AMERICAN BANKRUPTCY INSTITUTE

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Mass Tort Chapter 11 Cases Today: Sexual Abuse, Opioid and Asbestos Cases

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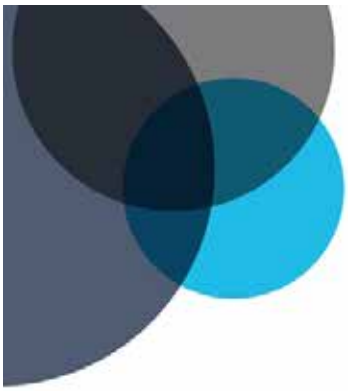
CONCURRENT SESSION

2021



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MASS TORT CHAPTER 11 CASES TODAY: SEXUAL ABUSE, OPIOID AND ASBESTOS CASES

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CHANNELING INJUNCTIONS & SUBSTANTIAL CONTRIBUTIONS FROM THIRD PARTY NON-DEBTORS

Overview

- Substantial Contribution & Ability To Pay
- Identification of Potential Assets to Increase The Contribution
  - Asset Investigations
  - Cash Tracing
  - Commingled Accounts & Investments
  - Unrestricted vs Restricted Assets
  - Related Trusts & Foundations

Master Mortgage

Courts generally consider some variant of the five factors identified in Master Mortgage Investment Fund when deciding whether to approve third-party releases and channeling injunctions. *In re Master Mortgage Inv. Fund, Inc., 168 B.R. 930, 938 (Bankr. W.D. Mo. 1994).*

- There is identity of interest between the debtor and third party
- The third party made a substantial contribution to the trust
- The injunction is essential to the bankruptcy
- The impacted creditors support the injunction, and
- The plan provides for paying substantially all claims.

Substantial Contribution

Evaluating A Substantial Contribution

- **Ability To Pay**
  - **Historical Performance & Trends**
  - **Projections Of Future Performance & Needs**
  - **Assets & Liabilities**
    - Claims Exposure
      - In-Statute
      - Potential For Litigation Window To Be Opened
      - Global vs Individual Settlements
  - **Cash Flow**
  - **Credit Analysis**

Substantial Contribution

Identification of Potential Assets to Increase The Contribution

- **Asset Investigations**
  - **Non-Debtor Third Party Records**
    - Audits & Financial Statements
    - Underlying Accounting System Data
    - Tax Filings
    - Bank & Investment Account Statements
    - Board / Committee Meeting Minutes
  - **Public Records**
    - Court
    - Real Property
    - Personal Property – Uniform Commercial Code Filings
    - Social Media
    - Press / Media
    - Non-Debtor Third Party Website(s)
  - **Subscription Based Sources**
    - Commercial Databases (e.g., Lexis Nexis, Corporation Service Company, Hoover's)
    - Services That Monitor Not For Profits (e.g., GuideStar, ProPublica)

Substantial Contribution

Identification of Potential Assets to Increase The Contribution

- **Asset Tracing**
  - **Cash**
    - Lowest Intermediate Balance Rule
  - **Transfers Of Non-Cash Assets**

- **Commingled Accounts & Investments**
  - **Flow Of Funds**
    - Including Final Account & Any Intermediary Accounts

Substantial Contribution

Identification of Potential Assets to Increase The Contribution

- **Unrestricted vs Restricted Assets**
  - **Not For Profits**
  - **Donor Intent vs Debtor Designations**
    - **Donor Records**
      - Wills / Bequests
      - Contracts / Agreements
      - Correspondence
    - **Mandatory v. Precatory Language**
      - "I direct…"
      - "I wish, want, desire, recommend, hope…"
    - **Misclassifications Or Revised Classifications**
  - **Commingled**
    - Current Account(s)
    - Historical Treatment

Substantial Contribution

Identification of Potential Assets to Increase The Contribution

- **Related Trusts & Foundations**
  - **Disclosed**
  - **Undisclosed**
  - **Considerations**
    - Common Address
    - Common Directors & Officers
    - Common Purpose(s)
    - Funding – Initial & Subsequent
    - Transfer(s) Of Assets

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Industry Experience

Automotive
Construction
Internet and Telecommunications
Manufacturing
Not-For-Profit
Personal Injury
Real Estate
Transportation

Selected Public Cases

Albright et al v. Attorneys Title Insurance Fund et al
Archdiocese Of Milwaukee
Archdiocese Of New Orleans
Beehive State, LLC
Benson Bolt v. Zions First National Bank
Boy Scouts Of America
Bruce P. McNall
C3 Investments
Castle Arch Real Estate Investment Company LLC
Catholic Diocese Of Wilmington
Christian Brothers Institute
Diocese of Camden

Experience

Matthew K. Babcock is a Director with Berkeley Research Group, LLC ("BRG"). Mr. Babcock is a Certified Public Accountant, Certified in Financial Forensics (CPA / CFF), a Certified Fraud Examiner (CFE), and a Certified Insolvency and Restructuring Advisor (CIRA) with over 23 years of experience providing services in bankruptcy, forensic / investigative accounting, and litigation support. He has significant experience in the Catholic diocese bankruptcy matters.

Prior to BRG, Mr. Babcock worked with LECG LLC, Neilson Elggren LLP, Arthur Andersen, Neilson Elggren Durkin & Company, and the Federal Bureau of Investigation ("FBI"). As an Honors Intern with the FBI, Mr. Babcock was assigned to work with the Office of Independent Counsel investigating former Secretary of Agriculture Mike Espy.

Mr. Babcock has served in numerous bankruptcy and insolvency matters, including court appointments as Trustee, Receiver, Accountant to the Trustee, Accountant to the Liquidating Estate Manager, Accountant to the Debtor, Financial Advisor to the Official Committee of Unsecured Creditors and Financial Advisor to the Official Committee of Tort Claimants. His experience includes the investigation of alleged insider dealings, investigation and pursuit of preferences, fraudulent transfers and other causes of action, tracing of funds, financial data reconstruction, liquidation and substantive consolidation analyses, plan feasibility analyses, plan preparation, solvency analyses, claims analysis / resolution, and liquidation of assets. He has assisted Trustees in operating Chapter 11 companies, including analyzing prior and on-going operations, developing cash flow projections, budgeting, and managing other day-to-day accounting activity.

Mr. Babcock has provided both civil and criminal litigation support services, including the investigation of fraud and mismanagement, tracing of funds, partner disputes, lost profit damages, patent infringement damages, breach of contract, economic analyses, and financial record reconstruction.

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Selected Public Cases (cont'd)

Diocese Of Great Falls – Billings
Diocese Of Rochester
Diocese of Rockville Centre
Diocese Of Stockton
DVI, Inc.
Husting Land & Development, Inc.
JD Services, Inc.
Le-Nature's, Inc.
Marshall v. Marshall
National School Fitness Foundation
Natural Wonders, Inc. / World Of Science, Inc.
Promega v. Lifecodes
Revolution Dairy LLC et al
Rich International Airways, Inc.
Semnani v. USPCI
Society of Jesus Oregon Province
Tri-Valley Distributing, Inc.
The Weinstein Company
William J. Del Biaggio III
Wolf Creek Properties LC

Experience (cont'd)

Mr. Babcock has significant training and experience investigating fraud and mismanagement, including financial statement fraud, "Ponzi" schemes, embezzlement schemes, check kiting, bank fraud, and bankruptcy fraud. He has conducted numerous presentations relating to business fraud, financial statement fraud, bankruptcy fraud, and other fraud schemes. He has also served as a professional faculty member at the University of Utah, assisting in the instruction of the University's "Fraud Examination & Forensic Accounting" course.

Education and Affiliations

Mr. Babcock graduated with a Bachelor of Science degree in Accounting (Magna Cum Laude), as well as a Master's degree in Professional Accountancy from Brigham Young University. He is a member of the American Institute of Certified Public Accountants, Utah Association of Certified Public Accountants, Association of Insolvency and Restructuring Advisors, Association of Certified Fraud Examiners, and American Bankruptcy Institute.

Bankruptcy Court's Ability to Impair Third Party Insurance Rights

By: Everett J. Cygal and Jin Yan[1]

Bankruptcy courts agree that where a debtor and a third party insured both have rights under an insurance policy, the third party's rights under that policy are independent of the debtor estate's rights. *See*, *e.g.*, *In re Petters Co.*, 419 B.R. 369, 376 (Bankr. D. Minn. 2009) ("[A]ny individual insured has a contractually-distinct status that runs directly between itself and the insurer" and "the right to receive payment on a covered claim [is] the property of that insured itself"); *In re Adelphia Commc'ns Corp.*, 364 B.R. 518, 527 (Bankr. S.D.N.Y. 2007) (additional insureds' rights to payment pursuant to their own policy entitlements would be received from the insurers "as a contractual entitlement . . . and would be independent of anything the Estate sought or received"); *In re Forty-Eight Insulations, Inc.*, 133 B.R. 973, 978 (Bankr. N.D. Ill. 1991), *aff'd*, 149 B.R. 860 (N.D. Ill. 1992) ("In this case, both the Debtor and FWC have rights under and interests in the policies. Only Forty–Eight's interests are property of the estate. FWC's claims against the insurers or its interests in the insurance policies are not property of Forty–Eight's estate.").

However, there is a divergence in authority on the extent to which a bankruptcy court may impair a third party's contractual rights under an insurance policy that is also an asset of a debtor's estate. Discussions of some key decisions in this issue are below.

MacArthur

The Second Circuit's decision in *MacArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89 (2d Cir. 1989) is perhaps the leading case holding that a third party's rights under an insurance policy can be impaired. *MacArthur* arises from debtor Johns-Manville's bankruptcy and the debtor's

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settlements with its insurers, which were a critical aspect of its plan of reorganization. Under the settlements, the insurers would make a cash contribution of $770 million and in exchange, would be relieved of all obligations relating to their policies and be protected by injunctive orders. A distributor objected to the settlements on the grounds that it was a co-insured pursuant to certain vendor endorsements in the policies, and that the injunctive orders called for by the settlements would preclude the distributor from obtaining insurance coverage for its sales of the debtor's asbestos-containing products.

The Second Circuit rejected the distributor's argument that the bankruptcy court lacked jurisdiction to impair the distributor's policy rights. It reasoned that the distributor's rights as an insured vendor of the debtor's products were "completely derivative" of the debtor's rights as the primary insured and were "inseparable" from the debtor's own coverage, over which the bankruptcy court had jurisdiction.

The Second Circuit also rejected the distributor's argument that it was unfair for the distributor to take on the burden of defending lawsuits from asbestos victims without the benefit of its insurance coverage. Reasoning that "when a debtor's assets are disposed of free and clear of third party interests, the third party is adequately protected if his interest is assertable against the proceeds of the disposition," the court found the distributor was adequately protected because it retained the ability to assert claims against the $770 million fund created by the debtor's settlements with its insurers.

Forty-Eight Insulations

In contrast to *MacArthur*, the bankruptcy court in *In re Forty-Eight Insulations, Inc.*, 133 B.R. 973 (Bankr. N.D. Ill. 1991) held that a third party's insurance rights could not be impaired. There, similarly to *MacArthur*, a debtor reached settlements with its insurers, which settlements

required injunctive relief precluding further claims against the insurers. The debtor's parent objected to the settlements on the basis that it was an additional insured under the policies and was entitled to coverage for asbestos-related claims.

In analyzing *MacArthur*, the bankruptcy court in *Forty-Eight Insulations* was unpersuaded by the Second Circuit's logic. The court disagreed that a non-debtor's interest in a policy was somehow part of the debtor's estate and subject to bankruptcy court jurisdiction. In particular, the court noted that the third party parent was a named insured with a right to make direct claims against the insurers. As a result, the parent's right were not merely derivative of the debtor's rights, as the parent had "rights to be defended and to indemnification that do not depend on a prior resolution of any claim against [the debtor]."

The court in *Forty-Eight Insulations* also found the remedy afforded in *MacArthur*—the third party's right to assert claims against the insurance settlement proceeds—was insufficient. As a legal matter, the court found this alternative remedy was not sufficient to deprive the parent of its insurance rights without its consent. Further, as a practical matter, the debtor in *Forty-Eight Insulations* was liquidating and there was unlikely to be sufficient assets to adequately protect the parent's interests.

Finally, the court in *Forty-Eight Insulations* noted an important factual distinction between that case and *MacArthur*. In *MacArthur*, the court was concerned with providing compensation to asbestos victims while also helping the debtor to successfully reorganize, which may have motivated the courts to "find equitable powers that otherwise would not exist." The same concerns were not present in *Forty-Eight Insulations*, which involved a liquidating debtor.

SportStuff

The Eighth Circuit Bankruptcy Appellate Panel agreed with *Forty-Eight Insulations* in *In re SportStuff, Inc.*, 430 B.R. 170 (B.A.P. 8th Cir. 2010) and held that the bankruptcy court "did not have the jurisdiction or authority to impair or extinguish" independent contractual rights of third party insureds. Similarly to the facts of *MacArthur*, *SportStuff* involved vendors objecting to a debtor's settlements with insurers that would preclude those vendors from asserting claims against the settling insurers.

While the bankruptcy court in *SportStuff* cited *MacArthur* as the basis for approving the challenged settlements, the Eighth Circuit found the differing facts of that case merited a different result. First, under the policies at issue in *SportStuff*, the vendors' rights were not derivative of the debtor's rights, as the vendors had independent rights to make claims for defense and indemnification. Second, similarly to the circumstances in *Forty-Eight Insulations* and unlike those in *MacArthur*, the debtor in *SportStuff* was not reorganizing but instead planned to sell substantially all of its assets. Third, unlike in *MacArthur*, were the third party vendor had potential recourse to a fund created by the insurance settlements, the insurance proceeds in *SportStuff* was allocated exclusively to benefit personal injury claimants.

Recent Case Law

It appears the trend of case law has followed *Forty-Eight Insulations* and *SportStuff* in holding that a bankruptcy court cannot impair the rights of third party insureds. *See generally* Insurance Issues in Bankruptcy: A Collier Monograph ¶ 3.03[2][d] (2014) ("The more common approach holds that a co-insured's interest in a debtor's policy is not property of the bankruptcy estate" and "[a]s these contract rights do not belong to the debtor, they cannot be impaired by a bankruptcy court").

In *In re Archdiocese of St. Paul & Minneapolis*, 579 B.R. 188 (Bankr. D. Minn. 2017), the bankruptcy court refused to confirm a plan that transferred the debtor's insurance policies to a trust for sexual abuse claimants free and clear of the interests of third party parishes that were additional insureds. Citing *Forty-Eight Insulations*, the court held the proposed plan could not impair the parishes' rights without their consent, particularly where the plan did not provide for the preservation of those parishes' indemnification and contribution claims to be paid by the settling insurers or from the trust established for abuse victims.

Earlier this year, in *In re Congoleum Corporation*, 2021 WL 1521522 (Bankr. D.N.J. Apr. 16, 2021), the bankruptcy court held that a plan confirmation order protected an additional insured from environmental liabilities as part of a settlement with the debtor's insurer. That settlement effectuated a policy buyback free and clear of all past, present, and future claims, including those of additional insureds. In so holding, the court cited to *SportStuff* and reasoned that absent plan protection for additional insureds, the insurance settlement could not have been approved because additional insureds would not have received adequate compensation for their rights and would have been exposed to ongoing claims for which they would lack insurance coverage.

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In chapter 11 cases filed by religious entities, a major issue that can dramatically affect creditor recoveries is whether certain properties are protected from claims based on the Religious Freedom Restoration Act of 1993 (42 U.S.C. § 2000bb *et seq*.) ("RFRA"), the so-called "Church Autonomy Doctrine," and the First Amendment to the United States Constitution (the "First Amendment").

I.
INTRODUCTION

At least since the early 2000's, Catholic dioceses and religious orders, in the face of escalating claims of clergy sex abuse by childhood sexual abuse survivors, have engaged in out-of-court corporate restructurings to place hundreds of millions of dollars of their assets beyond the reach of their creditors, while ensuring that the debtors remained in control of the assets. These restructurings involve the incorporation of previously unincorporated parishes, establishment of charitable foundations and the formation of revocable self-settled trusts (the "trusts") controlled by the dioceses or orders. A classic example is the reorganization by the Archdiocese of Santa Fe ("ASF"). Between 2013 and 2018, ASF made massive transfers of its assets to a real estate trust and a personal property trust. As of the petition date of ASF's bankruptcy, many parishes were separately incorporated, ASF's financial assets had been transferred to the trusts, the newly incorporated parishes were the beneficiaries of the trusts, and most (but not all) of ASF's real estate had been transferred to a real estate trust. ASF disclaims any interest in the assets held in the trusts. ASF also disclaimed any interest in real properties

that remained titled to ASF, asserting that such properties are held in an equitable trust for the benefit of the parishes.

In ASF, the bankruptcy court granted the committee authority to commence, prosecute, and settle on behalf of ASF's estate the claims under Section 544 and other Bankruptcy Code sections. The committee's complaints sought (i) to avoid fraudulent transfers to the trusts, (ii) declaratory and injunctive relief that the trusts are self-settled and therefore subject to the claims of ASF's creditors under New Mexico law, and (iii) to avoid alleged unrecorded interests of the parishes in real property pursuant to Bankruptcy Code section 544(a)(3). The trusts and parishes contended that avoiding the transfers of assets to the trusts pursuant to New Mexico fraudulent transfer law, or applying any provision of the Bankruptcy Code or New Mexico law by which the assets in the trusts could be determined to be property of ASF's estate, would substantially burden their free exercise of religion in violation of RFRA and the First Amendment.

As a matter of law, RFRA, the so-called Church Autonomy Doctrine, and First Amendment defenses (collectively, the "Religious Liberty Defenses") do not apply to bar any of the claims asserted in adversary proceedings.

RFRA provides defense only against "a government" and is inapplicable to suits to which the government is not a party. Three United States Courts of Appeals have concluded that the statutory language makes clear that Congress intended RFRA to apply only in cases where the "government" is a party. *Listecki v. Official Comm. of Unsecured Creditors,* 780 F.3d 731, 737

(7th Cir. 2015); *Gen. Conference Corp. of Seventh-Day Adventists v. McGill,* 617 F.3d 402, 411-12 (6th Cir. 2010); *Sutton v. Providence St. Joseph Med. Ctr.*, 192 F.3d 826, 834 (9th Cir. 1999).

A committee is a private non-government entity that stands in the shoes of the Debtor's estate, which is also a non-government actor. *Listecki* 780 F.3d at 737-741). Therefore, RFRA cannot provide a defense to claims asserted by the committee on behalf of the estate. Nor may RFRA be applied to state law, such as the New Mexico fraudulent transfer, corporate, and trust laws that govern the claims set forth in adversary proceedings.

The ASF and related entities urged the application of the so-called Church Autonomy Doctrine defenses to defeat the estate's fraudulent transfer claims against the trusts.[1] The purported church autonomy cases defendants relied upon in opposing the standing motion declined to decide solely ecclesiastical disputes (*i.e.,* intra-organizational disputes over religious beliefs or internal governance). These cases do not stand for the right of a religious organization to act with independence from civil law, but rather for the principle that courts may not decide matters of religious belief or church government.

Defendants' argument was that the challenged transfers were not of property of the estate because at the time of the transfers, the transferred assets were held in pre-existing equitable trusts for the benefit of the unincorporated parishes. Under New Mexico law, the parishes had

[1] The Supreme Court does not use this label. *See* Marci A. Hamilton, *Foundations of Church Autonomy: Article: Religious Institutions, the No-Harm Doctrine, and the Public Good,* 2004 B.Y.U.L. Rev. 1099, 1113 n. 50-51 (2004) ("The Supreme Court has never used the phrase to describe its jurisprudence, and it appears in the Supreme Court's cases only twice solely as footnote references to law review articles;" explaining that the term was popularized among academics in 1981). Recently, in *Our Lady of Guadalupe School v. Morrissey-Berru,* 140 S. Ct. 2049, 2061 (2020), the Supreme Court referred for the first time to the "general principle of church autonomy" as "independence in matters of faith and doctrine and in closely linked matters of internal government." The *Morrissey-Berru* case involved application of the ministerial exception to an employment dispute between a church and one of its ministers.

no legal existence separate from ASF prior to their incorporation and could not be trust beneficiaries. Defendants argued the Church Autonomy Doctrine requires the Court to disregard New Mexico law and instead apply canon law, and to find that the unincorporated parishes were "juridic" entities and therefore could be trust beneficiaries.

The Supreme Court has repeatedly held that ecclesiastical abstention, grounded in the First Amendment, only applies to internal church disputes and cannot be applied to prevent the application of neutral and generally applicable civil law to resolve disputes with the secular world. Indeed, the Supreme Court has rejected the idea that fraudulent or improper actions can ever be excused in the name of religion. The Tenth Circuit has held that a threshold issue for application of the Church Autonomy Doctrine is whether the challenged conduct is "rooted in religious belief." *Bryce v. Episcopal Church in the Diocese of Colorado*, 289 F.3d 648, 657 (10th Cir. 2002). ASF's transfers to the trusts were divorced from religious belief and done as part of a sophisticated asset protection scheme to avoid liability for enabling the sexual abuse of children. The Adversary Proceedings do not raise the kind of intra-church dispute that the Church Autonomy Doctrine protects from court interference.

The bankruptcy court cannot impermissibly entangle itself in the interpretation and application of ecclesiastical law. Application of the Church Autonomy Doctrine, as urged by the ASF, would have required the Court to apply and interpret canon law to determine the rights of secular creditors to recover fraudulent transfers from a religious entity and determine what constitutes property of the estate. The Supreme Court has cautioned against this type of

entanglement in religious matters when, as here, the dispute can be resolved by application of neutral principles of civil law.

ASF filed a voluntary petition, electing to submit itself to the bankruptcy process and to take full advantage of the automatic stay, discharge, and other provisions of the Bankruptcy Code that increase its leverage over its creditors. By its Church Autonomy Doctrine and First Amendment defenses, ASF sought to cherry-pick provisions of the integrated Bankruptcy Code under the cover of religious freedom to immunize themselves from liability and accountability to the survivors of childhood sex abuse. Identical arguments have been raised in other diocesan chapter 11 cases and have been uniformly rejected. It is beyond dispute that the torts of, and fraudulent transfers to, religious entities are subject to secular legal remedies.[2]

Finally, summary judgment was appropriate against the First Amendment defense. Under well-settled Supreme Court precedent, application of neutral, generally applicable provisions of the Bankruptcy Code to resolve the claims asserted in adversary proceedings violates neither the Free Exercise nor the Establishment clauses of the First Amendment.

A. RFRA Affirmative Defense Does Not Allow the Church to Shield Assets in Bankruptcy.

The RFRA defenses fail as a matter of law for at least three reasons. First, RFRA does not create a defense against a creditors committee, which is private non-government actor.

[2] *See, e.g., Cantwell v. Conn.,* 310 U.S. 296, 306 (1940) (fraudulent or improper actions are not excused in the name of religion); *McDaniel v. Paty,* 435 U.S. 618, 643 n.* (1978) (Stewart, J., concurring) ("[A]cts harmful to society should not be immune from proscription simply because the actor claims to be religiously inspired."); *Listecki v. Off. Comm. of Unsecured Creditors,* 780 F.3d 731, 749 (7th Cir. 2015) ("We do not believe that there is, nor can there be, a religious exception that would allow a fraudulent conveyance in the name of free exercise."); *Doe v. Archdiocese of Denver,* 413 F. Supp. 2d 1187, 1193 (D. Colo. 2006) ("The general duty of care [owed to sex abuse victims] depends in no way upon the religious status of the defendant organizations.").

Second, RFRA may not be applied to modify, preempt, or trump state law. Third, RFRA does not modify or limit the provisions of the Bankruptcy Code because it, and its provisions for the recovery of fraudulent transfers, does not burden the Defendants' exercise of religion and the provisions serve a compelling government interest.

1. RFRA Does Not Create a Cause of Action or Defense Against Non-Government Actors.

RFRA, 42 U.S.C. § 2000bb *et seq*., only creates a cause of action or defense against "a government," and a committee is a private party.

a. The plain language of RFRA only permits a defense against "a government."

The interpretation of any statute begins with the text. *Conrad v. Phone Directories Co.,* 585 F. 3d 1376, 1381 (10th Cir. 2009); *In re Lobera*, 454 B.R. 824, 836-37 (Bankr. D.N.M. 2011). RFRA provides:

> (a) In General. ***Government*** shall not substantially burden a person's exercise of religion even if the burden results from a rule of general applicability, except as provided in subsection (b) of this section.
>
> (b) Exception. ***Government*** may substantially burden a person's exercise of religion only if it demonstrates that application of the burden to the person—(1) is in furtherance of a compelling governmental interest; and (2) is the least restrictive means of furthering that compelling governmental interest.
>
> (c) Judicial relief. A person whose religious exercise has been burdened in violation of this section may assert that violation as a claim or defense in a judicial proceeding and obtain appropriate relief ***against a government***. Standing to assert a claim or defense under this section shall be governed by the general rules of standing under article III of the Constitution.

42 U.S.C. § 2000bb-1 (emphasis supplied).

RFRA defines "government" to include "a branch, department, agency, instrumentality, and official (or other person acting under color of law) of the United States." 42 U.S.C. § 2000bb-2(1). RFRA "applies to all Federal law, and the implementation of that law." 42 U.S.C. § 2000bb-3. RFRA's "Judicial relief" section provides that "[a] person may assert a violation of this chapter as a claim or defense in a judicial proceeding and obtain appropriate relief against a government." 42 U.S.C. § 2000cc-2.

The Sixth, Seventh, and Ninth Circuit Courts of Appeal have concluded that this language makes clear that Congress intended RFRA to apply only in cases where the "government" is a party. *Gen. Conference Corp. of Seventh-Day Adventists v. McGill,* 617 F.3d 402, 411-12 (6th Cir. 2010); *Listecki v. Official Comm. of Unsecured Creditors*, 780 F.3d 731, 737 (7th Cir. 2015); *Sutton v. Providence St. Joseph Med. Ctr.,* 192 F.3d 826, 834 (9th Cir. 1999). *See also Mathis v. Christian Heating & Air Conditioning, Inc.,* 158 F. Supp. 3d 317*,* 325-27 (E.D. Pa. 2016) (summary judgment striking RFRA as affirmative defense in suit between private parties); *Van Stry v. McCrea,* 2020 U.S. Dist. LEXIS 62338 at *17-21 (E.D. Tex. Apr. 9, 2020) (same).

These decisions emphasize that the statute prohibits the ***"government"*** from substantially burdening the free exercise of religion except when that burden is justified by a "compelling governmental interest." 42 U.S.C. § 2000bb-1 (emphasis added); *McGill*, 617 F.3d at 411. The statute provides relief ***"against a government"*** to parties asserting RFRA as a claim or defense. 42 U.S.C. § 2000cc-2 (emphasis added); *Listecki,* 780 F.3d at 737 ("If the government is not a

party, no one can provide the appropriate relief."). In addition, Congress emphasized the importance of the government's presence in the findings and purposes section of RFRA. Specifically, Congress found that "governments should not substantially burden religious exercise without compelling justification" and the statute provides that one of its purposes is to "provide a claim or defense to persons whose religious exercise is substantially burdened by government." 42 U.S.C. § 2000bb(b)(2); *McGill,* 617 F.3d at 411.

Furthermore, the burden-shifting framework set forth in RFRA requires the government to "demonstrate[]" that its action is in furtherance of a compelling government interest and that it is the least restrictive means of furthering that compelling government interest. 42 U.S.C. § 2000bb-1(b). RFRA defines "demonstrates" as "meet[ing] the burdens of going forward with the evidence and of persuasion." 42 U.S.C. § 2000bb-2(3). "It is self-evident that the government cannot meet its burden" under this framework "if it is not a party to the suit." *Listecki,* 780 F.3d at 736. "A private party cannot step into the shoes of the 'government' and demonstrate a compelling governmental interest and that it is the least restrictive means of furthering that compelling governmental interest because the statute explicitly says that the 'government' must make this showing." *Id*; *see also Rweyemamu v. Cote*, 520 F.3d 198, 203 n.2 (2d Cir. 2008) ("Where, as here, the government is not a party, it cannot 'go[] forward' with any evidence." (quoting *Hankins v. Lyght,* 441 F.3d 96, 114-15 (2d Cir. 2006) (Sotomayor, J. dissenting)).

It has been suggested that there is a split of authority on the issue of whether RFRA only applies where the government is a party, relying on *Hankins v. Lyght,* 441 F.3d 96, 114-14 (2d Cir. 2006); *EEOC v. Catholic Univ. of Am.,* 83 F.3d 455, 470 (D.C. Cir. 1996); and *Christians v.*

Crystal Evangelical Free Church (In re Young), 82 F.3d 1407, 1420 (8th Cir. 1996), *vacated*, 521 U.S. 1114 (1997), *reinstated by* 141 F. 3d 854 (8th Cir. 1998), *cert denied*, 525 U.S. 811 (1998). However, *Hankins* involved a suit brought under the Age Discrimination in Employment Act (ADEA) in which the Second Circuit permitted a private defendant to assert a RFRA defense because, hypothetically, the government, through the EEOC, could have been a party to the action. *Id.* at 103. Notably, the Second Circuit has since retreated from the holding in *Hankins* because it could "not understand how" RFRA "can apply to a suit between private parties, regardless of whether the government is capable of enforcing the statute at issue." *Rweyemamu*, 520 F.3d at 203 n.2; *see also* then-Judge Sotomayor's dissent wherein she explained that "[i]f RFRA amends all federal statutes as they apply to suits in which the government is a party, then the substance of [a statute's] prohibitions most certainly *can* change depending on who enforces it." *Hankins.* at 115 (Sotomayor, J., dissenting) (emphasis in original).

The legislative history of RFRA also confirms that the government must be a party in order for the statute to apply. *See Bd. of Cty. Commissioners v. Suncor Energy (USA) Inc.,* 965 F. 3d 792, 804 (10th Cir. 2020) ("If statutory meaning cannot be derived merely by reference to the text, we may also look to traditional canons of statutory construction to inform our interpretation, and may seek guidance from Congress's intent, a task aided by reviewing the legislative history;" internal quotations and citations omitted). The Senate Committee on the Judiciary issued a report on RFRA that "began by stating that the nation was founded by those with a conviction that they should be free to practice their religion 'free from Government

interference' and 'Government actions . . . ' In describing RFRA's purpose, the report refers to 'government actions,' 'only governmental actions,' and 'every government action.'" *Listecki,* 780 F.3d at 737 (quoting S. Rep. No. 103-111, at 4, 8-9 (1993)).

The plain language of RFRA, its legislative history, and cases including *Listecki* confirm that the statute only provides a defense, if at all, to actions in which the government is a party. A committee is a private party acting on behalf of unsecured creditors, and the government is not a party to this action. As a matter of law, RFRA is not an applicable defense to any claim asserted by a committee.

b. A committee is not a government under RFRA.

The Committee is not a "government" under any conceivable interpretation of the statute's definition.

Pursuant to RFRA, 42 U.S.C. section 2000bb-2(1), "the term 'government' includes a branch, department, agency, instrumentality, and official (or other person acting under color of law) of the United States, or of a covered entity." The Committee is not a branch, department, agency or instrumentality of the United States. Nor is it an official or other person acting under color of law of the United States.

The Bankruptcy Code also treats creditors' committees as private, non-governmental actors. For example, a creditors' committee is not included in the Bankruptcy Code's definition of "governmental unit," which provides:

> The term "governmental unit" means United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States (but not a United States trustee while serving as a trustee in a case under this title), a

> State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government.

Bankr. Code § 101(27).[3]

The committee represents its creditor-constituents' private interests and seeks to maximize the value the estate to advance those private non-governmental interests. In fact, in a chapter 11 case, sexual abuse survivors are involuntary creditors who were not engaged in commercial activity or any other activity regulated by the government when they became creditors at the time of their abuse. Thus, RFRA does not apply to, or bar, a committee's complaints because, as a matter of law, a committee is not a government, or government actor, and does not represent the interests of the government.

c. A committee is not a government actor under RFRA because it is neither acting "under color of law" nor "willfully participating in joint action with government officials."

The Seventh Circuit's decision in *Listecki* is the only decision to consider whether a creditors' committee is the "government" for RFRA purposes. *Listecki* held unequivocally that it is not.

The phrase "color of law of the United States" in RFRA mirrors that found in 42 U.S.C. § 1983, which applies civil rights liability to those acting "under color of" any statute, ordinance, regulation, custom, or usage. Circuit courts uniformly conclude that this word choice is not coincidental and have held that Congress intended for RFRA's "color of law" analysis to overlap with section 1983 analysis. *Tanvir v. Tanzin,* 894 F.3d 449, 462 (2d Cir. 2018); *Listecki,* 780

[3] The Bankruptcy Code's treatment of a creditors' committee as a nongovernmental entity is underscored by the fact that only "persons" are eligible to serve on a creditors' committee and the Bankruptcy Code's definition of "person" specifically excludes "governmental units," with a narrow exception that permits only certain government creditors to serve on committees. *See* Bankr. Code § 101(45). No governmental units are members of a committee. *See Notice of Appointment of Committee of Unsecured Creditors* [Bankr. Docket No. 53].

F.3d at 738; *Sutton*, 192 F.3d at 834-35 (all interpreting RFRA "acting under color of law" in the same way as section 1983 because "[w]hen a legislature borrows an already judicially interpreted phrase from an old statute to use it in a new statute, it is presumed that the legislature intends to adopt not merely the old phrase but the judicial construction of the phrase" (internal citation omitted); *see also Brownson v. Bogenschultz,* 966 F. Supp. 795, 797 (E.D. Wis. 1997) (same).

In *Listecki,* the Seventh Circuit explained at length why a creditors' committee cannot be considered to be acting under color of law. *Id.* at 738-39. A committee typically consists of private, individual creditors, whose actions are supervised by the court, but its actions are not those of the government or of the court. *Id. Listecki* explains:

> [O]nce a committee is created, it takes on a life of its own. The committee can, with the court's approval, employ one or more attorneys, accountants, or other agents to represent or perform services for the committee. 11 U.S.C. § 1103(a). Here, a committee has retained counsel that represents them in this appeal. Those professionals report to the committee, not the Trustee or the court. The committee has an attorney-client relationship with the attorney. Neither the Trustee nor the court is involved. All of a committee's expenses, and the fees and expenses of the professionals that the committee hires, are paid for by the Estate and not the government. The Trustee can weigh in, and the court has input, but the money ultimately comes from the Estate, rather than the public coffers.
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> **Perhaps most problematic for the Archdiocese's argument is that a committee represents the larger interests of the unsecured private creditors, and it is to them, and not the Trustee, court, or any governmental actor, that the committee owes a fiduciary duty.** *Smart World Techs., LLC v. Juno Online Services,* 423 F.3d 166, 175 n.12 (2d Cir. 2005) ("[C]reditors' committee owes a fiduciary duty to the class it represents, but not to the debtor, other classes of creditors, or the estate."); *In re SPM Mfg. Corp.*, 984 F.2d 1305, 1315-16 (1st Cir. 1993) (same).

> The committee does not have to act in accordance with the Trustee's or court's wishes. In fact, the committee can, and should, oppose the Trustee if it is acting against the best interests of the unsecured creditors. *See In re Bayou Group*, LLC, 564 F.3d 541, 547 (2d Cir. 2009) (noting both the creditors' committee and bankruptcy court disagreed with Trustee's motion to appoint trustee); *In re Columbia Gas Sys., Inc.*, 33 F.3d 294, 295 (3d Cir. 1994) (noting difference between the committee's and Trustee's position on interpretation of statute). **It is beholden to no governmental actor.**

Listecki, 780 F.3d at 738-739 (emphasis added). A committee acts on behalf of the members of its constituent class and has a fiduciary duty to protect the interests of that class, not the debtor, the U.S. Trustee, or any government actor.

2. RFRA May Not Be Applied to Modify or Preempt State Law.

RFRA cannot be applied to modify or preempt state law in order to preclude a committee's claims. In *City of Boerne v. Flores,* 521 U.S. 507 (1997), the Supreme Court held that RFRA, as applied to state law, was a violation of (1) the inherent limitations of federalism (*id.* at 534), (2) the separation of powers (*id.* at 536), and (3) the procedures for constitutional amendment in Article V of the Constitution (*id.* at 529). At a bare minimum, RFRA is beyond Congress's power to regulate the states and any attempt to modify, preempt, or trump state law through RFRA is unconstitutional.

While Bankruptcy Code section 541 defines what property of the debtor becomes part of the bankruptcy estate, the nature and extent of the debtor's interest in that property is governed by state law. *See Butner v. United States,* 440 U.S. 48, 55 (1979). RFRA does not apply to preclude a determination of what constitutes property of the estate under section 541, which is governed by state law. *Tort Claimants v. Roman Catholic Archbishop of Portland*, 335 B.R. 842, 860 (Bankr. D. Or. 2005) ("Portland"). In *Portland,* the court questioned how RFRA could

apply to determining what constitutes property of the estate even though the issue had not been raised by the committee. The *Portland* court held that even if RFRA did apply, section 541 does not impose a substantial burden on the free exercise of religion because it merely makes all interests in property of the debtor at the commencement of the case property of the estate. *Id.* Because these property interests are determined by state law, to which RFRA does not apply, section 541 cannot constitute a substantial burden.

A bankruptcy estate's fraudulent transfer claims are asserted under state law as permitted by Bankruptcy Code section 544(b).[4] While a federal law (*i.e.*, Bankruptcy Code section 544(b)) enables the debtor (and in certain circumstances, a committee) to stand in the shoes of a creditor who can assert a fraudulent conveyance action under state law, the underlying cause of action for the avoidance of the fraudulent transfer itself is brought under state law. *Boerne* prohibits the application of RFRA to fraudulent transfer claims under state law.

A RFRA defense would contravene the Bankruptcy Code and section 544, which is designed to expand the estate's rights to recover transfers by a debtor, not contract them.[5] State law cannot be modified or limited by RFRA.

[4] Bankruptcy Code section 544(b) provides, "(1) Except as provided in paragraph (2), the trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502 (e) of this title."

[5] *See Comm. of Tort Litigants v. Catholic Diocese of Spokane (In re Catholic Diocese of Spokane)*, 329 B.R. 304, 324 n.5 (Bankr. E.D. Wash. 2005) ("If application of a particular Code section would constitute a substantial burden on religion, the appropriate remedy would be dismissal of the bankruptcy case. The Code is an integrated statutory scheme. 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."), *rev'd in part on other grounds*, 364 B.R. 81 (E.D. Wash. 2006).

3. RFRA Does Not Bar a committee's Claims Because the Bankruptcy Code and Its Provisions for Recovery of Fraudulent Transfers Serve a Compelling Government Interest.

Even if RFRA were applicable to efforts by a Committee to recover assets, it would not bar prosecution of claims under sections 541, 542, 544 and 548 of the Bankruptcy Code because the Code, and these provisions in particular, serve a compelling interest and provide the least restrictive means of advancing that interest.[6] *Listecki* 780 F.3d 731, 746 (extensive discussion of the scope, nature, and Supreme Court precedent leading to the conclusion that the Bankruptcy Code advances a compelling governmental interest). *See also In re Newman*, *supra,* 183 B.R. 239, 252 (Bankr. D. Kan. 1995) ("The compelling nature of the interest is reflected in the fact that recovery of fraudulent transfers has been a basic tenet of bankruptcy law for 400 years."), *aff'd*, 203 B.R. 468 (D. Kan. 1996). They are also the least restrictive means to serve the fairness interests at the heart of the fraudulent conveyance provisions. *In re Newman,* 203. B.R. at 477-78 (fraudulent transfer statute satisfies least restrictive means requirement of RFRA). As the *Newman* court noted:

> Section 548 (a)(2) draws a line between proper and improper diminution in what would seem to be the only practical way: by determining whether the quantifiable economic value received by the debtor is reasonably equivalent to that of the property transferred. As stated above, this standard is neutral toward religion and can operate to avoid non-religious transfers where no economic value is received by the debtor.

Id. at 475, n.4. *See also In re Meyer*, 467 B.R. 451, 460-61 (Bankr. E.D. Wis. 2012) ("Congress demonstrated a compelling interest in maintaining an equitable system for the protection of

[6] Even when RFRA is applicable, the statute creates an exception where the challenged burden serves a compelling government interest and is the least restrictive means of furthering that interest. 42 U.S.C. § 2000bb-1(b).

creditors and for permitting debtors to obtain a fresh start from overwhelming debt;" rejecting First Amendment challenge to denial of discharge); *In re Navarro*, 83 B.R. 348, 353 (Bankr. E.D. Pa. 1988) (pre-RFRA; administration of bankruptcy system and protection of legitimate interests of creditors are compelling governmental interests).

Even if RFRA were applicable, the claims do not violate RFRA because the challenged application of the Bankruptcy Code serves a compelling government interest and is the least restrictive means of doing so.

B. The Church Autonomy Doctrine Defenses Do Not Bar Recovery of Fraudulent Transfers.

1. The Church Autonomy Doctrine Only Applies to Intra-church Disputes That Require a Court to Determine Matters of Religious Doctrine or Belief.

Religious entities assert the Church Autonomy Doctrine as affirmative defense to fraudulent transfer claims on the grounds that the claims for relief require a court to interfere with and disregard the entity's ecclesiastical structure and governance in violation of the First Amendment to the United States Constitution, which protects the rights of religious organizations to adhere to their own ecclesiastical governments. Avoidance actions do not raise the kind of intra-church disputes that the Church Autonomy Doctrine protects from court interference. Moreover, the Supreme Court has never held that the Church Autonomy Doctrine shields a religious entity from liability to third parties based on generally applicable law.[7]

[7] *See* Marci A. Hamilton, *Foundations of Church Autonomy: Article: Religious Institutions, the No-Harm Doctrine, and the Public Good, supra* n. 4, 2004 B.Y.U.L. Rev. at 1182-90 (Supreme Court does not use the phrase "church autonomy;" explaining how religious freedom cases underscore the absolute protection of beliefs while actions affecting third parties are governed by neutral principles of law).

Roman Catholic diocese have contended that under canon law, parishes are separate "juridic" entities, and that notwithstanding the fact that a diocese held legal title to its real and personal property when it was transferred to trusts, under canon law, the parishes either owned the property or the debtor held it in trust for them and therefore the transfers were not of property of the estate. These entities may assert that the Church Autonomy Doctrine precludes the Court from applying the neutral and generally applicable provisions of the Bankruptcy Code and state law to resolve the disputes raised in adversary proceedings.

The Supreme Court has instructed that civil courts must decline to decide internal church controversies when to do so would require the court to implicate itself in doctrinal religious questions. Civil courts have no authority to resolve disputes over "matters of church government as well as those of faith and doctrine." *Kedroff v. Saint Nicholas Cathedral of Russian Orthodox Church*, 344 U.S. 94, 116 (1952). Examples of questions of doctrine and governance subject to ecclesiastical abstention include whether a denomination has departed from its previous theological commitments, *Presbyterian Church in U.S. v. Mary Elizabeth Blue Hull Mem'l Presbyterian Church*, 393 U.S. 440, 442-443 (1969) ("Presbyterian Church"), which church officials are entitled to hold sacred offices, *Serbian E. Orthodox Diocese v. Milivojevich*, 426 U.S. 696, 724 (1976), who is "transmitting the [religious] faith to the next generation," *Hosanna-Tabor Evangelical Church & Sch. v. EEOC,* 565 U.S. 171, 192 (2012), or who is "educating and forming students in the faith." *Our Lady of Guadalupe School v. Morrissey-Berru,* 140 S. Ct. 2049, 2069 (2020). To resolve such disputes, courts would necessarily pass judgment on questions of religious doctrine or governance. But courts have neither a legitimate interest in

regulating such issues nor the competence to decide them. *Milivojevich,* 426 U.S. at 714 n.8 (citing *Watson v. Jones, infra*).

The seminal case relied upon for church autonomy makes clear that a court should abstain only from determining internal church disputes that require it to determine matters of religious doctrine or ecclesiastical government:

> **In this country the full and free right to entertain any religious belief, to practice any religious principle, and to teach any religious doctrine which does not violate the laws of morality and property, and which does not infringe personal rights, is conceded to all.** The law knows no heresy, and is committed to the support of no dogma, the establishment of no sect. The right to organize voluntary, religious associations to assist in the expression and dissemination of any religious doctrine, and to create tribunals for the decision of controverted questions of faith within the association, and for the ecclesiastical government of all the individual members, congregations, and officers within the general association, is unquestioned. **All who unite themselves to such a body do so with an implied consent to this government, and are bound to submit to it.**

Watson v. Jones, 80 U.S. 679, 728-29 (1872) (emphasis added). By contrast, where the dispute does not involve ecclesiastic questions, "[the church]'s decision would be utterly disregarded by any civil court." *Id.* at 733.

The Supreme Court cases in which the court abstained from determining ecclesiastical issues based on church autonomy where property rights were at stake, were, in fact, intra-organizational disputes involving conflicts between two or more church factions. Both *Watson v. Jones,* 80 U.S. 679, and *Presbyterian Church,* 393 U.S. 440, involved disputes over religious doctrine in which one faction of the Presbyterian church, embracing doctrinal views that differed from the traditional views, sought recognition as the "true" church, as well as the control of church property. In *Watson*, two factions within the church differed over the issue of slavery in

relation to church teachings; in *Presbyterian Church*, the controversy revolved around the decision to ordain women and to take positions on social issues of the day. *Milivojevich,* 426 U.S. 696, involved a dispute between the Serbian Mother Church and its North American diocese over the removal of a U.S. bishop and the reorganization of the diocese into three separate dioceses. The diocese claimed that the bishop's removal and the diocesan reorganization were both improper under binding church rules, and the Illinois Supreme Court ultimately agreed, ordering the bishop's reinstatement and invalidating the reorganization. The U.S. Supreme Court reversed, holding that the state court violated the First Amendment based on its "impermissible rejection of the decisions of the highest ecclesiastical tribunals of this hierarchical church ... and [by] impermissibly substituting its own inquiry into church polity and resolutions based thereon" in place of the church hierarchy's determinations. *Id.* at 708. Using jurisdictional language, the Supreme Court emphasized that secular courts have no authority to override an ecclesiastic decision by church authorities. *Id.* at 713-15. *See also Kedroff, supra,* 344 U.S. 94 (state statute changing who within a church controlled a cathedral unconstitutional); *Kreshik v. Saint Nicholas Cathedral of Russian Orthodox Church*, 363 U.S. 190, 191 (1960) (same regarding judicial review applied to use and occupancy of cathedral).

In light of these Supreme Court decisions, the Tenth Circuit noted: "The church autonomy doctrine . . . does not apply to purely secular decisions, even when made by churches**.** ***Before the church autonomy doctrine is implicated, a threshold inquiry is whether the alleged misconduct is 'rooted in religious belief.'"*** *Bryce v. Episcopal Church in the Diocese of*

Colorado, *supra,* 289 F.3d 648, 657 (employment discrimination suit dismissed based on ministerial exception) (emphasis added).

Supreme Court precedent makes clear that the Church Autonomy Doctrine cannot be applied to the claims asserted in adversary proceedings, which only raise disputes between *secular* and religious entities and do not require the Court to determine questions of religious doctrine or church government. *Gen. Council on Fin. & Admin. v. Cal. Superior Court,* 439 U.S. 1369, 1372-73 (1978) ("[T]his Court never has suggested that those [intrachurch] constraints similarly apply outside the context of such intraorganization disputes. . . . Such considerations are not applicable to purely secular disputes between third parties and a particular defendant, albeit a religious affiliated organization, in which fraud, breach of contract, and statutory violations are alleged."); *Cantwell v. Conn.,* 310 U.S. at 306 ("Nothing we have said is intended even remotely to imply that, under the cloak of religion, persons may, with impunity, commit frauds upon the public."); *Employment Div. Dept. of Human Resources of Ore. v. Smith* ("Smith"), 494 U.S. 872, 885 (1990) (To make compliance with a neutral law contingent upon coincidence with religious beliefs would permit each individual "to become a law unto himself.")(citing *Reynolds v. U.S.*, 98 U.S. 145 (1879)); *McDaniel v. Paty,* 435 U.S. 618, 643 n.* (1978) (Stewart, J., concurring) ("[A]cts harmful to society should not be immune from proscription simply because the actor claims to be religiously inspired."); *Gonzalez v. Roman Catholic Archbishop,* 280 U.S. 1, 16, (1929) (noting fraud exception to intrachurch religious autonomy doctrine).

As the Seventh Circuit observed in *Listecki,* 780 F. 3d at 742 (holding that RFRA and First Amendment do not bar fraudulent transfer claims against religious entity), "Here, we have what was alleged to be a fraudulent or otherwise avoidable transfer, and the court need not interpret any religious law or principles to make that determination, nor must it examine a decision of a religious organization or "tribunal" on whether or not the transfer was fraudulent." The *Listecki* court continued, "We do not believe that there is, nor can there be, a religious exception that would allow a fraudulent conveyance in the name of free exercise." *Id.* at 749. *See also Portland*, 335 B.R. at 851 (rejecting church autonomy defense on issue of separate existence of unincorporated parishes, holding that restriction on the court's jurisdiction "does not mean that it may never adjudicate matters involving church property").

2. Application and Interpretation of Canon Law to Determine the Status of Estate Property Would Impermissibly Entangle the Court in Religious Doctrine.

The application of the Church Autonomy Doctrine would impermissibly entangle a bankruptcy court in religious questions by requiring it to apply, and then interpret, canon law, rather than the neutral and generally applicable provisions of the Bankruptcy Code, state law, and the underlying purported trust documents and deeds, to determine (i) whether unincorporated parishes have a legal existence separate from a diocese and can own property or be trust beneficiaries; and (ii) property of the estate.

The Supreme Court has explained that civil courts must avoid this type of entanglement in religious questions. *Jones v. Wolf,* 443 U.S. 595, 603 (1979) involved a property dispute between two rival factions of a church. The Supreme Court held that civil courts deciding

intrachurch property disputes need not follow the determinations of the highest denominational authority, explaining that First Amendment values are better served if courts apply "neutral principals of law" by resolving intrachurch property disputes on the basis of "objective, well-established concepts of trust and property law familiar to lawyers and judges." *Id.* at 603. This approach "free[s] civil courts completely from entanglement in questions of religious doctrine, polity, and practice." *Id.* A court "may adopt any one of various approaches for settling church property disputes so long as it involves no consideration of doctrinal matters, whether the ritual and liturgy of worship or the tenets of faith," and is "constitutionally entitled to adopt neutral principles of law as a means of adjudicating a church property dispute." *Id.* at 602, 604. *See also Mitchell v. Helms,* 530 U.S. 793, 828 (2000) (plurality op.) ("It is well established, in numerous other contexts, that courts should refrain from trolling through a person's or institutions religious beliefs."); *Watson v. Jones*, 80 U.S. at 729 (rejecting "appeal to the secular courts" for resolution of "any religious doctrine").

Avoidance actions seek the Court's resolution of claims by a secular entity representing secular third party creditors against a religious entity. These disputes turn on the defendants' actions, not their religious beliefs. To adjudicate these disputes the Court will not be required to resolve matters of religious doctrine, ecclesiastical office, employment of ministers, or property disputes between church factions.

Critically, a court cannot "abstain" or otherwise avoid resolving the disputes raised by the adversary proceedings which the application of the Church Autonomy Doctrine would require. As the Supreme Court noted in *Jones v. Wolf,* 443 U.S. at 602, the government is

obligated to provide for "the peaceful resolution of property disputes," and it has a duty to "provid[e] a civil forum" where the ownership of property "can be determined conclusively." *See Presbyterian Church,* 393 U.S. at 449 (similar). Because the Court must resolve the dispute over what constitutes property of the estate, the question is not whether it should decline to rule as in a typical Church Autonomy Doctrine case, but rather, whether it can apply and interpret neutral and generally applicable civil law in doing so. The only way for the Court to adhere to the First Amendment is to avoid entanglement with ecclesiastical law and apply civil law. *Jones v. Wolf* expressly held that it is constitutionally ***permissible*** to apply standard principals of trust, property and corporate law to resolve intrachurch property disputes. Where the dispute over property involves the rights of a secular entity, that approach is constitutionally ***required.***

As discussed in detail below, every court that has faced the issue has rejected the argument that the Church Autonomy Doctrine requires a court to defer to canon law in determining what constitutes property of the estate and the legal status of unincorporated parishes.

3. The Church Autonomy Doctrine Has Been Rejected by Every Court That Has Considered It in a Diocesan Bankruptcy Case.

Defendants contend that claims by secular entities must be adjudicated according to religious law has been rejected by every court that has considered it in diocesan bankruptcy cases. In *Portland, supra,* 335 B.R. 842, 849, the archdiocese was incorporated as a corporation sole under Oregon law and only one of the 124 parishes within the archdiocese had been separately incorporated as of the petition date. *Id.* The archbishop claimed that the bulk of the archdiocese's assets were held in trust for the benefit of the unincorporated parishes and other

juridic persons within the diocese, consistent with canon law. *Id.* at 848. The *Portland* court specifically rejected the argument that it was required to consider and apply internal church law in determining whether the parishes were legal entities separate from the archdiocese:

> **The parties in this case seek a determination of whether particular property titled in the name of debtor belongs to debtor or belongs instead to parishes, schools, or others.** Whether or not such a determination allows or requires the Court to consider the Roman Catholic Church's internal law, called the Code of Canon Law, it does not require resolution of a dispute over matters of church government, doctrine, or faith. **Who owns the property is, quite simply, not a theological or doctrinal matter.**
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> As I explained above, however, neutral principles of law require application of secular neutral principles, not sacred ones. The religious organization's internal law is not relevant to the dispute, unless neutral principles of civil law make it so. **There is no constitutional requirement that internal church law be considered in determining a purely secular dispute.**

Id. at 853-54 (partial summary judgment granted that RFRA and First Amendment do not preclude determination of estate property with respect to assets titled in the debtor; emphasis added). The *Portland* court expressly rejected the argument "that, even if the parishes are not legal entities that can hold title to real property, they have sufficient legal existence to allow them to be beneficiaries of a trust."[8] In rejecting the debtor's argument that a judicial determination that parish assets were property of the estate would substantially burden the free exercise of religion, the *Portland* court observed that civil law did not prevent the archdiocese

[8] *Id*. at 867. ("Those statutes [tax code and state charitable trust code] do not provide support for concluding that parishes are sufficiently separate from debtor to be the beneficiaries of trusts. If anything, they show that, if an unincorporated religious organization is to have legal status for some purpose, a statute must expressly provide for such status.")

from holding property in a manner consistent with its internal organization. Enforcement of the archdiocese's choice of how to organize its affairs with relation to the secular world, including its choice of how to hold title to property, does not substantially burden the exercise of religion. *Id.* at 853.

In *Portland*, the diocese had a civil law solution to the problem it created; namely, separate incorporation decades ago of each juridic person, instead of as part of a massive asset protection scheme to put assets out of reach of sex abuse survivors. Canon law did not excuse the need to follow the formalities of state property, corporate and trust law with regard to how the property is held. *Id.* at 856. As the *Portland* bankruptcy judge observed:

> Debtor has chosen to organize its operations under a corporation sole. It chose to separately incorporate (or allow the separate incorporation of) [only one parish]; it could also have chosen to incorporate the other parishes as religious corporations, by which they would gain a civil legal status and could exercise the powers granted to such corporations, including the power to hold and dispose of property and to sue and be sued. Debtor did not, however, choose to do that, and gives no reason why it could not, under state law, have separately incorporated the parishes or in some other way organized itself to protect the canonical ownership rights, if any, of the schools and parishes.

Id. at 867.[9]

In the bankruptcy of the Diocese of Spokane, the bankruptcy court similarly rejected the argument that it was bound to impose canon law upon third parties who deal with the diocese in secular transactions. In particular, the court held civil law rather than canon law must be applied in determining whether the unincorporated parishes were separate legal entities and whether

[9] Conversely, when the parishes have been incorporated under state law, and hold legal title to real or personal property, absent substantive consolidation or application of the alter ego doctrine, their assets are not property of the estate. *In re Archdiocese of Milwaukee*, 483 B.R. 693, 699 (Bankr. E.D. Wis. 2012).

property titled to the diocese was actually owned by the parishes or held in trust for them. *In re Catholic Bishop of Spokane, supra* at n. 11, 329 B.R. 304, 325 ("Application of commonly understood and commonly applied statutes and common law regulating property interests, rather than application of ecclesiastical law, does not interfere with the free exercise of religion. Application of § 541 to this debtor on the same basis as its application to all other bankruptcy debtors does not interfere with the free exercise of religion.").

Transfers of assets to trusts are not "rooted in religious belief." *Bryce,* 289 F. 3d at 657. Permitting the Church Autonomy Doctrine defenses to survive this summary judgment motion would condone a constitutional broadside by imposing ecclesiastical rules upon third parties who deal with ASF in secular transactions, or who are the victims of secular torts committed by the debtor. Recognition of the Church Autonomy Doctrine under these circumstances would allow religious entities to fraudulently transfer assets with impunity. The adversary proceedings do not implicate an internal church dispute among church factions or between a church and its current or former members over matters of religious doctrine or church government. *Portland, Spokane,* and *Listecki* teach that the application of neutral and generally applicable provisions of civil law to determine what constitutes property of the estate in a diocesan chapter 11 case does not implicate the First Amendment or the Church Autonomy Doctrine. *Jones v. Wolf* teaches that this is the approach that most fully complies with the First Amendment and ensures that the Court is not entangled in resolving religious questions.

A court's determination regarding estate property is purely secular -- between secular creditors on the one hand, and a church debtor, the trusts it created and transferred its assets to,

and the parishes, on the other hand. Neutral and generally applicable legal principles under the Bankruptcy Code and state corporate and trust law enable the Court to resolve the secular disputes raised by adversary proceedings without entangling itself in internal church government or canon law and without making any decision "on the basis of religious doctrine or practice." *Jones v. Wolf,* 443 U.S. at 602. There is no basis for the application and interpretation of canon law to determine what constitutes estate property or any other aspect of adversary proceedings.

C. The First Amendment Does Not Shield Fraudulent Transfers.

1. As a Matter of Law, Efforts to Recover Fraudulent Transfers Do Not Violate the Free Exercise Clause.

Countless reported decisions hold that religious entities are bound by neutral and generally applicable laws.[10] The right of free exercise does not relieve a religious organization of its obligations to comply with a valid and neutral law of general applicability. *Smith*, 494 U.S. at 879 (denial of unemployment benefits based on dismissal for unlawful peyote use did not violate Free Exercise Clause). Moreover, the First Amendment does not require that laws of general application be justified by a compelling governmental interest whenever they burden a particular religious practice. *Id.* at 883.

Under the Free Exercise Clause, "neutral, generally applicable laws may be applied to religious practices even when not supported by a compelling governmental interest." *Burwell v.*

[10] *See, e.g., Employment Div., Dept. of Human Resources of Ore. v. Smith,* 494 U. S. 872, 879-882 (1990). Consistent with the First Amendment and religious autonomy doctrine (and over sincerely held religious objections), the government may compel religious institutions to pay Social Security taxes for their employees, *United States v. Lee,* 455 U. S. 252, 256-261 (1982); deny nonprofit status to entities that discriminate because of race, *Bob Jones Univ. v. United States,* 461 U. S. 574, 603-605 (1983); require applicants for certain public benefits to register with Social Security numbers, *Bowen v. Roy*, 476 U. S. 693, 699-701 (1986); enforce child-labor protections, *Prince v. Massachusetts,* 321 U. S. 158, 166-170 (1944); and impose minimum-wage laws, *Tony and Susan Alamo Foundation v. Secretary of Labor*, 471 U. S. 290, 303-306 (1985).

Hobby Lobby Stores, Inc., 134 S. Ct. 2751, 2761 (2014) (quoting *City of Boerne v. Flores*, 521 U.S. 507, 514 (1997)); *Smith*, *supra,* 494 U.S. at 886 n. 3. If prohibiting religion is not the object of a law but merely the incidental effect of a generally applicable and otherwise valid provision, the First Amendment has not been violated. *Id* at 878. Neutral, generally applicable laws, such as the Bankruptcy Code, are subject only to a review for rationality, which requires no more than a showing that the government has a rational basis for the law. *Id.* at 878-79 ("We have never held that an individual's religious beliefs excuse him from compliance with an otherwise valid law prohibiting conduct that the State is free to regulate."); *Church of Lukumi Babalu Aye v. City of Hialeah,* 508 U.S. 520, 531 (1993). Thus, the First Amendment does not relieve a religious organization of its obligation to comply with a valid and neutral law of general applicability on the ground that the law prohibits conduct that religion prescribes. *Smith,* 494 U.S. at 879.

A more exacting standard—strict scrutiny—is reserved for instances in which the law is either not neutral or not generally applicable. *Church of Lukumi Babalu Aye*, 508 U.S. at 546 ("A law burdening religious practice that is not neutral or not of general application must undergo the most rigorous of scrutiny;" non-neutral law targeting religious practice violated First Amendment).[11] Strict scrutiny requires the government to show that there is a compelling interest supporting the law and that the law is narrowly tailored to the ends sought. *Id.* at 546-47.

[11] A law is not neutral if it discriminates on its face by "refer[ring] to a religious practice without a secular meaning discernible from the language or context." *Church of Lukumi Babalu Aye v. City of Hialeah*, 508 U.S. at 533. Courts also look at whether the object of the law is a neutral one, examining both direct and circumstantial evidence. *Id*. at 540. In terms of general application, all laws are selective to some extent, but "categories of selection are of paramount concern when a law has the incidental effect of burdening religious practice." *Id*. at 542. The Free Exercise Clause, at its heart, "protects religious observers against unequal treatment;" in other words, the government "cannot in a selective manner impose burdens only on conduct motivated by religious belief." *Id*. at 542-43 (alterations and quotations omitted). If a law is not of general and neutral applicability, courts are required

The Bankruptcy Code's fraudulent transfer sections are neutral and of general applicability. None of the Bankruptcy Code's fraudulent transfer provisions or analogous state laws were drafted to target religious actors, and they do not operate to single out religious actors. To the contrary, these laws operate neutrally and generally across all debtors and trusts, religious or not religious, who choose to file for voluntary bankruptcy, and all creditors affected by such filings and/or other transferees that might be the target of an avoidance action. Thus, rational review governs their constitutionality.

Even if strict scrutiny were applied, the fraudulent transfer laws would stand because they serve a compelling interest. *See Listecki,* 780 F.3d 746; *In re Newman*, 183 B.R. at 252, and 203 B.R. at 475 n. 4; *In re Meyer*, 467 B.R. at 460-61 (holding that even if strict scrutiny were necessary, the Code withstands "the highest test for constitutionality" and "Congress demonstrated a compelling interest in maintaining an equitable system for the protection of creditors and for permitting debtors to obtain a fresh start from overwhelming debt"). In sum, application of the Challenged Bankruptcy Provisions and analogous state laws violates no rights under the Free Exercise Clause of the First Amendment.

2. As a Matter of Law, Efforts to Recover Fraudulent Transfers Do Not Violate the Establishment Clause.

The First Amendment provides that "Congress shall make no law respecting an establishment of religion." U.S. Const. amend. I. "At its core, the Establishment Clause enshrines the principle that government may not act in ways that 'aid one religion, aid all religions, or

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to inquire whether the law is justified by a compelling governmental interest that is narrowly tailored to advance that interest. *Id*. at 531-32.

prefer one religion over another.'" *Snyder v. Murray City Corp.,* 159 F.3d 1227, 1230 (10th Cir. 1998) (quoting *Lee v. Weisman,* 505 U.S. 577, 600 (1992) (Blackmun, J., concurring)). After the passage of the Fourteenth Amendment following the Civil War, the United States Supreme Court determined that the Establishment Clause is applicable to the states. *See Everson v. Board of Education*, 330 U.S. 1, 15-16 (1947).

Efforts to recover fraudulent transfers do not violate the Establishment Clause. The most protective and most cited test was articulated by the Supreme Court in *Lemon v. Kurtzman*, 403 U.S. 602 (1971). There, the Supreme Court stated that for state action to pass constitutional muster it must meet the following three requirements: (1) it must have a secular purpose; (2) its principal or primary effect must be one that neither advances nor inhibits religion; and (3) it must not foster excessive government entanglement with religion. *Lemon*, 403 U.S. at 612-13.

The "purpose and effect prongs" of *Lemon* are to be interpreted "in light of Justice O'Connor's endorsement test." *Weinbaum v. City of Las Cruces, N.M.*, 541 F.3d 1017, 1030 (10th Cir. 2008). "Under the 'endorsement test,' the 'government impermissibly endorses religion if its conduct has either (1) the purpose or (2) the effect of conveying a message that religion or a particular religious belief is favored or preferred.'" *Id.* (quoting *Bauchman v. West High School,* 132 F.3d 542, 551 (10th Cir. 1997)). *Lemon's* excessive entanglement prong comes into play only where the government involves itself with a religious institution. *Weinbaum,* 541 F.3d at 1031. Against this Supreme Court and Tenth Circuit precedent, any defense to adversary proceedings on the grounds that they violate the Establishment Clause cannot survive summary judgment.

Fraudulent transfer law easily meet the first two prongs of the *Lemon* test. Likewise, these provisions easily satisfy Justice O'Connor's endorsement test. The application of neutral and generally applicable laws to determine a property dispute between secular parties, on the one hand, and religious entities, on the other hand, does not foster excessive government entanglement with religion.

Faculty

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