

**IN THE  
SUPREME COURT OF THE UNITED STATES  
OCTOBER TERM 2004**

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**In the Fellowship Church, Inc., Debtor**

Fellowship Church, Inc.,

Petitioner

v.

Official Committee of Unsecured Creditors of Fellowship Church, Inc.

Respondent.

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December 10, 2004

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTEENTH CIRCUIT IS GRANTED, LIMITED TO CONSIDERATION OF THE FOLLOWING QUESTIONS:

1. Whether a religious organization debtor may be subjected to the appointment of a trustee under section 1104 of the Bankruptcy Code.
2. Whether a creditors' committee may properly bring a derivative preference action under section 547(b) of the Bankruptcy Code

**UNITED STATES COURT OF APPEALS  
SIXTEENTH CIRCUIT**

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**In the Matter of Fellowship Church, Inc., Debtor** }

Official Committee of Unsecured Creditors of  
Fellowship Church, Inc. }

Appellant }

v. }

Fellowship Church, Inc. }

Appellee }

**No. 04-0538**

**Decision and Order**

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**Decided: July 1, 2004**

Before VOPAT, RANDO and SCHILLER

VOPAT, Circuit Judge, for the Court.

The Court today considers two issues: (1) whether an official committee of unsecured creditors may properly bring a preference action when the debtor-in-possession has failed to do so, and (2) whether a bankruptcy trustee may be appointed for a religious organization that has filed a petition for bankruptcy relief.

*Facts and Background*

In 1975, the debtor, Fellowship Church, Inc. (hereinafter, “Fellowship”), was founded as a non-denominational community-based religious organization in New York City by five young Manhattan families seeking spiritual growth. The church was incorporated as a non-profit corporation under the laws of the State of Kent, which was viewed as having a very favorable non-profit corporation law. The congregation began meeting in a classroom at a local private school in the Tribeca<sup>1</sup> area of lower Manhattan and was an immediate success. With its ethical

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<sup>1</sup> Tribeca, or TriBeCa, means “triangle below Canal”, and is an increasingly trendy area of Manhattan. Shaped like a triangle, it is bounded by Canal Street on the north, Broadway on the east, and the Hudson River on the west.

ecumenical message, its youthful, enthusiastic members, and the addition, in 1982, of a dynamic young pastor, Fellowship began experiencing exponential growth. In 1989, with more than one-thousand active members, Fellowship elected to become affiliated with the Union of Nondenominational Churches of America (hereinafter, “UNCA”), a national association of independent churches. UNCA provided its member churches with printed material, religious music for worship, administrative support, and occasionally, financing.

By 1990 Fellowship had grown to four thousand members and was receiving tithes and offerings averaging \$25 thousand a week. In need of larger quarters, the congregation appointed a real property search committee composed of several of its prominent members. Wishing to remain in the Tribeca area of Manhattan, the Committee, after an exhaustive study over two years, recommended to the congregation in 1992 that Fellowship purchase a commercial building in lower Manhattan, renovate the lower portion for church use, and continue renting the remaining floors to tenants as a source of additional church revenue. In pursuance of this objective, Fellowship embarked on a building fund drive spanning four years. By 1997, Fellowship had accumulated better than \$4 million in cash contributions plus an additional \$2 million in pledges and was receiving over \$30 thousand per week in tithes and offerings.

After additional study, the Committee proposed the purchase of the a ten-story building on Canal Street. The building was owned by a member of Fellowship who agreed to sell the building to the church for \$14 million, a substantial discount from market value. With many of its members employed in the burgeoning Wall Street securities’ industry, which, like the Tribeca area, was only a few blocks away, the location seemed ideal. An additional advantage was that the tenant occupying the lobby and first floor level of the building was looking for larger quarters

and was negotiating a termination of its lease, making immediate renovations for church purposes feasible.

It was estimated that the purchase price and renovation costs would total \$18 million. Fellowship applied to UNCA for financing. After negotiations, UNCA entered into a commitment to make a 30 year self-amortizing loan of \$10 million, secured by a first mortgage on the building. The loan closed on January 2, 1998, the property was purchased, and the mortgage was executed and properly recorded as required by New York law. The remaining costs would be paid from a \$6 million loan obtained from a local bank, secured by a second lien on the building, and \$2 million from the building fund.

Fellowship immediately began renovations on the building. After two years of extensive repairs and renovations, the congregation held its first worship services in the partially renovated building in 2000.

However, even in the early stages of the construction, there were some dark clouds gathering on the horizon, which became more ominous as the renovations proceeded. These included the dot-com crisis and the consequent fall off in the stock market, endangering the livelihood of many of the church's members; the fact that the congregation, with many of its members now beyond middle age, faced competition for young members from the rival Community Church, which had a more youthful membership and a ritual more in keeping with a growing return to traditional worship. Furthermore, there were cost overruns in the construction and additional unexpected expenses for high ticket items such as a custom-crafted organ and the latest audio/video equipment. Despite these circumstances however, Fellowship continued to make its timely monthly payments to UNCA and the bank.

In 2001, however, Fellowship's membership had declined from its high in 1998 of 4,000 to 2,500. Significantly, Fellowship's weekly receipts had dropped below \$20 thousand, a technical default of its loan agreement with UNCA. Additionally, less than half of the two million building fund pledges had been collected, leaving the building fund with a balance of only \$3 million. Then on September 11, 2001, the destruction of the World Trade Center decimated the value of real estate in lower Manhattan and resulted in a severe recession, especially among securities dealers. Tenants in the building defaulted in rent payments and vacated, and Fellowship's membership declined precipitously.

By the end of 2002, Fellowship's congregation had dwindled to 750 members. With Fellowship unable to make debt service payments to UNCA for almost six months, the church elders met with UNCA's representatives. The balance of the UNCA loan for the purchase and renovation of the building was then \$8.5 million. UNCA demanded that Fellowship pay down the loan by \$2 million from Fellowship's Building Fund. In return, UNCA agreed to forebear from foreclosure for at least six months. Fellowship made the payment to UNCA on January 15, 2003.

The situation for Fellowship, however, became worse. Unable to pay remaining construction and trade creditor debts, several of Fellowship's creditors commenced suits for payment of past due accounts. These creditor's claims totaled \$1.8 million. In addition, Fellowship was in default in payment of debt service to the second mortgagee.

On March 3, 2003, Fellowship filed a Chapter 11 petition in the District of Kent, the state of its incorporation. Fellowship listed in its schedules assets of real property valued optimistically at \$7 million and cash of \$1.7 million represented by the remaining balance in the

building fund and bank accounts. It listed liabilities of \$12 million to UNCA, the bank and trade creditors.

The debtor remained in possession under the supervision of the Senior Pastor. Over the strenuous objections of UNCA, the creditors' committee urged that an action be brought to set aside the \$2 million payment to UNCA as a preference. Fellowship's Senior Pastor informed the committee that the payment was not preferential under section 547(c) (3) and that, in any case, he had no intention of pursuing a preference action against his brothers in the faith. The creditor's committee filed a motion for the appointment of a Chapter 11 trustee based on Fellowship's refusal to assert the UNCA preference claim and other allegations of mismanagement and self-dealing by the Senior Pastor, or, in the alternative, for leave to bring the preference action. The Bankruptcy Court denied the motion for appointment of a trustee without hearing the creditors' committee's evidence, citing the First Amendment to the Constitution as authority for denying the appointment. However, the Bankruptcy Court, after hearing evidence and argument, granted the committee's request to bring the preference action derivatively on behalf of the Fellowship bankruptcy estate. Fellowship appealed the Bankruptcy Court's ruling permitting the creditors' committee to bring the preference action and the creditors' committee appealed the Court's refusal to appoint a trustee. The decision of the Bankruptcy Court was affirmed by the United States District Court for the District of Kent. Both parties appeal.

#### *The First Amendment and Trustee Appointment*

The court today addresses the question of the proper interpretation of the First Amendment<sup>2</sup> in the context of a voluntary Chapter 11 bankruptcy filing by a non-profit religious organization. Fellowship claims the appointment of a trustee itself violates the First Amendment

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<sup>2</sup> U.S. Const. amend. I, stating in relevant part "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof".

by allowing a government-appointed trustee to oversee the activities of a church. Fellowship's claim must be rejected whether it is viewed as a Free Exercise claim or an Establishment claim.

If viewed from a Free Exercise perspective, Fellowship's claim is that the appointment of a trustee violates the First Amendment because it limits its freedom to operate the church in the manner dictated by its highest official, the Senior Pastor. That claim is easily dismissed under the Supreme Court's modern Free Exercise cases. *See, e.g., Employment Division v. Smith*, 494 U.S. 872 (1990). In *Smith*, the Court found laws of general application required neither heightened scrutiny nor religious exemptions. Thus, under modern jurisprudential thought, the concept of "formal neutrality" governs our First Amendment analysis.

Even laws having a substantive effect on religion are valid as long as they are not tainted by "the unconstitutional object of targeting religious beliefs and practices." *City of Boerne v. Flores*, 521 U.S. 507, 529 (1997). Fellowship concedes, as it must, that both the Bankruptcy Code as a whole and the section 1104 provision for appointing a Chapter 11 trustee are neutral laws that do not target religion. Its contention is that the Religious Freedom Restoration Act (hereinafter "RFRA"), 42 U.S.C. 2000bb-1, which was passed in response to *Smith*, blocks the operation of section 1104 here.

RFRA purports to override *Smith* by invalidating laws of general application if they "substantially burden a person's exercise of religion," unless the application of the burden on religion is in furtherance of a compelling governmental interest and is the least restrictive means of furthering that interest. *See* 42 U.S.C. 2000bb-1(a & b). We reject Fellowship's RFRA claim for several reasons. First, the Bankruptcy Code provisions at issue here were not imposed upon Fellowship. Rather, Fellowship voluntarily sought bankruptcy relief and is merely being forced to accept the burdens of that choice along with its benefits. We see no substantial burden on

Freedom's exercise of religion. Whatever burden may be imposed by the trustee's control of its property is certainly less of a burden than having its assets seized by creditors, as would be its fate absent the protection of the Bankruptcy Code.

Second, preserving the integrity of the bankruptcy process and preventing abuse of the Chapter 11 process is a compelling governmental interest. *See In re Navarro*, 83 B.R. 348, 353 (Bankr. E.D. Pa. 1988). Third, the appointment of a trustee to replace debtors-in-possession who violate their fiduciary duties is less restrictive of Fellowship's exercise of religion than other available options such as dismissing the case or immediately liquidating its assets.

Fellowship cannot use RFRA to draft its own bankruptcy law, devoid of all rules that might limit Fellowship's freedom of action. One need not be very imaginative to foresee that Fellowship's argument would apply equally well to a host of other common Chapter 11 provisions. Such a result, the creation of a special bankruptcy law that treats religious institutions more favorably than non-religious ones, would violate the Establishment Clause. If RFRA were so interpreted we would be compelled to hold it unconstitutional. *See Cutter v. Wilkinson*, 349 F.2d 257 (6<sup>th</sup> Cir. 2003), *cert. granted*, \_\_\_ U.S. \_\_\_, 125 S.Ct. 308 (Oct. 12, 2004) (holding similar RLUIPA unconstitutional and suggesting RFRA is unconstitutional).<sup>3</sup>

Fellowship's Establishment Clause argument presents a closer case, but it too must be rejected. While the modern "formal neutrality" approach is most well-developed in cases decided under the Free Exercise clause, it also applies to Establishment claims. In the Establishment context, the Supreme Court has held that once the non-discrimination test is met, indirect aid to religious organizations is permissible. *See Zelman v. Simmons-Harris*, 536 U.S. 639 (2002). Indeed, direct aid to religion has been upheld in *Agostini v. Felton*, 521 U.S. 203

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<sup>3</sup> Although the Supreme Court has held that RFRA is unconstitutional as applied to the states, that holding does not limit its application to federal laws like the Bankruptcy Code provision at issue here. *See Christians v. Crystal Evangelical Free Church (In re Young)*, 141 F.3d 854, 859, *cert. denied*, 525 U.S. 811 (1998).

(1997) (permitting public-funded remedial education in religious schools) and *Mitchell v. Helms*, 530 U.S. 793 (2000) (using public funds for instructional equipment in religious schools).

The dissent relies almost entirely on the argument that the appointment of a trustee for a debtor religious institution creates excessive entanglement between government and religion that violates the *Lemon* test. In *Lemon v. Kurtzman*, 403 U.S. 602 (1971), the Court appeared to establish a three-pronged test for evaluating Establishment Clause claims. When faced with a law, like section 1104 of the Bankruptcy Code, that is religiously neutral on its face a reviewing court must consider (1) whether the law has a secular purpose; (2) whether the primary effect of the law advances or inhibits religion; and (3) whether the law creates an excessive entanglement between government and religion. What the dissent fails to recognize is that the entanglement factor is not a separate test that must be satisfied, but is merely part of the second prong – the primary effects test. This was made clear in the 1997 case of *Agostini v. Felton*, where Justice O’Connor wrote for the majority: “[T]he factors we use to assess whether an entanglement is ‘excessive’ are similar to the factors we use to examine ‘effect’ ... [I]t is simplest to recognize why entanglement is significant and treat it ... as an aspect of the inquiry into a statute’s effect.” 521 U.S. at 232. More recently, Justice O’Connor reaffirmed the view that *Agostini* “folded the entanglement inquiry into the primary effect inquiry” in her concurrence in *Zelman*. 536 U.S. at 668 (O’Connor, J., concurring). The Court’s elimination of entanglement as a separate Establishment Clause factor brings its Establishment Clause jurisprudence in line with the “formal neutrality” approach used in its modern Free Exercise opinions.

Having established the proper legal framework for our analysis, we now turn our attention to the Bankruptcy Code provision at issue here. We begin by noting that bankruptcy traditionally has been a collective creditor remedy. The filing of a petition in bankruptcy creates

an estate that is comprised of virtually all property of the debtor. *See* 11 U.S.C. 541. The trustee is the representative of the estate. 11 U.S.C. 323(a). In a Chapter 7 liquidation case,<sup>4</sup> a trustee would be appointed automatically and would have the duty to liquidate the property of the estate. *See* 11 U.S.C. 701 & 704. During the 1930's our concept of bankruptcy was expanded to include the rehabilitation of failed enterprises. Thus, Chapter 11 of the Bankruptcy Code permits a debtor to reorganize by confirming a plan of reorganization, instead of merely being liquidated. In a typical Chapter 11 case, no trustee is appointed. The debtor remains in possession of the estate and, as a debtor-in-possession, performs most of the functions and duties of a trustee. *See* 11 U.S.C. 1101 & 1107. Section 1104 of the Bankruptcy Code, the section at issue here, provides for the appointment of a trustee for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, or if the appointment is in the interests of creditors and other interests of the estate. 11 U.S.C. 1104(a). However, even after the appointment of a Chapter 11 trustee to administer the estate, the debtor still has the right to propose a plan of reorganization. 11 U.S.C. 1121(a). Nothing in any of these sections distinguishes between religious institution debtors and other types of debtors.

Section 1104(a) of the Bankruptcy Code is a religiously neutral statute that does not violate the Establishment Clause even when applied to a religious institution debtor. Applying the *Lemon-Agostini* analysis, it is clear from the evolution of the trustee provision that the statute has a secular purpose. Indeed, bankruptcy filings by religious institutions are exceedingly rare. The second prong of the test asks whether the “primary effect” of the law either advances or inhibits religion. Even if the appointment of a trustee in this case would result in substantial entanglement, it can hardly be said the primary effect of 1104 is the advancement or inhibition of

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<sup>4</sup> We note that a non-profit debtor like Fellowship could not be forced into an involuntary Chapter 7, but could file voluntarily. *Compare* 11 U.S.C. 301 (voluntary cases) *with* 11 U.S.C. 303(a) (involuntary cases).

religion. The statute's primary effect is in the thousands of cases where a trustee is appointed for a debtor that is not a religious institution.

On the entanglement question, it is important to note that the trustee's duties relate to the economic aspects of the church, and not its religious tenets. The Senior Pastor will continue to have exclusive authority over doctrinal matters and over the debtor's plan proposals. It is the church that chose to avail itself of the relief provided by Chapter 11. Having invoked the protections offered by the Code, the church must accept its burdens, one of which is the possibility of appointment of a trustee in those instances, as may exist here, where the debtor-in-possession fails to honor its fiduciary duties to the estate and its creditors. The church is not entitled to special exemptions from ordinarily applicable bankruptcy rules. It is simply being treated in the same manner as any other debtor.

We therefore conclude that the appointment of a Chapter 11 trustee in this case would not violate the First Amendment.

#### *Creditor Committee Standing to Pursue Preference Actions*

Although it would be easier, as the dissent suggests, to dispose of this case on statutory grounds by granting the creditors' committee derivative standing, we are not free to ignore the plain language of section 547(b) of the Bankruptcy Code or the Supreme Court's analysis of virtually identical language in *Hartford Underwriters Insurance Co. v. Union Planters Bank, N.A.*, 530 U.S. 1 (2000). We thus follow the lead of those courts that have honored *Hartford's* command and hold that the bankruptcy court lacks authority to grant derivative standing to a creditors' committee to bring a preference action on the estate's behalf. *In re Fox*, 305 B.R. 912, 914-16 (10<sup>th</sup> Cir. BAP 2004); *c.f. Holloway v. IRS (In re Odom Antennas, Inc.)*, 340 F.3d 705, 709 (8<sup>th</sup> Cir. 2003) (no derivative standing under sections 502(d) and 724(a)), *contra, Official*

*Committee of Unsecured Creditors of Cybergenics Corp. v. Chinery*, 330 F.3d 548 (3d Cir. 2003) (*en banc*).

Section 547(b) provides that “the trustee may avoid” certain pre-bankruptcy transfers that prefer one creditor over other creditors. The \$2 million payment by Fellowship to UNCA less than two months prior to bankruptcy is alleged to be such an avoidable transfer. The only question before us is whether the statutory language must be read to vest in the trustee or debtor-in-possession<sup>5</sup> an exclusive power to bring such actions, or whether the power is not exclusive and the bankruptcy court retains equitable power to authorize some other party, such as the creditors’ committee, to assert such actions in the trustee’s stead. Only if we determine that the power is not exclusive do we reach the policy issues and historical observations that drive the dissent’s analysis.

Congress clearly has the power when creating statutory right to define the class of persons who may enforce those rights. Further, where “a statute authorizes specific action and designates a particular party empowered to take it is surely among the least appropriate in which to presume nonexclusivity.” *Hartford*, 530 U.S. at 6-7. We find the statutory language of section 547(b) clear, explicit, unambiguous, and absolute. It names the trustee and only the trustee as the party with the power to assert preference actions. Congress is quite able, when it wishes, to indicate that additional parties may assert various powers. When entities other than the trustee are allowed to initiate contested matters or adversary proceedings the scheme of the Bankruptcy Code is to place that authority in a “party in interest.” *See, e.g.*, 11 U.S.C. §§ 105(a) and (d); 1104(a), (b), and (c); 1121(c), (d), and (e); 362(d); 1301(c); 704(7); 1102(a)(2) and (3); 1301(c);

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<sup>5</sup> Section 1107 grants to a debtor-in-possession the trustee’s power to avoid preferential transfers. *See* 11 U.S.C. 1107(a).

1307(c) and (d); 502(a); 1126(e); 1328(e); 727(c)(2); 1112(b); 304(b); 1128(b); 1108; 1109(b); 1105; 554(b); and 303(g).

Even if we were inclined to interpret section 547(b) to vest a non-exclusive power in the trustee, that option has been foreclosed by the Supreme Court's analysis in *Hartford*. There the Court was faced with the argument that virtually identical language "the trustee may recover" in section 506(c) vested a non-exclusive power in the trustee. That argument was flatly rejected by a unanimous Court on plain language grounds. The Court stated: "It is thus far more sensible to view the provision as answering the question 'Who may use the provision?' with 'only the trustee' than to view it as simply answering the question 'May the trustee use the provision?' with 'yes.'" *Hartford*, 530 U.S. at 6. The clear and unequivocal mandate of both the statutory language and *Hartford* is that only the trustee (or debtor-in-possession) has standing to bring a preference action.

The dissent's attempts to distinguish *Hartford* must be rejected. The *Hartford* Court's reference to derivative creditors' committee standing in footnote five is nothing more than an acknowledgement that that issue was not before it. The Court's introductory language, "Whatever the validity of that practice . . .", makes clear that it was in no way blessing the practice. *See Hartford*, 530 U.S. at 13 n.5. Any inference in the footnote to the contrary is irreconcilably at odds with the language of the opinion itself.

The dissent, following the *Cybergenics* opinion, relies on policy grounds to find in the bankruptcy court an equitable discretion to authorize the creditors' committee to bring avoidance actions where the trustee or debtor-in-possession unjustifiably refuses to do so. Regardless of the strength of those policy justifications, the bankruptcy court's equitable power does not authorize it to contravene the express command of section 547(b). Further, in our view the

policy analysis supports our plain language interpretation of section 547(b). In a Chapter 11 case, the need for centralizing the control of the case in the trustee (or debtor-in-possession) is ample reason for Congress to vest avoiding powers exclusively in the trustee. Section 547(b) says that the trustee “may” avoid transfers, not that he or she “must” do so. There are many reasons why a trustee or debtor-in-possession might choose not to pursue a particular avoidance action. These include the cost of bringing the action, the possibility of defenses, and even the debtor’s need to maintain favorable relations with the potential defendant in order to reorganize. While the creditors’ committee may be asserting the action for the benefit of the estate, rather than for strictly personal advantage like the *Hartford* claimant, the creditors’ committee may have little or no concern for the rehabilitation of the debtor. Creditors are interested only in the value that they can receive, whether sharing or not, and not in re-establishing a solid path for the debtor. Nor is it necessary to grant the creditors’ committee derivative standing in order to honor the Bankruptcy Code’s policies. The creditors have other ample remedies. For example, if the creditors’ committee can prove on remand that Fellowship has breached its fiduciary duty as a debtor-in-possession by unjustifiably refusing to assert the claim against UNCA, then an independent trustee will be appointed.

### *Conclusion*

For the reasons set forth above, we reverse the District Court’s order and hold that the Establishment Clause of the First Amendment does not bar the appointment of a trustee in a bankruptcy case instituted by a religious organization. We further hold that the powers vested in the trustee under section 547(b) of the Bankruptcy Code cannot be delegated to the creditors’ committee. We remand for further proceedings consistent with this opinion.

So ordered.

RANDO, Circuit Judge, dissenting.

I respectfully dissent from the majority's disposition of this case. While it is obvious to me that the appointment by the government of a trustee to operate a religious institution crosses the line between church and state that is so clearly established by the First Amendment, I believe that the proper construction of section 547(b) avoids the need to address the constitutional issue in this case. The court below appropriately accommodated both the needs of the creditors and the interest in religious autonomy by authorizing the creditors' committee to prosecute the potential preference action at issue here.

*Creditors' Committee Standing to Pursue Preference Actions*

For the reasons set forth below, I would affirm the District Court's decision that the creditors' committee has standing to bring a derivative action under section 547(b) of the Bankruptcy Code, 11 U.S.C. 547(b).

Relying on *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1 (2000), the majority makes much of the fact that section 547(b) says that "the trustee may avoid" preferential transfers. The majority, purportedly bound by *Hartford*, interprets that language to grant only to the trustee (or debtor-in-possession) the ability to bring a preference action. However, what my esteemed colleagues fail to appreciate is that the Supreme Court in *Hartford* did not decide the issue before us. See *Official Committee of Unsecured Creditors of Cybergenics Corp. v. Chinery*, 330 F.3d 548, 558 (3rd Cir. 2003) (*en banc*).

In *Hartford*, the Court held that section 506(c) did not provide an administrative claimant with a direct right to use that provision to seek payment of its claim. *Hartford*, 530 U.S. at 6. Central to the Court's holding was the importance of trustee control in Chapter 7 liquidation

cases. In a Chapter 7 liquidation proceeding, the trustee plays a central role -- a “unique role [which] makes it entirely plausible that Congress would provide a power to him and not to others.” *Hartford*, 530 U.S. at 7. The situation herein, however, is different. Here, unlike *Hartford*, the creditors’ committee is not seeking payment of a specific creditor’s claim, nor is it asserting a direct right to recover such a claim, possibly in competition with the trustee. Instead, the creditors’ committee is seeking the right to add an asset to the estate where the debtor-in-possession allegedly has unjustifiably refused to do so. The *Hartford* Court properly rejected the assertion that individual administrative claimants could recover their claims from a secured creditor under section 506(c). The administrative nightmare created by multiple and potentially inconsistent actions by specific creditors is ample reason to restrict the section 506(c) power to the trustee.

The situation here is quite different and the control policy commands a different result. This action is being brought by the statutorily-created representative of the unsecured creditors. The Bankruptcy Court authorized derivative standing only after a hearing at which the debtor-in-possession appeared and presented argument. The court approval mechanism employed here avoids the administrative chaos that drove the *Hartford* result. Further, unlike an actual trustee, the debtor-in-possession is an interested party that will have conflicts of interest and that may not always hold its fiduciary duty to the estate paramount. Derivative standing for the creditors’ committee provides not only an important check on the debtor-in-possession in cases like this, where the debtor-in-possession may have breached its duty, but is also a useful device for investigating and prosecuting claims against insiders and other related parties in cases where the debtor-in-possession may have a conflict. Against this backdrop it is clear that the Court’s reference to derivative standing in footnote five of *Hartford* was not merely a statement of the

obvious point that derivative standing issues were not before it, but rather a recognition that the issues presented by derivative standing are fundamentally different from those presented by the reimbursement of administrative expenses. *See Hartford*, 530 U.S. at 13 n.5. While the majority quotes only the first six words of the critical language in footnote five, the full passage makes clear that *Hartford* does not apply here. After referencing the practice of creditors' committees bringing actions under, *inter alia*, section 547(b), the Court stated, "Whatever the validity of that practice, it has no analogous application here, since petitioner did not ask the trustee to pursue payment under § 506(c) and did not seek permission from the Bankruptcy Court to take such action in the trustee's stead. Petitioner asserted an independent right to use § 506(c), which is what we reject today." *Id.*

Other courts support this conclusion. Most notably, the Third Circuit in *Cybergenics* held that a creditors' committee could, under certain circumstances, be granted derivative standing to bring an avoidance action. *See Cybergenics*, 330 F.3d at 566-69. *Cybergenics* honored the Supreme Court's admonition in footnote five and limited *Hartford* to the question of whether the language in the relevant provision ("the trustee may") grants a non-trustee a unilateral right to assert an avoiding action. *Id.* at 558-59. I agree with the *Cybergenics*' majority that the "trustee may" language does not preclude a bankruptcy court from using its "equitable power to craft a remedy when the Code's envisioned scheme [of having the debtor-in-possession pursue avoidance actions] breaks down." *Id.* at 559 (*emphasis omitted*).

Contrary to the majority's assertion, my view is not purely policy based, but rather is based on the most natural reading of Bankruptcy Code sections 503(b)(3)(B), 1103(c)(5) and 1109(b), which must be read together with section 547(b). *Cybergenics*, 330 F.3d at 562. Reading these sections together demonstrates that Congress recognized and approved of

derivative standing. Sections 1103(c)(5) and 1109(b) show that Congress intended that creditors' committee would play an active and central role in Chapter 11 adversarial proceedings and that it would perform services on behalf of the estate. Finally, section 503(b)(3)(B), which provides administrative expense treatment for a creditor who has expended money to recover for the benefit of the estate property concealed or transferred by the debtor, makes little sense if only the trustee (or debtor-in-possession) has standing to bring such an action. Thus, I adopt the view of the *Cybergenics* court that bankruptcy courts have the equitable power to "craft flexible remedies that, while not expressly authorized by the Code, effect the result the Code was designed to obtain." *Id.* at 568.

This conclusion is further supported by the compelling pre-Code practice of allowing courts to confer derivative standing on creditors' committees to bring avoidance actions. *Id.* at 569-70; *see also Term Loan Holder Committee v. Ozer Group, LLC (In re Caldor Corp.)*, 303 F.3d 161 (2nd Cir. 2002) (permitting non-trustee derivative standing); *Fogel v. Zell*, 221 F.3d 955, 965-66 (7th Cir. 2000) (same).

The bankruptcy court properly applied the test for granting a creditors' committee derivative standing.<sup>6</sup> Here Fellowship made a substantial transfer to UNCA that appears to be preferential in light of UNCA's undersecured position. The creditors' committee asked Fellowship to bring a preference action against UNCA, but Fellowship refused. The evidence

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<sup>6</sup> Derivative standing is appropriate where: 1) a demand has been made upon the debtor-in-possession to take action; 2) the demand is declined; 3) a colorable claim that would benefit the estate if successful exists, based on a cost-benefit analysis performed by the court; and 4) the refusal is unjustified in light of the statutory obligations and fiduciary duties of the debtor-in-possession in a Chapter 11. *See In re Gibson Group, Inc.*, 66 F.3d 1436, 1438 (6<sup>th</sup> Cir. 1995); *see also Louisiana World Exposition v. Federal Ins. Co.*, 858 F.2d 233, 247 (5<sup>th</sup> Cir. 1988) (requiring "the claim be colorable, that the debtor-in-possession have refused unjustifiably to pursue the claim, and that the committee first receive leave to sue from the bankruptcy court"); *Fogel*, 221 F.3d at 965 (allowing the committee to bring claims with the bankruptcy court's permission where the "trustee unjustifiably refuses a demand to bring an action to enforce a colorable claim ....").

that the refusal may have been based on the Senior Pastor's unwillingness to sue his brothers in the faith was sufficient for the Bankruptcy Court to find that the refusal was unjustified.

*Appointment of a Trustee Violates the First Amendment*

I also strongly disagree with the majority's view of the First Amendment. The Establishment Clause of the First Amendment provides that "Congress shall make no law respecting an establishment of religion ..."<sup>7</sup> This provision erects a wall of separation between church and state and furthers the constitutionally significant value of ensuring the autonomy of religious institutions. *See Everson v. Board of Education*, 330 U.S. 1, 16 (1947). Preserving the independence and integrity of religious institutions was a driving force behind the adoption of the First Amendment. As James Madison noted, the establishment of religion harms religion and is an "unhallowed perversion of the means of salvation."<sup>8</sup> It is difficult to imagine a more egregious encroachment on the time honored principle of separation of church and state than the appointment of a government official to operate a religious organization.

The majority's assertion that a Chapter 11 trustee's role is solely "economic" is misguided. The economic and spiritual aspects of a church are inextricably intertwined and cannot be divided. The majority's reference to Chapter 7 practice as support for its view is disingenuous. In a Chapter 7 case, the trustee's primary role is the collection and distribution of assets. There are no significant entanglement issues raised by such a limited role. In contrast, a Chapter 11 proceeding envisions the continued operation of the debtor while a plan is being formulated. And, where a Chapter 11 trustee has been appointed, section 1108 of the Bankruptcy Code specifically provides that "the trustee may operate the debtor's business." 11 U.S.C. 1108.

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<sup>7</sup> U.S. Const. amend I.

<sup>8</sup> James Madison, Memorial and Remonstrance Against Religious Assessments (June 20, 1785), *reprinted in* 5 The Founders' Constitution at 82, 83 (Philip B. Kurland & Ralph Lerner eds., 1987).

What does the majority think the business of a church is if not religious? Even relatively mundane operational decisions will hopelessly entangle the trustee in church policy and questions about the value of various religious activities. There is no way to separate the authority to appoint ministers from the authority to pay them or the decision to hold a worship service from the decision to incur the electric bill for lighting the church in which the service will be held. Realistically, a church can hardly be independent from the state when a state actor, with powers imbued by the judiciary, controls the purse strings of the congregation.<sup>9</sup>

While the majority's failure to appreciate the role of a Chapter 11 trustee undermines its application of the *Lemon v. Kurtzman*, 403 US 602 (1971), test, I also respectfully disagree with its revisionist interpretation of *Lemon* to eliminate the entanglement prong of the Establishment Clause analysis. To paraphrase Mark Twain, the reports of its demise are greatly exaggerated. First, I read Justice O'Connor's majority opinion in *Agostini v. Felton*, 521 U.S. 203 (1997), not to eliminate the entanglement prong of the *Lemon* test, but merely to recognize that excessive entanglement is one effect that might doom a facially neutral law. More importantly, in the post-*Agostini* case of *Sante Fe Independent School District v. Doe*, 530 U.S. 290, 314 (2000), the Court reaffirmed that "[W]e assess the constitutionality of an enactment by reference to the *three* factors first articulated in *Lemon* ..." (emphasis added). I conclude that the entanglement analysis continues to have validity and that, even if weakened by *Agostini*, it retains sufficient vitality to condemn the truly excessive degree of entanglement that arises from the granting of almost total control over a religious institution to a government appointed official.

I also disagree with the majority's treatment of Fellowship's argument based on the Religious Freedom Restoration Act ("RFRA"), 42 U.S.C. 2000bb-1. First, that act is

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<sup>9</sup> To the extent that the majority bases its analysis on the theory that Fellowship's voluntary institution of this Chapter 11 proceeding waived its First Amendment objection, that analysis must be rejected. The separation of church and state is a structural protection and not a protection personal to the church that can be waived by it.

constitutional since it merely accommodates religion and protects religious freedom in general from governmental intrusion, while not endorsing or benefiting any particular religious sect or viewpoint. *Christians v. Crystal Evangelical Free Church (In re Young)*, 141 F.3d 854, 862-63 (8<sup>th</sup> Cir. 1998) (RFRA constitutional); *c.f. Madison v. Riter*, 355 F.3d 310, 317-20 (4<sup>th</sup> Cir. 2003) (RLUIPA constitutional). As discussed above, the appointment of a trustee will substantially burden Fellowship's exercise of religion. This burden triggers an analysis of both the governmental interest involved and alternatives available to serve that interest. Compelling governmental interests are those involving the survival of the republic or the physical safety of its citizens. The purely economic interests served by the bankruptcy legislation simply do not rise to the level of a compelling governmental interest. *See In re Tessier*, 190 B.R. 396, 405 (Bankr. D. Mont. 1995). Finally, even if the interest here in recovering a potentially preferential transfer were a compelling one, it can be served by less extreme steps than appointing a governmental official to run the church.

For the aforementioned reasons, the opinion below should be affirmed.