable" and if the debtor in possession is unjustified in failing to pursue it based on a cost-benefit analysis.[117]

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[112] *See, e.g.*, Archdiocese of Milwaukee, *Archdiocese Clarifies 7th Circuit Court Ruling on Cemetery Trust in Chapter 11* (Mar. 10, 2015), http://www.archmil.org/News-2.0/Archdiocese-Clarifies-7th-Circuit-Court-Ruling-on-Cemetery-Trust-in-Chapter-11.htm; Objection and Response to Motion for Off. Comm. of Unsecured Creditors for Authority to Commence, Prosecute and Settle Litigation on Behalf of Bankruptcy Estate Against the Holy See and Diocese-Related Entities, , *In re* Catholic Bishop of Northern Alaska, 4:08-bk-00110 (Bankr. D. Alaska March 2, 2009); 5-6, in BANKRUPTCY ARCHIVE, *supra* note 9; (explaining transfer of $3 million contributed to and held by the diocese in trust for parishes to Catholic Trust of Northern Alaska as formalizing a pre-existing trust) (hereinafter *Northern Alaska Debtor's Objection and Response*).

[113] *See, e.g.*, Hopfensperger & Bjorhus, *supra* note 111 (quoting David Clohessy, director of Survivors Network of Those Abused by Priests (SNAP) as characterizing the Archdiocese of St. Paul and Minneapolis's pre-petition transfers as "self-serving financial maneuvers" and asking "Can anyone honestly claim that Jesus would have spent time and energy shielding assets?"); Milo Gyelin, *Earthly Assets: Besieged Church Tries to Protect Vast Real Estate—Fearing Sex-Abuse Awards, Diocese Restructure: Incorporating the Parish—We Did It for Clarification*, WALL ST. J., May 15, 2002, at A1 (quoting counsel for tort plaintiffs accusing dioceses of "going through their assets and shoving them back to local parishes.").

[114] 11 U.S.C. § 544(a) ("The trusee shall have… the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor….").

[115] 11 U.S.C. § 1107(a) ("…a debtor in possession shall have all the rights…and powers, and shall perform all the functions and duties… of a trustee serving in a case under this chapter."). The debtor in possession is the fiduciary and legal representative for the estate in a chapter 11 case, with the power to sue and be sued. 11 U.S.C. § 323. The debtor in possession, as the "trustee", also has primary standing to bring avoidance actions. *See* TABB, *supra* note 66, at 1055.

[116] *E.g.*, Estate of Spirtos v. Superior Court Case, 443 F.3d 1172, 1175-76 (9th Cir. 2006) (a creditor cannot assert a RICO claim on behalf of the estate without authorization from the court or the chapter 7 trustee); Off. Comm of Unsecured Creditors of Cybergenics Corp. *ex re.* Cybergenics Corp. v. Chinery, 330 F.3d 548, 567 (3d Cir. 2003) (holding that Congress approved of derivative standing for committees to exercise the trustee's avoiding powers and that bankruptcy courts could grant derivative standing as an exercise of general equitable powers where the debtor in possession unreasonably refused to pursue an avoidance claim); Term Loan Holder Comm. V. Ozer Group, L.L.C., 303 F.3d 161, 166 (2d Cir. 2002) (recognizing a qualified right for creditors' committees to exercise the trustee's avoiding powers); Fogel v. Zell, 221 F.3d 955, 965 (7th Cir. 2000) (a creditor may obtain bankruptcy court permission to bring an adversary action if the trustee unjustifiably refuses to do so).

[117] *E.g.*, PW Enters. V. N.D. Racing Comm'n, 540 F.3d 892, 901 (8th Cir. 2008) (determination of whether the trustee unjustifiably refuses to bring an avoidance action requires the court to perform a cost benefit analysis); *In re*

The cost-benefit test for derivative standing was an issue in the Diocese of Northern Alaska case. Like the dioceses of Spokane and Portland, the Diocese of Northern Alaska had held title to all property including the real property used by parishes and other diocesan affiliates.[118] In 2007, within the year before it filed for relief, the diocese amended its articles of incorporation to clarify that it held title to parish property in an express trust for parishes.[119] In the bankruptcy case, the creditors' committee sought derivative standing to avoid the express trusts as fraudulent transfers.[120] The court denied the motion.[121] The Diocese of Northern Alaska covered 410,000 square miles with 46 parishes and 17 priests. Only 8 parishes raised enough from contributions of parishioners to cover their expenses.[122] Given the insolvency of parishes and the low likelihood of recovery even if the avoidance action was successful, the cost of litigation to avoid transfers from the diocese to the parishes was simply not worth the candle.[123]

In the Archdiocese of Milwaukee case, the creditors' committee tried and failed to obtain derivative standing to recover $35 million in pre-petition transfers the archdiocese had made out of an investment account (the Fund) to parishes. The archdiocese held title to the Fund into which parishes made deposits (a pooled-investment account). About seven years before it filed for bankruptcy, the archdiocese dissolved the Fund and transferred to parishes the amounts each had

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STN Enterprises, 779 F.2d 901, 904 (2d Cir. 1985) (the committee must show that the action it seeks to take on behalf of the debtor in possession is a colorable claim and that the debtor in possession unjustifiably failed to pursue it, with unjustifiability turning on a cost-benefit analysis as to whether pursuit of the action is likely to benefit the estate.); *In re* Toledo Equipment Co., 35 B.R. 315, 320 (Bankr. N. D. Ohio 1983) (committee must show that the debtor-in-possession's refusal to bring an action is "unjustifiable or abusive of their discretion").

[118] *See Appendix A, supra* note 11.

[119] *Northern Alaska Debtor's Objection and Response*, *supra* note 112 at 4-5. At the same time, each parish recorded a "notice of beneficial interest" in real property in the local property records reflecting the parish's beneficial interest in parish real property titled in the name of the bishop. *Id.*

[120] [Redacted] Motion for Official Committee of Unsecured Creditors for Authority to Commence, Prosecute and Settle Litigation on Behalf of Bankruptcy Estate Against the Holy See and Diocese-Related Entities at 5-8, *In re* Catholic Bishop of Northern Alaska, 4:08-bk-00110 (Bankr. D. Alaska, May 11, 2009) in BANKRUPTCY ARCHIVE, *supra* note 9 [hereinafter *Northern Alaska Creditors' Committee Motion*].

[121] Memorandum Regarding Committee's Motion to Pursue Litigation and Debtor's Motion to Strike, *In re* Catholic Bishop of Northern Alaska 13-14, 4:08-bk-00110 (Bankr. D. Alaska Sept. 11, 2009) in BANKRUPTCY ARCHIVE, *supra* note 9 [hereinafter *Memorandum Regarding Committee's Motion*].

[122] *Northern Alaska Debtor's Objection and Response* at 8. Most of the parish property at issue was inaccessible by road and about one-third of the target parishes lacked running water. *Id.* at 15.

[123] *Id.* at 16. The court did grant the committee derivative standing to pursue an avoidance action regarding a $3 million transfer between a pooled investment fund the diocese had operated for the benefit of parishes and a trust the diocese created to administer the fund within a year before it filed for relief. *Id.* at 16.

[123] The court found that the cost-benefit analysis for pursuit of this cash transfer was relatively straightforward, and that the debtor was unjustified in its refusal to pursue a fraudulent transfer avoidance action against the trust. *Id.* at 16-17.

deposited into it.[124] The committee alleged that the transfers were avoidable fraudulent transfers under section 544(b)(1) and Wisconsin fraudulent transfer law.[125]

The bankruptcy court denied the committee's motion for derivative standing to challenge the transfers out of the Fund because the proposed action was not colorable. First, it was time-barred under the Wisconsin statute of limitations for actually fraudulent transfers.[126] Second, the parishes were good faith transferees and expressly protected from fraudulent transfer avoidance under Wisconsin law.[127] Moreover, assuming the avoidance action was "colorable," the debtor's failure to sue parish transferees was not "unjustified," noting that the creditors' committee had conceded that litigation against parishes would cost the estate more than $1 million in legal fees.[128] The court considered the overall impact of opening fraudulent transfer litigation against parish transferees. To pay their fraudulent transfer debts, parishes would turn to parishioners, students and benefactors to provide funds, which would "have an adverse effect" on their willingness to support the debtor which was critical to the debtor's ability to continue to operate and fund a chapter 11 plan.[129] Moreover, if the creditors committee prevailed, the parishes would file claims against the debtor, adding to the pool of creditors and diluting the effect of recovery from parishes for sexual abuse claimants.[130]

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[124] *In re* Archdiocese of Milwaukee, 483 B.R. 855, 864 (Bankr. E. D. Wis. Dec. 2012).

[125] *Id.* at 858.

[126] *Id.* at 866. *See* Wis. Stat. § 893.425 ("brought within 4 years after the transfer is made . . . or, if later, within one year after the transfer . . . is or could reasonably have been discovered by the claimant.").

[127] *Id.* at 866 ("In short, the status of the Archbishop as president and board member of the Parish corporations does not, without more, render the Parishes bad faith transferees…."). *See* Wis. Stat. § 242.08(1) (defense for a "person who took in good faith and for a reasonably equivalent value.").

[128] *Id*. at 869-70. About a year earlier, a pooled investment account, was a hot button issue in the Diocese of Wilmington case. Official Comm. of Unsecured Creditors v. Catholic Diocese of Wilmington, Inc., 432 B.R. 135 (Bankr. D. Del. 2010). The debtor disclosed in its schedules that it held title to a $120 million pooled investment account (the PIA), $45 million of which was property of the estate, and the balance subject to a trust in favor of 31 parish depositors, albeit without an express trust agreement. *Id.* at 142-43. The committee challenged the validity of the trust under Delaware law. The bankruptcy court held that under Delaware law, the investment account was subject to a resulting trust in favor of the parish depositors. *Id.* at 148 (the relationship between the parish depositors and the debtor was analogous to that between investor and broker). *See also* E. Lake Methodist Episcopal Church, Inc. v. Trustees of the Peninsula-Delaware Annual Conf. of the United Methodist Church, Inc., 731 A.2d 798, 809 (Del. 1999) (even without an express trust agreement, diocese held investment funds delivered to it by parishes in a "resulting trust" so that funds were not property of the estate). Under bankruptcy law, however, because the Wilmington parishes' deposits were commingled with property of the estate and untraceable, the entire $120 million PIA was property of the estate free and clear. *Catholic Diocese of Wilmington,* 432 B.R. at 149-50, 158-61. In contrast, in the Milwaukee case, the Fund was a parish-only investment account segregated from any diocesan funds, so that the parishes could easily trace their property interests in it. *Archdiocese of Milwaukee* 483 B.R. at 863-64.

[129] *In re* Archdiocese of Milwaukee, 483 B.R. at 870.

[130] *Id.* at 871.

After this defeat, sexual abuse claimants in the Milwaukee case raised a second challenge to a pre-petition transfer, which became the subject of fierce and protracted litigation through appeal to the Seventh Circuit.[131] The committee representing sexual abuse claimants sought to avoid as fraudulent a pre-petition transfer by the archdiocese of about $55 million from the archdiocese to an express trust known as the Cemetery Trust (the Trust). The archdiocese owned eight Catholic cemeteries and seven mausoleums in the Milwaukee area since 1857. For decades before its bankruptcy, it held an investment account known as the Cemetery Fund and used capital in the Fund to maintain its cemeteries. In 2007, less than a year after settling a group of sexual abuse claims for $17 million, the archdiocese created a trust to provide for maintenance of the cemetery property (the Cemetery Trust).[132] In March 2008, with approval from the Pope, the archbishop transferred about $55 million from the Cemetery Fund into the Cemetery Trust.[133]

The transfer was plainly part of a strategy to shield the funds from archdiocesan creditors. In a 2008 letter to the Holy See requesting approval for the transfer, the archbishop wrote that "[b]y transferring these assets to the Trust, I foresee an improved protection of these funds from any legal claim and liability."[134]

The transfer to the Cemetery Trust provided a much better chance for derivative standing for sexual abuse creditors than their previous attempt. Unlike the transfers from the pooled investment Fund to various parish depositors, the transfer from the archdiocese to the Cemetery Trust presented a single $55 million transfer to a single transferee. Moreover, the archdiocese made the transfer with the express intention, as he explained to the Pope, to shield cash from the impending claims of sexual abuse survivors.

The committee's challenge to the $55 million Cemetery Trust transfer put the archbishop in an unusual situation. In his capacity as trustee of the Cemetery Trust, he was the transferee. In his capacity as archbishop, he was the agent for the transferor. The archdiocese as debtor in possession had no incentive to assert the transfer avoiding powers against the archbishop to avoid the transfer to the Trust.[135] To rectify this conflict, with the agreement of the parties, the bankruptcy court granted the committee derivative standing.[136] The Cemetery Trust litigation proceeded with

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[131] Listecki v. Off. Committee of Unsecured Creditors, 780 F.3d 731 (7th Cir. 2015).

[132] Listecki v. Off. Comm. of Unsecured Creditors, 485 B.R. 385, 387 (Bankr. E.D. Wis. 2013).

[133] *Id*.

[134] Listecki v. Off. Comm. of Unsecured Creditors, 780 F.3d 731, 734 (7th Cir. 2015). The archdiocese explained that the transfer was not an "actual fraud" intended to hinder its creditors but rather a formalization of the trust for the perpetual care of cemeteries under which the Archdiocese had always held the funds that were transferred in 2008 into the Cemetery Trust. See *Archdiocese Clarifies 7th Circuit Court Ruling on Cemetery Trust in Chapter 11*, CATHOLIC HERALD, Mar. 10, 2013, https://www.archmil.org/News-2.0/Archdiocese-Clarifies-7th-Circuit-Court-Ruling-on-Cemetery-Trust-in-Chapter-11.htm.

[135] *See*, Listecki v. Off. Comm. of Unsecured Creditors, 485 B.R. 385, 387 (Bankr. E.D. Wis. 2013); Listecki v. Off. Comm. of Unsecured Creditors, 496 B.R. 905, 916 (E. D. Wis. 2013).

[136]Lisetcki v. Off. Comm. of Unsecured Creditors, 496 B.R. at 916-17. *See also* Listecki v. Off. Comm. of Unsecured Creditors, 485 B.R. at 391 ("The Committee, acting derivatively through the Debtor as debtor in possession, is defending a lawsuit concerning property of the estate.").

the archbishop and the committee at odds on the archbishop's protection from avoidance on religious liberty grounds as discussed below in part V.

3. Substantive Consolidation.

In the Saint Paul and Minneapolis case, sexual abuse creditors tried to augment the debtor's estate not by challenging individual transfers from the debtor to parishes but rather by dismantling the legal distinction between the debtor and separately incorporated parishes. Seventeen months after the case commenced, the official creditors' committee moved for substantive consolidation of the debtor with about 200 separately incorporated entities including 187 parishes, none of whom were debtors in bankruptcy.[137]

The district court held that substantive consolidation of the debtor with separately incorporated, non-debtor parishes would be inconsistent with section 303(a) of the bankruptcy code, which prohibits commencement of an involuntary bankruptcy case against a non-profit corporation.[138] The Eighth Circuit similarly held in favor of the debtor.[139] Section 105 only confers equitable powers that do not conflict with an explicit mandate of another provision of the bankruptcy code.[140] Substantive consolidation would in effect force parishes into involuntary bankruptcy and would violate section 303(a) which expressly protects non-profit organizations like parishes from involuntary bankruptcy.[141]

The Eighth Circuit "left for another day" the question of whether a bankruptcy court could order substantive consolidation of a debtor with a non-profit non-debtor if the latter was an alter ego or otherwise not entitled to be treated as legally distinct from the debtor under state law.[142] The committee had asserted that the parishes were legally indistinct from the archdiocese based on the archbishop's canonical supervisory role over parishes under canon law, and the provisions of Minnesota law governing religious corporations which expressly recognized the role of the bishop in organizing and operating parish corporations.[143] The court found that the committee did

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[137] *In re* Archdiocese of St. Paul & Minneapolis, 888 F.3d 944, 948 (8th Cir. 2018). Bankruptcy courts can order substantive consolidation of a debtor with other legally distinct entities as an exercise of their general equitable power under section 105. 11 U.S.C. § 105(a) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title…."). *See generally*, TABB, *supra* note 66, at 242.

[138] Off. Comm. of Unsecured Creditors v. Archdiocese of St. Paul and Minneapolis, 562 B. R. 755, 762-3 (D. Minn. 2016) (describing substantive consolidation as "effectively involuntary bankruptcy" for the non-debtors). *See* 11 U.S.C. § 303(a). The court also affirmed the bankruptcy court's finding that even if the court had authority to order substantive consolidation under § 105, the facts did not support it. *Id.* at 763-64 (applying Eighth Circuit precedent on substantive consolidation in *In re Giller*, 962 F.2d 796 (8th Cir. 1992)).

[139] Archdiocese of St. Paul & Minneapolis, 888 F.3d at 954.

[140] *Id.* at 952.

[141] *Id.*

[142] *Id.* at 953.

[143] *Id.* at 948-949.

not allege facts that could support disregard of the separate incorporation of the parishes under Minnesota law, and even if an alter ego theory under state law was viable for substantive consolidation of non-profit non-debtors, the committee had not alleged facts sufficient to survive motion to dismiss.[144]

IV. Religious Liberty.

A. The First Amendment and the Religious Freedom Restoration Act.

Debtors defended against sexual abuse claimants' efforts to expand property of the estate by asserting protection from the application of certain aspects of bankruptcy law under the First Amendment and RFRA. Like the legal issues under state and bankruptcy law about the extent of the debtors' estates, the legal contexts in which religious liberty issues arose depended on organizational structure, title to property, and property transfers unique to each debtor.

Before the Supreme Court's decision in *Employment Division v. Smith*,[145] the Court applied the First Amendment to protect against imposition of a substantial burden on religious expression unless the government could show that the burden was necessary to serve a compelling governmental interest.[146] In *Smith*, the Court held the Free Exercise Clause does not protect against enforcement of "neutral, generally applicable laws" that impose a substantial burden on religious expression even when those laws are not justified by a compelling governmental interest."[147]

In 1990, Congress enacted RFRA to supersede the Supreme Court's decision in *Smith.*[148] Under RFRA, "government shall not substantially burden a person's exercise of religion, even if the burden results from a rule of general applicability."[149] The general prohibition on substantial burden on exercise of religion under RFRA is subject to an exception that permits "government" to substantially burden a person's exercise of religion if it demonstrates that "application of the

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144 *Id.* at 953.

145 494 U.S. 872 (1990).

146 *E.g.*, Frazee v. Ill. Dep't of Emp't Sec., 489 U.S. 829 (1989); Wisconsin v. Yoder, 406 U.S. 205 (1972); Sherbert v. Verner, 374 U.S. 398 (1963).

147 *Smith*, 494 U.S. at 876-90. *See also* Burwell v. Hobby Lobby Stores, Inc., 134 S.Ct. 2751, 2761 (2014) (quoting City of Boerne v. Flores, 521 U.S. 507, 514 (1997).

148 Gonzales v. O Centro Espirita Beneficente Uniao do Vegetal, 546 U.S. 418, 424 (2006) (recounting the history of RFRA as Congressional action to supersede *Smith*); 42 U.S.C. § 2000bb(a)(4), (b)(1) (noting that the Supreme Court in *Employment Div. v. Smith* "virtually eliminated" the compelling interest test, and that one of the purposes of RFRA was to restore the compelling interest test as set forth in *Sherbert v. Verner*, 374 U.S. 398 (1963) and *Wisconsin v. Yoder*, 406 U.S. 205 (1982)). RFRA does not apply to the states. 42 U.S.C. § 2000bb-2 (2012) (RFRA applies only to the United States, its territories and possessions, the District of Columbia and Puerto Rico). S*ee also*, City of Boerne v. Flores, 521 U.S. 507(1997) (holding an earlier version of RFRA unconstitutional as applied to the states). Thirty-three states have either enacted similar state legislation or interpreted their state constitutions to require a heightened level of judicial scrutiny for state government action that imposes a burden on free expression of religion. *See* Douglas Laycock, *Religious Liberty and the Culture Wars*, 2014 U. ILL. L. REV. 839, 844 & n. 22, 845 & n. 26 (citations to state legislation and court decisions).

149 42 U.S.C. § 2000bb-1(a).

burden to the person: (1) is in furtherance of a compelling governmental interest; and (2) is the least restrictive means of furthering that compelling interest."[150] Under either First Amendment doctrine or RFRA, a party seeking protection from government enforcement of a neutral, generally applicable law must show that compliance with the law imposes a substantial burden on exercise of religion.[151]

B. The Bankruptcy Code as Neutral, Generally Applicable Law.

In the Cemetery Trust litigation in the Milwaukee case, the archbishop sought declaratory judgment on his religious liberty defense under RFRA to the committee's action by derivative standing to avoid the $55 million Cemetery Trust Transfer as a fraudulent transfer.[152] The archbishop conceded that the Bankruptcy Code was a law of general application, but he contended that it was not "neutral" to religion because it contains three subsections which recognize exceptions from a general transfer avoidance rule for certain charitable or religious contributions.[153] Particularly, the archbishop argued that these provisions favoring certain charitable contributions are "religious" under *Church of Lukumi Babalu Aye v. City of Hialeah*[154] because they "refer to a religious practice [charitable or religious contributions] without a secular meaning discernible from the language or context."[155] The Seventh Circuit rejected the archbishop's contention. The exceptions from avoidance for certain charitable contributions do not prohibit the practice of religion, but rather encourage it and thus do not implicate the First Amendment.[156] Moreover, the Bankruptcy Code provisions that establish property of the estate apply without regard to religion or religious beliefs.[157]

C. Substantial Burden on Free Exercise of Religion.

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[150] 42 U.S.C. § 2000bb-1(b). Subsection 1(c) provides for relief "against a government." 42 U.S.C. at § 2000bb-1(c).

[151] *See* Church of the Lukumi Babalu Aye v. City of Hialeah, 508 U.S. 520, 531-32 (1994) (the First Amendment does not protect against application of a neutral, generally applicable law that has only an incidental effect on exercise of religious beliefs); 42 U.S.C. § 2000bb-1(a); *In re* Roman Catholic Archbishop of Portland in Or., 335 B.R. 842, 859 (Bankr. D. Or. 2005) (RFRA puts the burden on the person who invokes it to show the neutral law imposes a substantial burden).

[152] Listecki v. Official Comm. of Unsecured Creditors, 780 F.3d 731, 735 (7th Cir. 2015).

[153] *Id. See* 11 U.S.C. § 548(a)(2)(exception from fraudulent transfer avoidance for certain charitable contributions); § 548(d)(4)(defining qualified charitable contributions); § 544(b)(2)(analogous protection for certain charitable contributions from avoidance under state fraudulent transfer law).

[154] *Lukumi*, 508 U.S. 520.

[155] *Listecki*, 780 F.3d at 743, *Lukumi*, 508 U.S. at 533-34.

[156] *Listecki*, 780 F.3d at 744.

[157] The Seventh Circuit identified the provisions of the Bankruptcy Code that together establish "property of the estate" including section 541 (defining "property of the estate") and the avoiding powers by which the trustee augments the estate. *Id.* at 743.

As to whether application of bankruptcy law governing property of the estate substantially burdens Catholic debtors' free exercise of religion, a recurring consideration was the *choice* of the debtor to seek relief in bankruptcy. In the Portland case the court noted that the debtor's choice to organize as a corporation sole and to hold record title to property, including property attributed to parishes under canon law, was the cause of its problems, not application of the Bankruptcy Code. The court noted "[i]f a religious organization's manner of holding property fails under neutral civil law to protect its internal view of property ownership, but such internal view could have been accommodated by civil law, the burden on the exercise of religion is caused not by the neutral law but by the religious organization's own choice."[158]

Similarly, in the Spokane case, the bankruptcy court reasoned that because the debtors chose the benefits of bankruptcy, they could not legitimately complain that the statutory constraints that come with it imposed a substantial burden on their free exercise right.[159] "It is not a burden on a religious organization which voluntarily seeks the protection of bankruptcy laws to require it to treat creditors in the same manner as any other debtor."[160] If the debtor found the application of bankruptcy law to be a burden on its religious liberty "the appropriate remedy would be dismissal of the bankruptcy case."[161]

Notwithstanding the Portland bankruptcy court's dim view of the debtor's argument regarding the substantial burden on religion of bankruptcy law generally, it delivered a small victory to the debtor. The court considered whether exercise of the trustee's power under section 544(a)(3) to avoid parishes' unrecorded interests in *all* parishes beneficial interests in real property could substantially burden the debtor's free exercise of religious belief.[162] It held that parishioners' c*omplete loss* of access to places for Catholic worship and education could be a substantial burden on the exercise of religion for purposes of the application of RFRA.[163] This possibility raised an issue of fact precluding summary judgment in favor of the committee.[164]

Because the bankruptcy court in the Portland case held that avoidance under section 544(a)(3) of *all* unrecorded parish interests in real property could substantially burden exercise of religion, it reached the question of whether the government's interest in the enforcement of the trustee's power under section 544(a)(3) was compelling. It grappled with the purpose of the section 544(a)(3): "It gives to the bankruptcy trustee…the ability to avoid certain interests in real property

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[158] *In re* Roman Catholic Archbishop of Portland in Or., 335 B.R. at 862. "It is not for the civil courts to enforce canon law if the actions of the religious organization under applicable civil law do not effectuate what canon law requires." *Id.*

[159] *Id.* at 324, n.5.

[160] *In re* Catholic Bishop of Spokane, 329 B.R. 304, 325 (Bankr. E.D. Wash. 2005).

[161] *Id.*

[162] The debtor argued that wholesale avoidance of parishes' beneficial interests would result in the loss to parishioners of access to places for religious worship and education. *Id.* at 859.

[163] *Id.* at 863.

[164] *Id.*

that would not be avoidable under state law if there were no actual bona fide purchaser of real property."[165] A few paragraphs later, it described the purpose of the avoiding powers generally to "maximize the bankruptcy estate and … the recovery for creditors." [166] The court observed that the bankruptcy code provides for exceptions that do not further this policy and concluded that the government's interest in enforcement of section 544(a)(3) in this circumstance would not be compelling.[167]

D. The Cemetery Trust Litigation.

In the Cemetery Trust litigation in the Milwaukee case, the archbishop argued that the committee's exercise (by derivative standing) of the trustee's fraudulent transfer avoiding power would impose a substantial burden on the free exercise of religion against which RFRA protected him absent a compelling governmental interest.[168] The archbishop argued that exercise of fraudulent transfer avoiding powers to recapture the corpus of the Cemetery Trust for the estate would interfere with his canonical obligation to maintain the cemetery as consecrated Catholic burial grounds.[169] It would also divert funds intended by the faithful for cemetery maintenance to another purpose (payment of sexual abuse claims), a diversion inconsistent with canon law.[170] Both effects would substantially burden the archbishop's exercise of religion as protected under the First Amendment and RFRA.[171]

1. Avoidance Actions as Action by the "Government" under RFRA.

The committee responded to the Archbishop's RFRA defense by raising a statutory interpretation issue under RFRA that the parties in the Spokane and Portland cases had not raised. It asserted that RFRA applies only to actions by the "government," the committee was not the "government," and therefore, RFRA did not apply to protect the archbishop at all.[172]

RFRA defines "government" to include a "branch, department, agency, instrumentality and official (or other person acting under color of law) of the United States."[173] The question was

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[165] *Id.*

[166] *Id*. at 864.

[167] *Id.*

[168] Listecki v. Off. Comm. of Unsecured Creditors, 780 F.3d 731, 735 (7th Cir. 2015).

[169] *Id. See also* Corrected Response Brief of Appellee, Off. Comm. Of Unsecured Creditors v. Listecki 6-8, in BANKRUPTCY ARCHIVE, *supra* note 9.

[170] Listecki v. Off. Comm. Of Unsecured Creditors, 496 B.R. 905, 911 (E.D. Wis. 2013); 1983 CODE C.1267, § 3 (offerings given by the faithful for a particular purpose may be applied only for that purpose).

[171] *Listecki*, 780 F.3d at 735.

[172] *Id.* at 736.

[173] 42 U.S.C. § 2000bb-2.

whether the committee, in its capacity as an official committee in a bankruptcy case, exercising the trustee's fraudulent transfer avoiding power via derivative standing, was "acting under color of law" so as to constitute the "government" for purposes of triggering RFRA protection. Nearly two decades earlier, when the Eighth Circuit in *In re Young*[174] considered whether RFRA protected a church from a chapter 7 trustee's fraudulent transfer action, the parties did not dispute whether the chapter 7 trustee was the "government" for purposes of RFRA protection, and the court did not address it. The Eighth Circuit noted only that "[t]he bankruptcy code is federal law, the federal courts are a branch of the United States, and our decision in the present case would involve the implementation of federal bankruptcy law."[175]

The Seventh Circuit concluded that RFRA applied only to "government" action.[176] It recognized a distinction on this point between RFRA protection and protection under the First Amendment, which provides protection against a lawsuit initiated by a private party.[177] As to whether the committee was the "government," the Seventh Circuit noted that the phrase "under color of law" in the definition of "government" in RFRA should be interpreted consistently with the same term under section 1983.[178] A private person who acts "under color of law" is a governmental actor.[179] Whether a person acts "under color of law" depends on the presence of a "close nexus between the State and the challenged action" such that the action "may be fairly treated as that of the State itself."[180]

The Archbishop argued that the committee was the government for RFRA purposes because as an official committee appointed by the United States Trustee, it was a "government-created, government-supervised, government-empowered, statutorily protected entity."[181] Second, the committee was acting "under color of law" by exercising via derivative standing the trustee's statutory avoiding powers, action that is "traditionally the exclusive prerogative of the State."[182]

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[174] United States v. Crystal Evangelical Free Church (*In re* Young), 82 F.3d 1407, 1420 (8th Cir. 1996) (Young II), *vacated sub nom.* Christians v. Crystal Evangelical Free Church, 521 U.S. 1114 (1997).

[175] *In re Young*, 82 F.3d at 1417.

[176] *Listecki*, 780 F.32d at 735-36.

[177] *Id. at* 741.

[178] *Id.* at 737. *See* 42 U.S.C. 1983 (recognizing a right to sue a person acting "under color of" state-level or local law for damages caused by deprivation of rights created by the U.S. Constitution or federal statutes).

[179] *Listecki*,780 F.3d at 737.

[180] *Id.* at 738. In *Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 937 (1982), the Court held that conduct is under color of law when the conduct is the "exercise of some right or privilege created by the [s]tate…or by a person for whom the state is responsible," and when the actor "may fairly be said to be a state actor."

[181] Appellee's Corrected Brief 17 in BANKRUPTCY ARCHIVE, *supra* note 9. *See also Listecki*, 780 F.3d at 782.

[182] Appellee's Corrected Brief 23 in BANKRUPTCY ARCHIVE, *supra* note 9 (citing *Young II,* 82 F.3d at 1420).

The creditors' committee argued that it was representing the private, non-governmental interests of sexual abuse claimants and therefore was not the "government." [183]

The Seventh Circuit rejected both arguments and held in favor of the committee.[184] It held that an official creditors' committee is not a government actor even though the U.S. Trustee's office appoints it and monitors its activities as part of the Trustee's responsibility to supervise a bankruptcy case.[185] Rather, the committee was "a combination of private decisions, United States Trustee appointment, and court supervision, with private actions providing the qualifying criteria for appointment."[186] The court drew an analogy between the role of a committee in a bankruptcy case and a public defender in a criminal case.[187] "Although some of [the committee's] activities are subject to governmental and court supervision, its core function is to act on behalf of, and advance the undivided interest of, its clients, namely the private creditors."[188]

The court similarly dismissed the archbishop's assertion that the committee's derivative standing to assert the rights of the bankruptcy trustee made it a governmental actor for RFRA purposes without addressing the merits of his argument. Because the archbishop had *agreed* to derivative standing for the committee to resolve his conflict as both agent for the debtor/transferor and trustee of the Cemetery Trust/transferee, the committee's exercise of avoiding powers by derivative standing was the result of "private ordering" not exercise of governmental powers.[189]

2. Compelling Governmental Interest.

Before the appeal to the Seventh Circuit, the district court had reached the compelling governmental interest issue because unlike the Seventh Circuit, the district court had held that the committee was the government for purposes of RFRA.[190] Because RFRA applied to the committee's action, the district court considered whether the committee's exercise of fraudulent transfer avoiding powers would substantially burden the archbishop's exercise of religion. It

[183] *Listecki*, 780 F.3d at 737-38..

[184] *Id.* at 738.

[185] *Id. See* 28 U.S.C. § 586(a)(3)(E).

[186] *Listecki,* 780 F.3d at 738. The court noted that once appointed, a committee "takes on a life of its own" independent of the government. It can retain counsel and obtain compensation from the estate, not the government, although the "Trustee can weigh in, and the court has input" on the attorney client relationship and fees. *Id.*

[187] *Id.* at 740-41 (citing Polk County v. Dodson, 454 U.S. 312, 318-19 (1981)).

[188] *Id.* at 741.

[189] *Id.* at 739. See criticism of this conclusion at text accompanying notes 261-265.

[190] *In re* Archdiocese of Milwaukee, 496 B.R. 905, 917 (E.D. Wis. 2012) (". . . [T]he pursuit of claims on behalf of a bankruptcy estate is a traditional public function.").

concluded that it would and that the government lacked a compelling interest that could justify such a burden.[191]

Recall that years earlier, the bankruptcy court in the Portland case also considered the debtor's argument that RFRA protected it from exercise (derivatively by the committee) of the trustee's power to avoid parishes unrecorded interests in real property under section 544(b)(3). Without addressing the contention that the committee exercising these powers would not be the "government" for RFRA purposes because the parties did not raise it, the court concluded, as did the district court in the Cemetery Trust litigation, that the burden on the debtor would be substantial and the government's interest in enforcement of section 544(a)(3) was not compelling.[192]

As explained above, when the Cemetery Trust litigation reached the Seventh Circuit, it held that because the committee was not the "government," RFRA did not apply. Nonetheless, it reached the issue of whether the government's interest was compelling as part of its analysis of whether the First Amendment protected the archbishop. For purposes of First Amendment protection, and notwithstanding *Employment Division v. Smith*, Seventh Circuit precedent required the court to consider whether application of a neutral law of general application would "substantially burden" free exercise of religion, and if so whether a compelling government interest justified that burden.[193] The court held that even assuming avoidance of the Cemetery Trust transfer would substantially burden the archbishop's exercise of religion, bankruptcy law furthers a compelling governmental interest sufficient to overcome even a substantial burden on the exercise of religion.[194]

The committee had asserted that the compelling governmental interest in enforcement of the fraudulent transfer avoiding power was "protection of creditors."[195] The Seventh Circuit adopted this assertion enthusiastically. "[T]he importance of protecting the interests of creditors is readily apparent."[196] As support for its conclusion, the court offered an assortment of anecdotes about the political and economic significance of bankruptcy law. For example, it cited cases that noted the history of federal bankruptcy law, none of which addressed the federal government's interest in enforcement of the bankruptcy code in general or the trustee's fraudulent transfer avoiding powers in particular.[197] The court undermined its conclusion that the government's

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[191] *Id.* at 921-22.

[192] *In re* Catholic Bishop of Spokane, 329 B.R. at 325. See discussion at text accompanying notes 154-62.

[193] *Listecki*, 780 F.3d at 745 (citing Vision Church v. Vill. of Long Grove, 468 F.3d 975, 996 (7th Cir. 2006).

[194] *Id.* at 745-46.

[195] *Id.* at 745.

[196] *Id.* at 747.

[197] *Id.* at 745-46. *See also* Central Virginia Comm. Coll. v. Katz, 546 U.S. 356, 365-69 (2006) (discussing the history of U.S. bankruptcy laws and support for inclusion of the bankruptcy clause in the constitution to permit the federal government to provide a uniform law for insolvency and discharge); BFP v. Resolution Trust Corp. 511 U.S. 531, 540-41 (history of fraudulent transfer laws); Katz, 546 U.S. at 372 (avoidance of preferential transfers has long been a "core aspect" of bankruptcy law); Cohen v. DeLa Cruz, 523 U.S. 213, 221 (1998) (the Bankruptcy Act prohibited discharge of claims based on fraud); Beiger v. IRS, 496 U.S. 53, 58 (1990) (avoidance powers "further

compelling interest in the bankruptcy code is protection of creditors by citing *U.S. v. Whiting Pools*[198] in which the Court noted that reorganization in bankruptcy furthers a variety of governmental goals other than maximizing return to creditors, such as preservation of the going-concern value of the debtor, jobs for its employees, and a return on investment for shareholders.[199] It cited to *United States v. Lee*,[200] in which the Court held that the government's interest in enforcement of social security taxation law is compelling. It noted that the social security system "aids those who have reached a certain age or are disabled," and the bankruptcy code "aids those who have reached a certain financial condition and who need assistance preying or recovering a debt."[201] The court's analogy between the bankruptcy code and the social security system would appear to support the conclusion that the government's compelling interest in the bankruptcy code is to offer relief to *debtors* not creditors.

As to whether the government's interest in enforcement of the bankruptcy code is compelling, the Seventh Circuit clearly expressed disagreement with the Eighth Circuit's contrary holding in *In re Young.*[202] Before *In re Young*, courts were divided as to whether the bankruptcy code presented a compelling governmental interest that could justify a substantial burden imposed on a debtor's free exercise of religion.[203] In *In re Young*, a chapter 7 bankruptcy trustee for an individual debtor brought a fraudulent transfer action against a church transferee for tithes the debtor had made to his church in the year before he filed for bankruptcy.[204] The church transferee asserted that RFRA protected it from avoidance.[205] The Eighth Circuit held for the church. RFRA protected the church from application of the trustee's avoiding powers because exercise of the trustee's power would substantially impair exercise of religion, and the trustee had not established that avoidance of the tithes furthered a compelling government interest.[206] The Eighth Circuit

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the 'central policy' of "[e]quality of distribution among creditors"); *In re* River West Plaza-Chicago, LLC, 664 F.3d 668, 671 (7th Cir. 2011) (a "central purpose" of bankruptcy law is to "maximize creditor recovery").

[198] 462 U.S. 198, 201-03 (1983).

[199] *Listecki*, 780 F3d. at 746-47 (Section 541 has two purposes, to protect creditors and to permit the debtor to "carry on and rebuild….") (citing as indirectly relevant *Andrews v. Riggs Nat'l Bank,* 80 F.3d 906, 909 (4th Cir. 1996)).

[200] 455 U.S. 252, 258-59 (1982).

[201] *Listecki*, 780 F.3d at 746.

[202] United States v. Crystal Evangelical Free Church (*In re* Young), 82 F.3d 1407, 1420 (8th Cir. 1996) (Young II), *vacated sub nom.* Christians v. Crystal Evangelical Free Church, 521 U.S. 1114 (1997).

[203] *See In re* Newman, 183 B.R. 239, 252 (Bankr. D. Kan. 1995) (holding that the government's interest in avoiding tithes to the debtor's church as fraudulent transfers was compelling); *In re* Navarro, 83 B.R. 348, 353 (Bankr. E.D. Pa. 1988) (holding that protection of legitimate interests of creditors is a compelling governmental interest.); *but see, In re* Tessier, 190 B.R. 396 (holding that exercise of avoiding powers to expand the estate for creditors is not a compelling interest).

[204] *In re Young*, 82 F.3d at 1420. The trustee argued that the tithes were transfers made "for less than reasonably equivalent value" while the debtor was insolvent, and thus avoidable under section 548 as constructively fraudulent.

[205] *Id.* at 1411-12.

[206] *Id.* at 1420.

stated its view on this issue clearly. "[W]e cannot see how the recognition of what is in effect a free exercise exception to the avoidance of fraudulent transfers can undermine the integrity of the bankruptcy system as a whole; its effect will necessarily be limited to the debtor's creditors, who will as a result have fewer assets available . . . ."[207]

The Seventh Circuit dismissed the Eighth Circuit's analysis in *In re Young* as "cursory" and criticized it for failing to consider "the importance of the [Bankruptcy] Code in Supreme Court precedent, our nation's history, or the effect it has on debtors and creditors."[208] It adopted the conclusion of the dissenting opinion in *In re Young*, that enforcement of the Bankruptcy Code as a whole "furthers the compelling governmental interest in . . . protecting the interests of creditors by maximizing the debtor's estate."[209] Moreover, it held that the Bankruptcy Code is "narrowly tailored" to achieve that interest.[210]

In November 2015, after the committee's victory before the Seventh Circuit in the Cemetery Trust litigation, the parties reached a settlement and confirmed a consensual plan.[211] The plan provided for a $21 million fund to compensate sexual abuse claimants, more than 5 times more than the debtor had proposed in a plan it filed in February 2014.[212] The Cemetery Trust

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[207] *Id.* at 1420. Congress amended the Bankruptcy Code expressly to exclude certain pre-petition charitable and religious contributions by debtors to religious organization from fraudulent transfer avoidance in the donor's bankruptcy case. 11 U.S.C. § 548(a)(2) (1997). In 2005, Congress amended the bankruptcy code again to protect debtors who make charitable or religious contributions. The 2005 amendments preclude a court from considering a debtor's qualifying charitable contributions for purposes of calculating his "means" to pay creditors, 11 U.S.C. § 707(b)(1). The amendments treat qualifying charitable contributions as "reasonably necessary expenses" for purposes of determining the "disposable income" available to pay creditors. 11 U.S.C. § 1325(b)(2), (3).

[208] Listecki v. Off. Comm. of Unsecured Creditors, 780 F.3d 731, 747 (7th Cir. 2015). The court described as "without explanation" the 8th Circuit's conclusion that the government's interest in creditor protection in the bankruptcy code is distinguishable from the government's interest in national security or public safety and therefore not compelling. *Id.*.

[209] *Id.* at 746 (quoting *Young II*, 82 F.3d at 1422-23 (Bogue, J. dissenting)).

[210] *Id.* The court must look "beyond broadly formulated interests justifying the general applicability of government mandates and scrutinize[] the asserted harm of granting specific exemptions to particular religious claimants." (quoting Gonzales v. O Centro Espirita Beneficente Uniao do Vegetal, 546 U.S. 418, 431 (2006). *Id.*

[211] *In re* Archdiocese of Milwaukee, Second Amended Chapter 11 Plan of Reorganization in BANKRUPTCY ARCHIVES, *supra* note 9.

[212] *Id. See also* Annysa Johnson, *Archdiocese of Milwaukee settles sexual abuse claims for $21 million*, J. SENTINEL, August 4, 2015, http://archive.jsonline.com/news/religion/archdiocese-settles-sexual-abuse-claims-for-21-million-b99542352z1-320651132.html/.

agreed to loan the debtor $3 million, and to contribute $8 million to the claims settlement fund.[213] Insurers provided $11 million. Total professional fees paid by the estate were $19.8 million.[214]

The bankruptcy court confirmed the consensual plan after concluding that the debtor's plan was in creditors' best interests compared to liquidation.[215] Notwithstanding a favorable outcome for sexual abuse claimants before the Seventh Circuit, the odds that the committee could avoid the $55 million Cemetery Trust transfer under section 544(b) and Wisconsin law were far from certain. Moreover, a hypothetical chapter 7 liquidation would occur after the liquidating trustee disavowed the settlements the debtor in possession had reached with insurers, and after litigating the debtor's objections on the merits of individual sexual abuse claims. Under these hypothetical conditions, the court concluded that the maximum recovery for unsecured creditors in a hypothetical chapter 7 would be less than the payout they would receive under the plan.[216]

V. Competing Plans and Cram Down.

The St. Paul and Minneapolis case was the first to involve a competing creditors' plan and cram down confirmation under section 1129. All previous cases, except San Diego (dismissed after settlement), had concluded with confirmation of a consensual plan.[217] While the substantive consolidation litigation was pending in the St. Paul and Minneapolis case, the archdiocese filed its first plan of reorganization in May 2016. The parties failed to reach a settlement, and after the expiration of the debtor's exclusive period in August 2016, the committee of sexual abuse claimants filed a competing plan.[218]

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[213] *In re* Archdiocese of Milwaukee, Second Amended Chapter 11 Plan of Reorganization 24 in BANKRUPTCY ARCHIVES, *supra* note 9. *See* Rich Kirchen, *Judge OK's final Archdiocese of Milwaukee Chapter 11 plan with $21M to abuse victims*, MILWAUKEE BUS. J., Nov. 9 2015, http://www.bizjournals.com/milwaukee/news/2015/11/09/judge-oks-final-archdiocese-of-milwaukeechapter-11.html.

[214] *In re* Archdiocese of Milwaukee, Second Amended Chapter 11 Plan of Reorganization in BANKRUPTCY ARCHIVES, *supra* note 9.

[215] *In re* Archdiocese of Milwaukee, Fourth Amended Disclosure Statement in BANKRUPTCY ARCHIVES, *supra* note 9. The disclosure statement explained that the plan satisfied the best interest test as to sexual abuse claimants because in a hypothetical chapter 7 liquidation, unsecured creditors would receive no distribution unless the trustee achieved a significant recovery from the Cemetery Trust in fraudulent transfer avoidance litigation. *Id.* at 89-96.

[216] *In re* Archdiocese of Milwaukee, Second Amended Chapter 11 Plan of Reorganization at 89 in BANKRUPTCY ARCHIVES, *supra* note 9.

[217] *See* Marie T. Reilly, *Appendix B: Outcomes of Cases*, PENN STATE LAW ELIBRARY (2018), https://elibrary.law.psu.edu/bankruptcy/37/ [hereinafter *Appendix B*].

[218] *In re* The Archdiocese of St. Paul and Minneapolis, Chapter 11 Plan of Reorganization of the Official Committee of Unsecured Creditors, in BANKRUPTCY ARCHIVES, *supra* note 9. The debtor in a chapter 11 case has the exclusive right to file a plan of reorganization during the first 120 days after commencement of the case. 11 U.S.C. § 1121(b). If the debtor files a plan during this exclusive period, the debtor has until 180 days after commencement of the case to obtain creditor consent. 11 U.S. C. § 1121(c)(3). The court can extend the exclusive filing period (120 days) or the acceptance period (180 days) for cause. 11 U.S.C. § 1121(d)(1). In 2005, Congress capped the bankruptcy court's discretion to grant extensions beyond 18 months or the acceptance period beyond 20 months. 11 U.S.C. §

The debtor had settled with 11 of 13 of its insurers, subject to court approval of the plan.[219] Its plan provided for a $500,000 counseling fund for sexual abuse claimants and creation of an independent trust to administer and pay sexual abuse claims.[220] The trust included about $100 million to be contributed by diocesan insurers and $30 million by parishes, parish insurers and the diocese.[221] It provided for discharge of all tort claims against the Archdiocese and a channeling injunction that channeled any pre-petition claims against the Archdiocese, the parishes, and settling insurers, exclusively against the trust.[222]

The committee's competing plan similarly created a trust for payment of sexual abuse claims, but the archdiocese was required to contribute at least $80 million, the amount the committee estimated as the liquidation value of the debtor's assets.[223] The committee would control the trust which would succeed to the debtor in possession's transfer avoidance actions against parishes and its rights against its insurers, nullifying debtor's conditional settlements, and queueing up years of litigation.[224] It did not provide for immediate discharge of the debtor or the parishes or for a channeling injunction.[225]

Ninety-four percent of the members of the class of sexual abuse claimants voted to reject the debtor's plan.[226] The committee objected to confirmation under section 1129(b) on grounds that the bankruptcy court lacked jurisdiction to impose a channeling injunction protecting parishes (non-debtors) over the objection of the class of sexual abuse creditors whose claims would be

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1121(d)(2)(A), (B). After the amendment, competing plans, although still unusual, are more common. *E.g.*, *In re* Tribune Co., 464 B.R. 208 (Bankr. D. Del. 2011) (four plans were filed); *In re* Lehman Brothers Holdings, Inc., No. 08-13555 (Bankr. S.D.N.Y. 2012)(the debtors filed an unfinished plan on the last day of the 18-month maximum exclusive period and creditors filed two additional plans).

219 *In re* The Archdiocese of St. Paul and Minneapolis, Debtor's First Amended Disclosure Statement at 3-4 in BANKRUPTCY ARCHIVES, *supra* note 9. Under the plan, the debtor contributed all of its rights against insurers to the trust. *Id*. at 3. The committee conceded that six of the 11 settlements were reasonable and objected to the remaining 5. *Id.* at 4.

220 *Id.* at 2.

221 *Id*. at 2-3.

222 *Id.* at 90-92. *See also In re* The Archdiocese of St. Paul and Minneapolis, Debtor's First Amended Plan at 8-9 in BANKRUPTCY ARCHIVES, *supra* note 9.

223 *In re* The Archdiocese of St. Paul and Minneapolis, Committee's Disclosure Statement at 57 in BANKRUPTCY ARCHIVES, *supra* note 9.

224 Creditors reportedly valued the debtor's rights against insurers at over $1 billion. *Id.* at 23.

225 *Id.* at 33, 35.

226 *Id*. at 6 (noting that if the court were to confirm the debtor's plan including the channeling injunction protecting non-debtors it would be "the first bankruptcy court in the country to do anything of the kind."). The committee also argued that absent consent of the parties, the bankruptcy court lacked jurisdiction in effect to enter a final judgment on sexual abuse claimants' state law claims against non-debtors because such matters were not "core proceedings arising under title 11 or arising in a case under title 11." *In re* The Archdiocese of St. Paul and Minneapolis, Committee's Objection to Debtor's Plan at 11 in BANKRUPTCY ARCHIVES, *supra* note 9. *See* 28 U.S.C. § 157(b)(1).

affected.[227] The debtor argued in favor of confirmation of its plan, asserting that without a channeling injunction including claims against parishes and insurers, no reorganization would be possible.[228]

Both sides recognized a split in the circuits on the question of when a bankruptcy court can impose a channeling injunction without the consent of affected creditors.[229] The bankruptcy held that it had jurisdiction to order a channeling injunction to protect non-debtors.[230] However, the debtor's plan could not be confirmed absent "significant consent" by the creditors whose claims would be subject to the channeling injunction.[231] Because more than 90% of the members of the class of sexual abuse claimants voted to reject the debtor's plan, the requisite "significant consent" was lacking.[232]

The bankruptcy court held that the committee's plan was "replete with uncertainties and contingencies that will frustrate the debtor's effort to reorganize" and created a long list of issues for litigation and court resolution as part of the confirmation process.[233] Perhaps the most daunting open issue was a determination of the assets to be included in property of the estate and the value of those assets. The bankruptcy court dubbed the committee's plan a "plan of future litigation"

[227] In re The Archdiocese of St. Paul and Minneapolis, Committee's Objection to Debtor's Plan at 4 in BANKRUPTCY ARCHIVES, *supra* note 9.

[228] In re The Archdiocese of St. Paul and Minneapolis, Debtor's Omnibus Response to Objections at 5 in BANKRUPTCY ARCHIVES, *supra* note 9 ("Put simply, a channeling injunction represents the best and only vehicle for a fair and just global resolution of claims in this case."). *See id.* at 17 (citing *In re* 710 Long Ridge Rd. Operating Co., II, LLC, No. 13-13653 (DHS), 2014 WL 886433, *15-16 (Bankr. D. N.J. Mar. 5, 2014)) (because reorganization would otherwise be impossible, the court approved injunctions to protect the debtor's key employees notwithstanding claimants' rejection of the plan).

[229] *See* In re The Archdiocese of St. Paul and Minneapolis, Order Denying Confirmation of Debtor's Plan at 4-13, in BANKRUPTCY ARCHIVES, *supra* note 9 (describing state of the law among the circuits). The parties agreed that the applicable standard for an injunction protecting non-debtors was set out by the bankruptcy court in *In re Master Mortgage Investment Fund, Inc*. 168 B.R. 930 (Bankr. W.D. Mo. 1994). The court should consider five factors: 1) an identity of interest between the debtor and the third party, e.g. indemnity, such that a suit against the non-debtor is, in essence, a suit against the debtor or implicating estate assets; 2) the non-debtor has contributed "substantial assets" to the reorganization; 3) the injunction is essential to reorganization; 4) a "substantial majority" of the impacted class of creditors agrees to such injunction, 5) the plan provides a mechanism for the payment of "all, or substantially all," of the claims of the impacted class. *Id.*. at 935.

[230] *In re* The Archdiocese of St. Paul and Minneapolis, Order Denying Confirmation of Debtor's Plan at 13-15, in BANKRUPTCY ARCHIVES, *supra* note 9.

[231] *Id.* at 16.

[232] *Id.*

[233] *In re* The Archdiocese of St. Paul and Minneapolis, Order Denying Confirmation of the Committee of Unsecured Creditors' Plan, in BANKRUPTCY ARCHIVES, *supra* note 9.

and a "boon for lawyers" with no chance of achieving timely payment to creditors and successful reorganization of the debtor.[234]

In a joint memorandum denying confirmation, the bankruptcy judge expressed his frustration with both parties who failed to agree on a plan after three years.[235] Resolution of the case, the judge wrote, will require an agreement. The parties and their lawyers "must put aside their desire to win and decide to put together a resolution that is fair to all the people involved."[236] In June 2018, the parties reached agreement on a consensual plan that will provide $210 million for 450 sexual abuse claimants.[237]

VI. The Legacy of the Catholic Bankruptcy Cases.

A. Organization under Canon Law.

In some respects, the Catholic bankruptcies are not unusual among bankruptcy cases of non-profit organizations.[238] Bad management contributed to their financial crises. The absence of profit-seeking stockholders or any market analog to evaluate the effectiveness of managerial decisions relative to the competition increases risk of loss from incompetence or fraud.[239] Religious non-profit organizations are no different.[240]

The Catholic bankruptcies have been different from other non-profit religious organization bankruptcy cases because of the hierarchical structure of Catholic organizations within the Church under canon law. First, relative to congregational religious organizations, canon law assigns unilateral supervisory authority in the bishop over priests assigned to parishes. But, the bishop is not accountable to parishioners in the parishes where the priests serves. Nor is the bishop privy to day to day parish operations. The hierarchy canon law prescribes separates control decisions from

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[234] *Id*. at 25.

[235] *In re* The Archdiocese of St. Paul and Minneapolis, Joint Memorandum Denying Confirmation at 1 in BANKRUPTCY ARCHIVES, *supra* note 9.

[236] *Id*. at 3. The court noted that sexual abuse claimants' lawyers may be a source of plan funding. Assuming 33% contingency fees, attorneys' fees for sexual abuse claimants' lawyers would range between $30 and $40 million dollars, a "pretty hefty sum for completing proofs of claim." *Id.*

[237] See *Appendix B*, *supra* note 217.

[238] *See* Pamela Foohey, *When Churches Reorganize,* 88 AM. BANRK. L. J. 277, 278 (2014) (noting that about 90 religious organizations file petitions under chapter 11 each year).

[239] The USCCB has recognized this risk. *See Diocesan Internal Controls: A Framework, Committee on Budget and Finance* http://www.usccb.org/about/financial-reporting/diocesan-internal-controls-framework.cfm. (providing guidelines to alert bishops to weaknesses in internal controls, risk of embezzlement and fraudulent financial reporting).

[240] J.B. Duncan, D.L. Flesher and M.H. Stocks, *"Internal Control Systems in U.S. Churches: An Examination of the Effects of Church Size and Denomination on Systems of Internal Control*, 12 Accounting, Auditing, and Accountability Journal, 142, 142 (1999).

consequences. This separation increases the risk of mismanagement, cover up, and resulting tort exposure for Catholic organizations relative to that of non-hierarchical religious organizations.

Second, centralized authority in the bishop of formal title to parish property, or centralized supervisory authority in the bishop over separately incorporated parishes and indirectly over their decentralized property interests, likely increased the expected value of sexual abuse claims against Catholic dioceses relative to similar claims against non-hierarchical religious organizations. Professor Douglas Laycock noted the impact of the Catholic hierarchical organizational structure on the magnitude of its tort liability. "A scandal like [the clergy sexual abuse scandal] becomes utterly destructive of Catholicism in the United States and not of Protestantism in the United States without regard to differences in the culpability of the conduct."[241]

The hierarchical structure of Catholic organizations under canon law created a paradox in their bankruptcy cases because it departs from the ordinary democratic corporate governance structure that underlies efficient loss allocation under organizational law and bankruptcy law. The Catholic bankruptcy cases opened to public view the fact that Catholic parishes and the individual Catholics who support them financially are not analogous to shareholders of the diocese, or even ordinary autonomous donors to a non-hierarchical religious organization. Catholics do not control the management of their parishes or their diocese, other than as advisors to the pastor.[242] They can exercise the power of the purse by withholding contributions. However, use of this tool to discipline ineffective management is difficult to square with canon law that requires Catholics to support the Church.[243] Catholics can protest bad management by leaving the Church and there is evidence that Catholics have done so in response to the sex abuse scandal.[244] But abrogation of faith as a monitoring tool is costly relative to a shareholder's ability to sell shares in a mismanaged firm.

B. Contribution by Parishes and Parishioners.

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[241] Douglas Laycock *et al*., *Roundtable Discussion: Religious Organizations Filing for Bankruptcy*, 13 AM. BANKR. L. REV.25, 40 (2005), https://abi-org-corp.s3.amazonaws.com/law-review-articles/roundtable.pdf. Laycock asserted that the choice of religious structure "is a constitutionally protected choice." *Id. at* 41.

[242] 1983 CODE C.515, § 1, 537 (requiring each parish to have a parish council "regulated by universal law as well as by norms issued by the diocesan bishop" which serves to "aid the pastor in the administration of parish goods . . . .").

[243] 1983 CODE, C.22 (requiring the faithful to "assist with the needs of the Church so that the Church has what is necessary for divine worship, for the works of the apostolate and of charity, and for the decent support of ministers."). *E.g*., Elizabeth Fernandez, *Catholic group strives to mend church; Voice of Faithful wants active laity to address clergy scandal*, S.F. CHRON., February 3, 2003, http://www.sfgate.com/bayarea/article/Catholic-group-strives-to-mend-church-Voice-of-2636824.php (expressing frustration of the role of the laity as "pray, pay and obey").

[244] *See* Daniel Hungerman, *Substitution and Stigma: Evidence on Religious Competition form the Catholic Sex-Abuse Scandal*, AM. ECON. J.: ECON. POL'Y 5(3) (2013), (the scandal led to the departure of 2 million Catholics, generating an estimated 3 billion dollars in donations to other religious groups); Angela K. Dills & Rey Hernandez-Julian, *Negative Publicity and Catholic Schools*,50 ECONOMIC INQUIRY 143 (2012) (negative publicity from the sex abuse scandal explains about 5% of the decline in the number of Catholic schools in the last twenty years).

Sexual abuse claimants organized as creditors' committees were no doubt effective in using the tools available to creditors in bankruptcy court as leverage in plan negotiations outside of the courtroom. Although sexual abuse creditors achieved some successes on property of the estate issues in the Spokane and Portland cases, no bankruptcy court has entered an order to avoid a parish's interest in property, to avoid a property transfer to a parish, or to disregard the corporate distinction between a parish and a diocese to which the entities would otherwise be entitled to under state corporation law.

No doubt all parties in the Catholic bankruptcy cases understood that a bankruptcy court order approving a sale to conduct a trustee's sale of a Catholic parish church or school would likely set off explosion of self-immolating litigation. Apart from the daunting task of appraising and finding a market for specialized religious use property given zoning and other limitations on such property for non-religious use, the bankruptcy code requires that a non-profit debtor comply with any state law restrictions on property transfers, both for transfers under section 363(b)[245] and as a condition to confirmation of a plan of reorganization.[246] It is not clear how a bankruptcy court would apply state transfer regulations to a liquidating sale of parish property.

Nor is it clear how courts would rule on a religious liberty defense raised by a Catholic bishop in opposition to a bankruptcy court-ordered sale of a parish church or school. The bankruptcy cases so far have explored only the theoretical surface of RFRA or First Amendment protection from transfer avoidance litigation. Apart from the concern expressed by the bankruptcy court in Portland over a substantial burden on free exercise of religion upon loss of *all* facilities for worship and education, the bankruptcy cases have left unresolved bankruptcy and religious liberty issues triggered by a court ordered liquidation of parish property used for worship or religious education.

The focus of litigation in the Catholic bankruptcy cases on parish property as property of a diocesan debtor's estate should not obscure the importance of future contributions of Catholic faithful as a plan-funding source. Canon law obligates Catholics to support the Church.[247] It gives

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[245] 11 U.S.C. § 363(d) (permitting a trustee to "use, sell, or lease property out of the ordinary course" only in accordance with applicable non-bankruptcy law that governs the transfer of property by a corporation or trust that is [a non-profit organization]"). *See also* 11 U.S.C. § 541(f) (property held by a federal tax exempt debtor may be transferred to a non-tax exempt debtor only by complying with all "conditions that would apply" if the debtor had not filed for bankruptcy); § 363(l) (For all debtors, for profit or non-profit, all transfers of property of the estate under section 363(b) must comply with contract terms or applicable law with respect to the property which restrict or condition a transfer from the estate to a third party, except for terms that are triggered by the bankruptcy or financial condition of the debtor and which forfeit, modify or terminate the debtor's interest in the property).

[246] 11 U.S.C. § 1129(a)(16); *See generally* Alan N. Resnick & Henry J. Sommers eds., 3 COLLIER ON BANKR. para. 363.04 (16th 2018). New York law, for example, prohibits transfer of substantially all the assets of a non-profit organization unless, among other requirements, the terms of the transfer are "fair and reasonable to the corporation" and "the purposes of the corporation or the interests of the members will be promoted by the transaction." N.Y. Not-for-Profit Corp. Law § 511 (d).

[246] *See In re* HHH Choices Health Plan, LLC, 554 B.R. 697 (Bankr. S.D. N.Y. 2016) (considering all the circumstances and approving proposed sale of substantially all the assets of a non-profit debtor under § 363(d)(1)).

[247] *See* 1983 CODE C.222, § 1 (faithful are "obliged to assist with the needs of the Church so that the Church has what is necessary for divine worship, for the works of the apostolate and of charity, and for the decent support of

the bishop authority to tax parishes for ordinary support of the diocese, but imposes no obligation on the bishop to do so.[248] Assessment by dioceses of parishes is common, however, it appears that parishes comply voluntarily.[249] Although Catholic bishops no doubt expect Catholic faithful to provide financial support for the diocese through parish assessments, this expectation of support is not the diocese's *property* under secular law. Nor can an expectation of donative support serve as a basis for funding a feasible, confirmable plan.[250]

The question of whether a bankruptcy court could *compel* parishes or individual members of the Catholic faithful to fund a plan arose only in the St. Paul and Minneapolis case in the confirmation battle over the two competing plans. The committee's plan provided that the diocese

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ministers."); C.1262 ("The faithful are to give support to the Church by responding to appeals…"). The faithful are "free to give temporal goods for the benefit of the Church." C.1261, § 1. Commentators explain these provisions as directed at secular law that limits the freedom of the Church to receive donations or of the faithful to donate. NEW COMMENTARY ON CANON LAW, *supra* note 20, at 1461. (C.1261, § 1 is understood to be "directed at those, within or outside the Church, who would seek to deny or discourage such an exercise of religious liberty"); C.1260 (The Church "has an innate right to require from the Christian faithful those things which are necessary for the purposes proper to it."); NEW COMMENTARY ON CANON LAW, *supra* note 20, at 1461 (asserting bishops' right to financial support of the faithful against interference by civil authority).

248 1983 CODE C.1263. To impose a tax, the bishop must first consult with the diocesan finance council and presbyteral council. *Id.* The bishop also has authority to order parishes to take up a special collection "for specific parochial, diocesan, national, or universal projects." *Id.* at C.1266. *See* NEW COMMENTARY ON CANON LAW, *supra* note 20, at 1465 ("A bishop who chooses not to use the coercive instrument of taxation in order to meet the needs of the diocese, but who prefers to rely on free-will offerings in response to fund–raising appeals is free to do so."). *See generally* Donald J. Fruge, *Diocesan Taxation of Parishes in the United States, Sign of Communio or Source of Tension?*, 60 CLSA PROCEEDINGS 69 (1998); Robert L. Kealy, *Taxation, Assessments and Extraordinary Collections*, in CHURCH FINANCE HANDBOOK, ed. Kevin E McKenna et al. 79 (CLSA 1999). The bishop may impose an extraordinary tax on parishes and on individual parishioners for needs out of the ordinary course "in case of grave necessity." 1983 CODE, C.1263. *See generally* Matthew J. Barrett, *The Theological Case for Progressive Taxation as Applied to Diocesan Taxes or Assessments under Canon Law in the United States* 312, (2003) https://scholarship.law.nd.edu/cgi/viewcontent.cgi?referer=https://www.bing.com/&httpsredir=1&article=1827&context=law_faculty_scholarship (noting that a few bishops have used this authority to tax parishioners to raise revenue to fund an employee pension plan or for housing for retired priests); Gerard Sheehy & Francis G. Morrisey, THE CANON LAW LETTER AND SPIRIT 713 (1995) (noting that some bishops have imposed extraordinary taxes to pay diocesan legal fees in sexual abuse litigation).

249 *E.g.*, Diocese of Cleveland, *The Diocesan Assessment, The Process and Use of Parish Assessments*, available at file:///C:/Users/mtr12/AppData/Local/Packages/Microsoft.MicrosoftEdge_8wekyb3d8bbwe/TempState/Downloads/ParishAssessments2012%20(1).pdf
(noting "[e]ach parish is expected to remit their assessment to the Diocese in a timely fashion over the course of the fiscal year."); Diocese of Sault St. Marie, *Policy No. 2 Diocesan Administration Expense*, http://www.dioceseofsaultstemarie.org/documents/2016/10/031%20-%20031%20-%20Policy%2002%20-%20Diocesan%20Administration%20Expense%20DAE.pdf (noting that the assessment "is payable at the end of each month"); Diocese of Phoenix, *Bishop's Assessment Policy*, http://dphx.org/wp-content/uploads/2016/01/financePolicies_BishopsAssessmentPolicy.pdf (imposing a penalty for late payments).

250 11 U.S.C. § 1129(a)(11). *E.g.*, *In re* Roman Catholic Archbishop of Portland, 2007 Bankr. LEXIS 1180 , * 24 (Bankr. D. Or. 2007) ("Feasibility has been defined as whether the things which are to be done after confirmation can be done as a practical matter under the facts," (quoting *In re* Jorgensen, 66 B. R. 104, 108 (9th Cir. BAP 1986)). A plan funded primarily by future donations raises a concern about its feasibility. *See, E.g.*, *In re* Save Our Springs Alliance, Inc., 632 F.3d 168, 172-73 (5th Cir. 2011) (plan funded exclusively by donations was not feasible); *In re* Indian Nat'l Finals Rodeo, 453 B.R. 387, 402 (Bankr. D. Mont. 2011).

would transfer to the trust established to pay sexual abuse claimants the diocese's rights to collect past-due assessments owed to the diocese by the parishes.[251] The parishes objected to confirmation of the committee's plan arguing, among other things, that the archbishop's power to assess parishes is not a secular legal right, not property of the estate, and not an appropriate source of funding for a feasible plan.[252]

The bankruptcy court agreed with the debtor and insurers. It concluded that the bishop's authority to assess parishes is not a legal right and therefore is not property of the debtor's estate under section 541.[253] However, in a memorandum accompanying the order dismissing both plans and relegating the parties to resume negotiation, the court admonished parishes that they "must consider the possibility of contributing something" to compensate sexual abuse claimants as part of a consensual plan. "The fact that the abuse may not be the legal responsibility of the parishes… is hardly the point, any more than their work to help the hungry and homeless are motivated by legal responsibilities."[254]

C. Religious Liberty for Debtors.

Courts that have considered the Catholic debtors' religious liberty defenses to application of bankruptcy law have overwhelmingly rejected them. A recurring judicial reaction to debtors' arguments was that having chosen bankruptcy, Catholic dioceses and institutes must leave their religious status and religious liberty at the courthouse door. In the Spokane case, the bankruptcy court observed, "Bankruptcy debtors who voluntarily choose to participate in that statutory scheme, even those of a religious nature, should not be able to 'pick and choose' among Code sections."[255] In the Portland case, the bankruptcy court suggested that a party whose religious expression would be substantially burdened by application of section 541 does not need to assert the First Amendment to protect itself. It can simply forego the benefits of a bankruptcy proceeding.[256] In the Cemetery Trust litigation in the Milwaukee case, the Seventh Circuit noted that the archdiocese knew of and voluntarily undertook the risks of filing for bankruptcy,

[251] *In re* The Archdiocese of St. Paul and Minneapolis, Disclosure Statement for Chapter 11 Plan of Reorganization of the Official Committee of Unsecured Creditors at 56 in BANKRUPTCY ARCHIVES, *supra* note 9. *See also In re* The Archdiocese of St. Paul and Minneapolis, Unsecured Creditors' Committee's Second Amended Plan of Reorganization at § 5.2(b) (archdiocese will fund the required Trust payment through "increases in Parish assessments, fundraising, loan financing, and or the sale of selected assets.") in BANKRUPTCY ARCHIVES, *supra* note 9.

[252] *In re* The Archdiocese of St. Paul and Minneapolis, Objection of the Official Committee of Parish Creditors to Confirmation of the Chapter 11 Plan of the Official Committee of Unsecured Creditors at 2 in BANKRUPTCY ARCHIVES, *supra* note 9.

[253] *In re* The Archdiocese of St. Paul and Minneapolis, Order Denying Confirmation of Committee's Plan at 18 in BANKRUPTCY ARCHIVES, *supra* note 9.

[254] *In re* The Archdiocese of St. Paul and Minneapolis Joint Memorandum Denying Confirmation at 3in BANKRUPTCY ARCHIVES, *supra* note 9.

[255] Comm. of Tort Litigants, v. Catholic Diocese of Spokane, 329 B.R. 304, 324, n.5 (Bankr. E. D. Wash. 2005).
[256] Tort Claimants Comm. v. Roman Catholic Archbishop, 335 B.R. 842, 853 n. 9 (Bankr. D Or. 2005) (if the First Amendment protected the debtor from application of the bankruptcy code, the proper remedy "might well be dismissal of the case.").

particularly, the risk of loss of control over property to creditors.[257] It went so far as to assert that archdiocese's choice to file for chapter 11 relief was evidence of the government's "significant interest" in enforcement of bankruptcy laws.[258]

The Seventh Circuit in *Listecki* made it clear that it was not deciding whether the transfer from the archdiocese to the Cemetery Trust was avoidable as a fraudulent transfer under bankruptcy law, because that issue was not before it.[259] In reaching its decision that the archbishop was not entitled to protection from the committee's action under either the First Amendment or RFRA, the Seventh Circuit based its decisions on fundamental misunderstandings of bankruptcy law.

Its conclusion that an official creditors' committee exercising the trustee's avoiding powers by derivative standing is not the "government" for purposes of RFRA protection seems wrong based on basic bankruptcy law. When the bankruptcy court grants a committee derivative standing to assert the bankruptcy trustee's statutory avoiding powers, whether after contested litigation, or by agreement of the debtor in possession, the role of the committee shifts from that of a fiduciary for private creditors to that of the trustee from whose statutory power over property of the estate its standing derives. The trustee's statutory powers to avoid certain property transfers for the benefit of the estate is adjunct to the district court's *in rem* jurisdiction over such property.[260] The bankruptcy court's statutory *in rem* jurisdiction over property of the estate is distinct from creditors' private interests in enforcement of state law property entitlements, thus any exercise of this jurisdiction by the trustee, or by a creditors' committee with derivative standingis governmental.

Courts have consistently held that the *Barton* doctrine protects bankruptcy trustees from suit in district court for actions taken in their official capacity.[261] The *Barton* doctrine generally prohibits suit against a court-appointed receiver in a district court without permission of the court who appointed him.[262] The Seventh Circuit did not consider its own precedent in *In re Linton*,[263] in which it held that the *Barton* doctrine applies to suits against a bankruptcy trustee. In that case,

[257] Listecki v. Official Comm. of Unsecured Creditors, 780 F.3d 731, 747 (7th Cir. 2015).

[258] *Id*.

[259] *Id*. at 736.

[260] 28 U.S.C. § 1334(e) ("The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction (1) of all the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate."); 11 U.S.C. § 541(a) (commencement of a case creates an estate . . . comprised of all of the following property, wherever located and by whomever held . . . ."),

[261] *E.g*., Blixseth v. Brown, 841 F.3d 1090, 1094 (9th Cir. 2016); Muratore v. Darr, 375 F.3d 140, 147 (1st Cir. 2004); Carter v. Rodgers, 220 F.3d 1249 (11th Cir. 2000); *In re* Linton, 136 F.3d 544, 546 (7th Cir. 1998); Lebovits v. Scheffel, 101 F.3d 272, 276 (2d Cir. 1996); Allard v. Weitzman, 991 F.2d 1236, 1240 (6th Cir. 1993).

[262] Barton v. Barbour, 104 U.S. 126, 127 (1881) (plaintiffs must obtain the permission of the bankruptcy court before suing certain officers acting in their official capacities).

[263] 136 F.3d 544 (7th Cir. 1998).

the court held that the trustee in bankruptcy is "a statutory successor to the equity receiver . . . working in effect for the court that appointed or approved him, administering property that has come under the court's control by virtue of the bankruptcy code."[264]

The impact of the Seventh Circuit's opinion in *Listecki* on the issue of the trustee's status as a "governmental actor" appears to be limited. The Third Circuit has subsequently held, without distinguishing *Listecki*, that a bankruptcy trustee acting in her official capacity as agent for the estate is a governmental actor. In *In re J & S Properties*,[265] the court considered whether a bankruptcy trustee was entitled to qualified immunity from liability under section 1983 for actions taken in her capacity as trustee to preserve property of the estate.[266] Applying the test for qualified immunity set forth *in Harlow v. Fitzgerald*,[267] the Third Circuit held that trustee was entitled to immunity. Noting that a trustee has a duty to protect property of the estate, account for it to the court and perform other adjudicatory and administrative functions, the court held that it was "clear that chapter 7 bankruptcy trustees… are government officials…."[268]

Notwithstanding its conclusion about the non-application of RFRA, the Seventh Circuit reached the issue of whether the government's interest in enforcement of bankruptcy law is compelling for First Amendment purposes. Its conclusion that the government's interest is compelling rests on an absurdly sweeping generalization about the purpose of bankruptcy law. The Bankruptcy Code does not serve a single governmental purpose for which its interest in enforcement without exception is always compelling. Rather, it endeavors to achieve a balance among a host of sometimes conflicting governmental goals including but by no means limited to maximizing payout to unsecured creditors. The trustee's power to avoid fraudulent transfers does not invalidate every wealth-depleting transfer that reduces creditors' expected payment. Rather, whether the trustee can avoid a transfer as fraudulent depends on a delicate balance between the interests of the transferor's creditors and the interests of the transferee.[269]

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[264] *Id.* at 545.

[265] 872 F.3d 138 (3d Cir. 2017).

[266] After a dispute with a tenant, the trustee changed the locks on a building which was the largest asset in the estate, ostensibly to preserve the asset from damage. The tenant sued the trustee for wrongful eviction and violation of its Fourth and Fourteenth Amendment rights under section 1983. *Id.* at 141-42.

[267] 457 U.S. 800, 818 (1982).

[268] *Harlow*, 872 F.3d at 143. *See also* Curry v. Castillo, 297 F.3d 940, 950-51 (9th Cir. 2002) (noting that the bankruptcy trustee performs "both adjudicatory and administrative functions" and is a congressionally created "hybrid official").

[269] In general, fraudulent transfer law takes into account the bona fides of the transferee, protecting the transferee from avoidance in circumstances when the transferee participated in the transfer for value and in good faith. E.g., 11 U.S.C. § 548(c) (a transferee of an avoidable fraudulent transfer who takes for value and in good faith has a lien on the transferred property to the extent of value he gave for the property); BFP v. Resolution Trust Corp., 511 U.S. 531 (1994) (a transferee who acquires property at a non-collusive, regularly conducted foreclosure sale gives "reasonably equivalent value" and is protected from fraudulent transfer avoidance under section 548(a)(1)(B)(i) even though the foreclosure sale price is below the fair market value for the property).

Because the Seventh Circuit determined that exercise of the trustee's avoiding powers was not action of the "government," it did not decide whether, *if RFRA applied*, the government's interest in enforcing the trustee's avoiding powers against the archbishop would be sufficiently compelling to justify a substantial burden on free exercise of religion. Under RFRA, courts must consider whether the government's interest is compelling with reference to the application of a specific law to the "specific person whose sincere exercise of religion is being substantially burdened."[270] The Supreme Court has held in cases construing RFRA that whether a substantial burden is justified by a compelling governmental interest turns on "a case-by-case determination of the question, sensitive to the facts of each particular claim."[271] The compelling interest test under RFRA is "not to be made in the abstract" but rather "in the circumstances of [the] case."[272]

The Seventh Circuit's justification for its conclusion that the government's interest in enforcement of bankruptcy law was compelling for First Amendment protection fell short of the individualized analysis the Court has required under RFRA. The Seventh Circuit noted that ruling in favor of the archbishop would create a general "free exercise of religion exception" to the bankruptcy code[273] and a "logistical nightmare" for the courts.[274] It described a classic slippery slope: The court would have to consider every provision in the Bankruptcy Code, determine whether it substantially burdened the party's religious beliefs, and then determine whether the particular provision furthered a compelling governmental interest.[275] In *Gonzales v. O Centro Espirita Beneficente Uniao do Vegetal,*[276] a RFRA case, the Supreme Court characterized this argument as "the classic rejoinder of bureaucrats throughout history: If I make an exception for you, I'll have to make one for everybody, so no exceptions."[277] The Court made it clear in *Gonzales* that RFRA mandates that courts balance *on a case by case basis* the governmental interests in consistent enforcement of laws against the imposition in that case on individuals' religious liberty. It held that under RFRA, exceptions from law enforcement to protect free

[270] Gonzales v. O. Centro Espirita Beneficente Uniaodo Vegetal, 546 U.S. 418, 430-31 (2006) (citing 42 U.S.C. § 2000bb-1(b)).

[271] *Id.* at 431 (2006). *See also* Church of Lukumi Babalue Aye, v. City of Hialeah, 508 U.S. 520, 546 (1993) (a compelling interest is one "of the highest order" and is found in "rare cases.").

[272] Ca. Democratic Party v. Jones, 530 U.S. 567, 584 (2002). *See also* Burwell v Hobby Lobby, 234 S. Ct. at 2779 (government must demonstrate that its "marginal interest in enforcing the [challenged law] in these cases is compelling"); Brown v. Entm't Merchs. Ass'n, 564 U.S. 786, 803 n. 9 (2011) ("[T]he government does not have a compelling interest in each marginal percentage point by which its goals are advanced.").

[273] Listecki v. Official Comm. of Unsecured Creditors, 780 F.3d 731, 748 (7th Cir. 2015) ("Such an exception would also open up a religious affirmative defense beyond this case to all provisions of the Code, so long as that belief is sincerely held.").

[274] *Id.* at 748.

[275] *Id.*

[276] 546 U.S. 418 (2006) (holding that government failed under RFRA to demonstrate a compelling interest in enforcement of the Controlled Substances Act against a church and its members who used a controlled substance in religious worship).

[277] *Id*. at 436.

exercise of religion do not invariably open an unmanageable floodgate of requests for exceptions or fatally undermine the government's interest in enforcement.[278] In contrast to the Seventh Circuit's prediction of doom, the Supreme Court in *Gonzales* expressed confidence that courts are capable of deciding in individual cases when the balance tips in favor of protection of religious liberty.[279]

It remains to be seen how the Seventh Circuit's opinion in *Listecki* and the split it created with the Eighth Circuit's holding in *In re Young*, will influence the development of law governing religious liberty defenses to application of bankruptcy laws. It is likely that the effect will be limited. Compared to the individual debtor whose tithes the Eighth Circuit protected from fraudulent transfer avoidance on religious liberty grounds in *In re Young*, the Archdiocese of Milwaukee presented a less appealing case for protection from transfer avoidance on religious liberty grounds. Its transfer to the Cemetery Trust appeared to be an intentional wealth protective maneuver, not a sincere and routine act of faith. The decision resolved an expensive and long simmering issue in the case, shifted the leverage in favor of sexual abuse claimants, and smoothed the way for settlement and confirmation of a consensual plan of reorganization.

VII. Conclusion.

The use of bankruptcy proceedings by Catholic organizations as a means to resolve mass tort liability for clergy sexual abuse has been remarkably successful.[280] For the Catholic debtors, the price of bankruptcy relief has been an intense public scrutiny of previously private matters, including the external consequences of inter-hierarchical relationships prescribed in canon law. The bankruptcy cases have made it clear that Catholic religious organizations are economic actors in the secular world. Decisions made within the Catholic hierarchy of authority under canon law for internal religious purposes have profound external consequences, not only on creditors outside the Church, but also on the faithful within it.

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[278] *E.g.*, Wisconsin v. Yoder, 406 U.S. 205, 213, 236 (1972) (recognizing a religious liberty exemption from generally applicable state compulsory education laws for Amish children because the state failed to show an impediment to its "paramount" interest in education by recognizing an exemption for the Amish). *See also Gonzalez*, 546 U.S. at 436 (noting that the government had not established the particular type of administrative harm caused by individualized exceptions to law enforcement that it had recognized in three cases involving religious liberty protection under the First Amendment) (government 's interest in uniform application of social security employer withholding tax imposed under the Federal Insurance Contributions Act is compelling) (citing United States v. Lee, 455 U.S. 252 (1981)); Hernandez v. Comm'r, 490 U.S. 680 (1989) (government's interest in uniform rule regarding deductibility of charitable contributions under the Internal Revenue Code is compelling); Braunfield v. Brown, 366 U.S. 599 (1960) (government's interest in uniform enforcement of criminal law proscribing sale of certain goods on Sunday would "undermine the State's goal of providing a day of rest from commercial activity.").

[279] *Gonzalez*, 546 U.S. at 436. *See also* Cutter v. Wilkinson, 544 U.S. 709 (2005) (courts must use a case by case analysis to determine whether government's interest in uniform application of law is sufficiently compelling to justify a burden on free exercise of religion under the Religious Land Use and Institutionalized Persons Act of 2000, which applies RFRA standard to federal and state prisoners' requests for religious accommodations); United States v. Christie, 825 F.3d 1048 (9th Cir. 2016) (rejecting slippery slope reasoning in case involving a religious group's assertion of a free exercise exception to the cannabis prohibitions in the Controlled Substances Act (CSA)).

[280] *See Appendix B*, *supra* note 217.

Appendix A: Case Information

Name of Debtor	Date Filed	Court	Docket Number	Date Confirmed	Corporate Form of Debtor	Separately Incorporated Parishes?
Archdiocese of Portland	07/06/2004	D. Oregon	3:04-bk-37154	04/17/2007	Corporation Sole	No
Diocese of Tucson	09/20/2004	D. Arizona	4:04-bk-04721	08/01/2005	Corporation Sole	No
Diocese of Spokane	12/06/2004	E.D. Washington	2:04-bk-08822	04/24/2007	Corporation Sole	No
Diocese of Davenport	10/10/2006	S.D. Iowa	3:06-bk-02229	05/01/2008	Non-Profit Corp.	Yes
Diocese of San Diego	02/27/2007	S.D. California	3:07-bk-00939	Settled 11/16/2007	Corporation Sole	No
Diocese of Fairbanks	03/01/2008	D. Alaska	4:08-bk-00110	02/17/2010	Corporation Sole	No
Oregon Province, Society of Jesus	02/17/2009	D. Oregon	3:09-bk-30938	07/29/2011	Non-Profit Corp.	No*
Diocese of Wilmington	10/18/2009	D. Delaware	1:09-bk-13560	07/28/2011	Non-Profit Corp.	Yes
Archdiocese of Milwaukee	01/04/2011	E.D. Wisconsin	2:11-bk-20059	11/13/2015	Non-Profit Corp.	Yes
Christian Brothers of Ireland	04/28/2011	S.D. New York	7:11-bk-22820	01/13/2014	Non-Profit Corp.	Yes
Diocese of Gallup	11/12/2013	D. New Mexico	1:13-bk-13676	06/23/2016	Corporation Sole	No
Diocese of Stockton	01/15/2014	E.D. California	2:14-bk-20371	01/13/2017	Religious Corp.**	Yes
Diocese of Helena	01/31/2014	D. Montana	2:14-bk-60074	03/05/2015	Corporation Sole	No
Archdiocese of St. Paul and Minneapolis	01/16/2015	D. Minnesota	3:15-bk-30125	Pending	Religious Corp.**	Yes
Diocese of Duluth	12/07/2015	D. Minnesota	5:15-bk-50792	Pending	Religious Corp.**	Yes

Diocese of New Ulm	03/03/2017	D. Minnesota	3:17-bk-30601	Pending	Religious Corp.**	Yes
Diocese of Great Falls- Billings	03/31/2017	D. Montana	2:17-bk-60271	Pending	Corporation Sole	No
Crosier Fathers and Brothers	06/01/2017	D. Minnesota	4:17-bk-41681	Pending	Non-Profit Corp.	Yes

Appendix B: Outcomes of Cases

					Amount in Millions				
Name of Case	**Type**	**Date Filed**	**Date Confirmed**	**Time Filing to Confirmation**	**Settlement Total**	**Insurance Portion**	**Total Prof'l Fees**	**Number of Victims**	**Settlement Per Victim**
Portland	Archdiocese	07/06/2004	04/17/2007	2.78 Years	$74.4	$52.0	$19.1	173	$430,000
Tucson	Diocese	09/20/2004	08/01/2005	0.86 Years	$22.2	$14.8	$5.0	45	$493,300
Spokane	Diocese	12/06/2004	04/24/2007	2.38 Years	$48.0	$20.0	$10.9	150	$320,000
Davenport	Diocese	10/10/2006	05/01/2008	1.56 Years	$37.0	$19.5	$2.6	162	$228,390
San Diego*	Diocese	02/27/2007	11/16/2007*	0.72 Years	$198.1	$75.65	$5.0	144	$1,375,690
Fairbanks	Diocese	03/01/2008	02/17/2010	1.97 Years	$9.8	$1.4	$4.8	290	$33,790
Oregon Province Society of Jesus	Religious Order	02/17/2009	07/29/2011	2.44 Years	$166.1	$118.0	$8.6	535	$310,460
Wilmington	Diocese	10/18/2009	07/28/2011	1.78 Years	$77.4	$15.6	$15.8	148	$522,970
Milwaukee	Archdiocese	01/04/2011	11/13/2015	4.86 Years	$21.0	$10.7	$20.0	350	$60,000
Christian Bros. of Ireland	Religious Order	04/28/2011	01/13/2014	2.72 Years	$16.5	$3.5	$8.1	400	$41,000
Gallup	Diocese	11/12/2013	06/23/2016	2.62 Years	$22.0	$18.9	$3.5	57	$385,960
Stockton	Diocese	01/15/2014	01/13/2017	3.00 Years	$17.1	$3.3	$1.0	30	$570,000
Helena	Diocese	01/31/2014	03/05/2015	1.09 Years	$21.0	$14.4	$2.0	360	$58,000
St. Paul and Minneapolis	Archdiocese	01/16/2015	Pending						
	Total:				**$730.6**	**$367.7**	**$106.4**	**2,844**	**Average of $371,500 per victim**