St. John's University School of Law

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American Bankruptcy Institute

COMPETITION PROBLEM

32ND ANNUAL
DUBERSTEIN BANKRUPTCY
MOOT COURT COMPETITION
March 2 – March 4, 2024

Revised December 12, 2023

No. 23-0115

IN THE

Supreme Court of the United States

OCTOBER TERM, 2023

IN RE EUGENE CLEGG, DEBTOR

VERA LYNN FLOYD, CHAPTER 7 TRUSTEE, PETITIONER

V.

EUGENE CLEGG, RESPONDENT.

THE PETITION FOR A WRIT OF CERTIORARI IS GRANTED, LIMITED TO THE FOLLOWING QUESTIONS:

1. Whether any post-petition, pre-conversion increase in equity in a debtor's property inures to the benefit of the debtor or to the bankruptcy estate upon conversion of a case from chapter 13 to chapter 7 pursuant to 11 U.S.C. §§ 348 and 541.

2. Whether a chapter 7 trustee may sell, as property of the bankruptcy estate, the ability to avoid and recover transfers pursuant to 11 U.S.C. §§ 547 and 550.

Written by Paul R. Hage and Hon. John T. Gregg. Paul Hage is a Partner at Taft, Stettinius & Hollister, LLP in Detroit, Michigan. Judge Gregg serves in the United States Bankruptcy Court for the Western District of Michigan. The authors express no opinion on the issues presented herein.

Recommended for Full Text Publication

UNITED STATES COURT OF APPEALS
FOR THE THIRTEENTH CIRCUIT

EUGENE CLEGG,

CASE NO. 22-0359

DEBTOR.
______________________________________/

VERA LYNN FLOYD, CHAPTER 7 TRUSTEE

APPELLANT

V.

EUGENE CLEGG,

APPELLEE.
______________________________________/

Direct Appeal from the United States Bankruptcy
Court for the District of Moot

Decided: March 10, 2023

Before: Barrett, Gilmour and Mason, Circuit Judges

OPINION

Gilmour, Circuit Judge:

This appeal is representative of the severe financial problems faced by individuals in this country. Millions of Americans struggle each day to maintain their income so as to retain their property, including their homes. The Bankruptcy Code, a comprehensive statutory scheme designed to provide relief to the honest but unfortunate debtor, is not infallible.[1] For nearly forty-

[1] The Bankruptcy Code is set forth in 11 U.S.C. §§ 101 *et seq*. Specific sections of the Bankruptcy Code are identified herein as "section __."

five years, it has been subject to vastly differing interpretations – sometimes to the detriment of those who need relief most – as illustrated herein.

The debtor in this bankruptcy case is Cpl. Eugene Clegg (ret.) (the "Debtor"), a decorated veteran and small business owner. As a result of the COVID-19 health pandemic, the Debtor was forced to seek relief under chapter 13 in order to save his home. Unfortunately, due to serious illness and the loss of his business, the Debtor could not fulfill his payment obligations under his confirmed chapter 13 plan. Having run out of time and money, the Debtor converted his case in good faith to one under chapter 7.

Shortly after conversion, Vera Lynn Floyd, the chapter 7 trustee (the "Trustee"), sought authority from the bankruptcy court to sell the Debtor's home to capture for the benefit of the estate and its creditors an increase in equity after the petition date. The Trustee also requested approval to sell the right to avoid and recover alleged preferential transfers the Debtor made to his mother, Emily "Pink" Clegg ("Pink"). The Debtor objected to both requests for relief.

The bankruptcy court held that any post-petition increase in equity prior to the date of conversion does not constitute property of the chapter 7 estate because it belongs to the debtor pursuant to section 348(f)(1). Moreover, the bankruptcy court held that the ability of a chapter 7 trustee to avoid and recover preferential transfers under sections 547 and 550 is not estate property that can be sold but, rather, a statutory power that cannot.

The Trustee timely appealed both determinations. Having considered the arguments of the parties, we affirm the bankruptcy court on both issues.

Factual Background and Procedural History[2]

In 2011, the Debtor retired from the United States Army after a distinguished military career. Less than a year later, Pink transferred to the Debtor her 100% membership interest in The Final Cut, LLC ("Final Cut"), an entity that owned and operated a historic, single-screen movie theater in the City of Moot. At the time that Pink conveyed her membership interest to the Debtor, Final Cut had no liabilities whatsoever, and it consistently generated a net profit each year. For years, the Debtor's sole source of income was the modest salary that he received from Final Cut.

In 2016, the Debtor caused Final Cut to borrow $850,000 (the "Loan") from Eclipse Credit Union ("Eclipse"), a community-based financial institution that specialized in consumer vehicle and home loans and that had only recently begun to extend commercial loans. The purpose of the Loan was to renovate the theater, including its ornate ceiling. Eclipse was granted first priority liens on Final Cut's real and personal property, which liens were properly perfected. As additional security for repayment of the Loan, the Debtor executed an unconditional, unsecured personal guaranty in an unlimited amount.

The Debtor personally undertook much of the renovation work on the theater with assistance from other local veterans who graciously volunteered their time. Final Cut was therefore able to reduce typical labor costs such that it did not exhaust the proceeds of the Loan. The Debtor was extremely appreciative of the generosity exhibited by his fellow veterans. To that end, and unbeknownst to Eclipse, the Debtor caused Final Cut to donate the remaining proceeds of the Loan, approximately $75,000, to the Veterans of Foreign Wars (the "VFW") in early 2017.[3] Around that time and with the theater rehabilitation project complete, Final Cut reopened to the

[2] The facts, as set forth herein, have been stipulated to by the parties.

[3] Even after the donation, Final Cut remained solvent, fully capitalized and capable of satisfying its debts as they came due.

public. Local residents took great civic pride in the renovated theater and all that it represented. For three years, Final Cut was profitable.

In March 2020, the Governor for the State of Moot declared a public health emergency due to the COVID-19 pandemic and issued an executive order requiring all individuals within the State to stay at home. As a result, the theater was unable to operate for nearly a year. With no income from Final Cut, the Debtor was forced on September 8, 2020 to borrow, on an unsecured basis, $50,000 from his mother, Pink.

The theater finally reopened to the public in February 2021 with a local media campaign declaring that "The Show Must Go On!" Nevertheless, attendance failed to rebound to pre-pandemic levels. Exhibiting great mettle, the Debtor decided to forego his salary to help remedy Final Cut's cash flow problems. Without a reliable source of income, the Debtor was forced to incur significant credit card debt and fell behind on his home mortgage serviced by Another Brick in the Wall Financial Corporation (the "Servicer"). After the Debtor failed to make any mortgage payments for several months, the Servicer commenced foreclosure proceedings.

In an effort to save his home, the Debtor sought relief under chapter 13 of the Bankruptcy Code on December 8, 2021 (the "Petition Date"). The Debtor stated on Schedule A/B that the value of his home was $350,000 based on an appraisal that he had obtained only days before the Petition Date.[4] Schedule D identified a non-contingent, liquidated and undisputed secured debt to the Servicer in the amount of $320,000. Schedule E/F and Schedule H both included a contingent and unliquidated unsecured debt in an unknown amount owed to Eclipse.[5] On Schedule C, the Debtor properly claimed a state law homestead exemption in the amount of $30,000, which was

[4] This valuation has never been disputed.

[5] Eclipse timely filed a protective proof of claim for the full amount of the debt owed by Final Cut and guaranteed by the Debtor.

the maximum amount in the State of Moot. *See* 11 U.S.C. § 522(b). Finally, the Debtor disclosed on his Statement of Financial Affairs that he had made payments to Pink within one year prior to the Petition Date in the aggregate amount of $20,000.

The Debtor filed a chapter 13 plan which proposed to make payments to creditors over a three-year period.[6] With respect to the mortgage loan, the Debtor proposed to cure the prepetition arrears and make ongoing, continuing monthly payments to the Servicer with the chapter 13 trustee acting as a conduit. *See* 11 U.S.C. §§ 1322(b)(5), 1326(c). The plan provided that the value of the Debtor's home was $350,000, the same amount reflected on Schedule A/B. In an additional provision, the plan stated that, given the secured indebtedness and the homestead exemption, the Debtor maintained no equity in his home as of the Petition Date. The Debtor proposed to fund his plan solely through future earnings derived from Final Cut, which all parties in interest optimistically thought was on the cusp of returning to profitability. *See* 11 U.S.C. § 1325(a)(6).

During the meeting of creditors, Eclipse learned for the first time of the Debtor's donation to the VFW. *See* 11 U.S.C. § 341; Fed. R. Bankr. P. 2003. Eclipse was livid, to say the least. It promptly and timely commenced an adversary proceeding seeking to have the Debtor's debt related to the Loan declared non-dischargeable under section 523(a)(2)(A).

Leading up to confirmation, the chapter 13 trustee objected to the Debtor's plan as failing to satisfy section 1325(a)(4), which requires each creditor to receive under the plan no less than it would otherwise receive in a hypothetical liquidation under chapter 7. The chapter 13 trustee contended that, in such a liquidation, the alleged preferential transfers to Pink would be recovered and distributed to creditors. To resolve this objection, the Debtor amended the plan to increase the aggregate payments to creditors by $20,000 over the applicable commitment period. The

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[6] The Debtor used the national model chapter 13 plan prescribed for use in the District of Moot.

settlement was memorialized in a stipulation, wherein the chapter 13 trustee agreed that she would not seek to avoid and recover the payments made to Pink prior to the Petition Date.

Eclipse objected to the Debtor's plan as not being proposed in good faith. *See* 11 U.S.C. § 1325(a)(3). However, after weeks of negotiation, Eclipse, the Debtor and the chapter 13 trustee reached a resolution. Eclipse agreed to withdraw its plan objection in exchange for an estimated claim in the amount of $150,000, of which $25,000 was deemed non-dischargeable even in the event of conversion.[7] On February 12, 2022, the bankruptcy court confirmed the Debtor's plan which incorporated by reference the settlement with the chapter 13 trustee and expressly provided that all property of the estate vested in the Debtor. *See* 11 U.S.C. § 1327(b). Separately, the bankruptcy court entered an order approving the settlement between the Debtor and Eclipse.

The Debtor timely made payments under his confirmed plan for eight months. However, after contracting long-COVID in September 2022, the Debtor was unable to continue to work at the theater, which continued to suffer financially under the weight of the pandemic. In October 2022, the theater permanently closed, causing Eclipse to commence foreclosure proceedings against Final Cut.

Without income from Final Cut, the Debtor was no longer able to make payments under his plan. Confronted with either outright dismissal of his chapter 13 case, thereby allowing the resumption of collection efforts by creditors, or conversion to chapter 7, the Debtor chose the latter.[8] *See* 11 U.S.C. §§ 348, 1307. The bankruptcy court entered a generic order converting the case to chapter 7. In her final report, the chapter 13 trustee stated that she had distributed $10,000

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[7] The settlement with Eclipse further provided that the chapter 13 trustee was to hold any distributions for Eclipse in reserve, as its claim was merely an estimate and subject to reconsideration given the contingent nature of the debt related to the Loan. *See* 11 U.S.C. § 502(c), (j).

[8] No party in interest contended that the Debtor lacked good faith when he decided to convert his case.

to the Servicer under the plan. The chapter 13 trustee also reported that, upon conversion, she returned to the Debtor the funds that had been held in reserve for Eclipse.

Floyd was appointed as Trustee to administer the Debtor's chapter 7 estate. The Debtor's conversion schedules and other documents ascribed, as of the Petition Date, a value of $350,000 to his home and again disclosed the alleged preferential transfers to Pink. They also stated that the Debtor was indebted to Eclipse in the approximate amount of $200,000 due to the deficiency with respect to his guarantee of the Loan after foreclosure, which Eclipse completed post-conversion. In his statement of intention, the Debtor indicated that he intended to reaffirm the mortgage debt that he owed to the Servicer and remain in his home. *See* 11 U.S.C. § 524(c).

The Trustee initially concluded that the estate was, for the most part, bereft of assets. However, during the chapter 7 section 341 meeting of creditors, the Debtor mentioned that he had recently noticed that homes in his neighborhood were selling at a premium, consistent with a nationwide increase in home values in the years following the COVID-19 pandemic. The Trustee commissioned an appraisal of the Debtor's home which confirmed that the non-exempt equity in it had increased by $100,000 since the Petition Date.[9]

Consistent with the Trustee's duty to "collect and reduce to money the property of the estate for which such trustee serves" for the benefit of his creditors, 11 U.S.C. § 704(a)(1), the Trustee began marketing the home for sale. Eclipse, perhaps looking for retribution and redemption, offered to purchase both the home and the alleged preference claim against Pink for a total of $470,000. Content that Eclipse's offer maximized the value of the assets for the benefit of creditors of the estate, the Trustee filed a motion (the "Sale Motion") to sell both the home and the alleged preference claim to Eclipse under section 363(b).

[9] No party disputed the Trustee's valuation of the Debtor's home as set forth in the appraisal.

The Debtor objected to the Sale Motion on two grounds.[10] First, the Debtor argued that any post-petition, pre-conversion increase in the equity of his home should inure to his benefit. Accordingly, because there was no equity available for the estate as of the Petition Date, the Trustee could not sell the home. Second, the Debtor contended that the Trustee's statutory ability to avoid and recover transfers under sections 547 and 550 cannot be sold.[11] The bankruptcy court ruled in favor of the Debtor on both objections and denied the Sale Motion.

The Trustee timely appealed the court's ruling.[12] Upon the request of the parties, the disputes were certified for direct appeal to this court pursuant to 28 U.S.C. § 158(d)(2)(A).

Discussion

I. Legal Standard

The parties do not dispute the facts as set forth herein. Rather, the issues that we address in this appeal involve questions of law. Thus, our review is *de novo*. *See, e.g.*, *Fox v. Hathaway (In re Chicago Mgmt. Consulting Grp.)*, 929 F.3d 804, 809 (7th Cir. 2019). Under a *de novo* standard of review, the reviewing court decides an issue as if the court were the original trial court in the matter. *See, e.g.*, *Razavi v. Comm'r of Internal Revenue*, 74 F.3d 125, 127 (6th Cir. 1996) (quotation omitted).

II. Any Post-Petition, Pre-Conversion Increase in Equity in a Debtor's Property Inures to the Benefit of the Debtor Upon Conversion from Chapter 13 to Chapter 7

Chapter 13 of the Bankruptcy Code provides an alternative to chapter 7 by allowing a debtor with regular income to obtain a discharge of debts while retaining his or her property. *See*

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[10] The parties stipulated that the Debtor had standing to object to the Sale Motion on both grounds.

[11] The Debtor raised a purely legal issue as to whether the preference action is property of the estate that can be sold by the Trustee. He did not assert that the purchase price offered by Eclipse was not fair and reasonable. Thus, the sufficiency of the consideration offered by Eclipse is not before the court on appeal.

[12] The Trustee, Pink and Eclipse stipulated to toll any statute of limitations with respect to the preference action pending resolution of this appeal.

Harris v. Viegelahn, 575 U.S. 510, 514 (2015). Unlike in chapter 7, which requires the liquidation of non-exempt property, chapter 13 requires a debtor to make payments to satisfy the debts of creditors, typically from "future earnings or other future income." 11 U.S.C. § 1322(a)(1). Chapter 13 is therefore mutually beneficial. A debtor is able to retain his or her assets, while creditors collect as much or more than they would have received in a hypothetical chapter 7. *See* 11 U.S.C. § 1325(a)(4).

Upon the filing of any chapter 13 petition, an estate comprised of certain property is created and a chapter 13 trustee appointed. 11 U.S.C. §§ 541, 1302. An individual debtor in chapter 13, like in any other chapter, is entitled to exempt the value of certain property, and sometimes the property itself, from the estate. 11 U.S.C. § 522.

Shortly after the petition is filed, a debtor must propose a plan to repay creditors, among other things. 11 U.S.C. §§ 1321, 1326. The bankruptcy court determines whether a debtor's proposed plan should be confirmed. 11 U.S.C. §§ 1322–1325. Unless otherwise specified in the plan, "confirmation 'vests all of the property of the [bankruptcy] estate in the debtor,' and renders that property 'free and clear of any claim or interest of any creditor provided for by the plan.'" *Bullard v. Blue Hills Bank*, 575 U.S. 496, 502-03 (2015) (citations omitted). After confirmation, the chapter 13 trustee is "often charged with collecting a portion of a debtor's wages through payroll deduction, and with distributing the withheld wages to creditors." *Harris*, 575 U.S. at 514.

In exchange for successfully completing all required payments under the confirmed plan, a chapter 13 debtor's debts are discharged, subject to limited exceptions. 11 U.S.C. § 1328; *see United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 276-77 (2010). In many instances, however, a debtor will fail to confirm his or her plan or satisfy the obligations thereunder after confirmation, resulting in either conversion to another chapter or outright dismissal of the case.

11 U.S.C. §§ 348, 349, 1307. Importantly, when a case is converted from chapter 13 to chapter 7, "[t]he existing case continues along another track . . . without 'effect[ing] a change in the date of the filing of the petition.'" *Harris*, 575 U.S. at 515 (citation omitted); *see* 11 U.S.C. § 348(a).

Our first issue requires us to consider whether post-petition, pre-conversion increases in equity – in this instance, due to the appreciation in value of the Debtor's home and the mortgage payments he made pursuant to his plan – inure to the benefit of the Debtor or the chapter 7 estate after conversion. Diverging interpretations have recently emerged from the courts and even among our circuit court colleagues. *See, e.g.*, *Castleman v. Burman (In re Castleman)*, 75 F.4th 1052, 1055 n.3, 1058 (9th Cir. 2023) (collecting cases) (Tallman, J., dissenting); *Goetz v. Weber (In re Goetz)*, 651 B.R. 292, 302 (B.A.P. 8th Cir. 2023), *appeal docketed,* No. 23-2491 (8th Cir. June 23, 2023); *cf. Rodriguez v. Barrera (In re Barrera)*, 22 F.4th 1217, 1222 (10th Cir. 2022).

Reading the statute in isolation, the Trustee contends that section 348(f)(1)(A), which provides that "property of the estate in [a] converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion," requires property of the chapter 7 estate to include any increase in equity in the Debtor's home after the commencement of the case. 11 U.S.C. § 348(f)(1)(A); *see* 11 U.S.C. § 541(a). While we agree that, on its face, section 348(f)(1)(A) generally provides that property of the estate in the Debtor's converted case consists of property of the estate as of the petition date, the Trustee's interpretation is incomplete.

A "cardinal rule" of statutory construction requires the Bankruptcy Code "to be read as a whole . . . since the meaning of statutory language, plain or not, depends on context." *King v. St. Vincent's Hosp.*, 502 U.S. 215, 221 (1991) (citations omitted); *see also RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645 (2012) (citations omitted) ("Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions.”). Here, section 348(f)(1)(A) is contextualized by sections 348(f)(2) and 522.

Section 348(f)(2) provides that if a debtor converts a chapter 13 case in bad faith, “property of the estate in the converted case shall consist of the property of the estate *as of the date of conversion*.” 11 U.S.C. § 348(f)(2) (emphasis added). It thus penalizes a chapter 13 debtor for his or her bad faith conduct by requiring the forfeiture of any post-petition, pre-conversion interests in property that he or she would otherwise have been entitled to keep upon a good faith conversion. *See Harris*, 575 U.S. at 517; *In re Barrera*, 22 F.4th at 1220-21.

If Congress had truly intended to include post-petition, pre-conversion interests in property - such as the increase in equity in the Debtor’s home - as property of the estate under section 348(f)(1)(A), it would not have needed to enact section 348(f)(2). *See In re Harmon*, 2022 WL 20451952, at *6 (Bankr. E.D. La. June 9, 2022); *see also Harris*, 575 U.S. at 518 (reading section 348(f) in context); *City of Chicago v. Fulton*, 141 S. Ct. 585, 591 (2021) (interpretation should not “render superfluous another part of the same statutory scheme”). The Trustee’s alleged plain meaning interpretation would therefore render inconsequential the distinction between good faith and bad faith conversions under section 348(f)(1)(A) and section 348(f)(2), respectively.

We find further conflict in the statutory scheme when section 522 is considered. Nearly identical to the text of section 348(f)(1)(A), section 522 establishes, with limited exceptions not applicable here, the petition date as the date upon which property interests are valued for the purpose of a debtor’s exemptions.[13] 11 U.S.C. § 522(a)(2). Known as the “snapshot” rule, section

[13] Citing section 348(f)(1)(B), the dissent seems to suggest that determinations regarding value in a chapter 13 case do not apply when the case is converted to chapter 7. However, section 348(f)(1)(B) was enacted in 2005 to address the practice of “implicit valuation.” H.R. REP. NO. 109-3(I), at 73 (2005), *as reprinted in* 2005 U.S.C.C.A.N. 88, 140-41; *see In re Hodges*, 518 B.R. 445, 449-50 (E.D. Tenn. 2014) (citations omitted). It is therefore irrelevant to the issue before us.

522(a)(2) freezes a debtor's financial situation, including the value of his assets, in time. *See, e.g.*, *Rockwell v. Hull (In re Rockwell)*, 968 F.3d 12, 17 (1st Cir. 2020). If, as the Trustee argues, section 348(f)(1)(A) is not similarly subject to a snapshot rule, the Bankruptcy Code would be rendered non-sensical in that it could result in vastly different valuations as to the same property. In other words, the Debtor's home would absurdly be valued at only $350,000 for purposes of his homestead exemption, yet at $450,000 for purposes of property of the estate upon conversion, even though both section 348(f)(1)(A) and section 522(a)(2) reference the petition date. We therefore construe the meaning of the relevant text to be anything but plain.

Attempting to counter the snapshot rule, the Trustee relies on a recent decision from one of our sister circuits to assert that no difference exists between post-petition equity and the property from which it is derived, admittedly a clever argument. *See In re Castleman*, 75 F.4th at 1056. However, we are not persuaded by *Castleman* for three reasons. First, *Castleman* relies upon its own circuit precedent, *Schwaber v. Reed (In re Reed)*, 940 F.2d 1317, 1323 (9th Cir. 1991), to conclude that any post-petition increase in equity goes to the chapter 7 estate. Yet *Castleman* fails to mention that *Schwaber* predated the enactment of section 348(f)(1)(A) in its current form, making it inapposite to the present-day interpretation of that statute. Second, *Castleman* relies in large part on *Wilson v. Rigby*, 909 F.3d 306, 309 (9th Cir. 2018), a decision addressing whether the chapter 7 trustee or the debtor is entitled to an increase in equity. The problem with *Wilson* is that it involved a chapter 7 case in which conversion was never at issue. And third, *Castleman* rests entirely on the alleged plain meaning of section 348(f)(1)(A) without ever considering its inherent tension with sections 348(f)(2) and 522. Accordingly, we agree with the dissent in *Castleman* that the majority opinion in that case "sacrifices the text of the bankruptcy statutes on the altar of simplicity." *In re Castleman*, 75 F.4th at 1060 (Tallman, J., dissenting).

Given the ambiguity that arises when the relevant statutes are read in context, we turn to section 348(f)'s substantial legislative history. After all, "common sense suggests that inquiry benefits from reviewing additional information rather than ignoring it." *Wis. Pub. Intervenor v. Mortier*, 501 U.S. 597, 610 n.4 (1991). In 1994, Congress enacted section 348(f) to address post-petition, pre-conversion interests in property. The legislative history to section 348(f) reveals that Congress clearly intended for any post-petition, pre-conversion interests in property to be retained by the Debtor. It begins by recognizing that the chapter 7 estate does not include post-petition, pre-conversion property interests:

> This amendment would clarify the Code to resolve a split in the case law about what property is in the bankruptcy estate when a debtor converts from chapter 13 to chapter 7. The problem arises because in chapter 13 …, any property acquired after the petition becomes property of the estate, at least until confirmation of a plan. Some courts have held that if the case is converted, all of this after-acquired property becomes part of the estate in the converted chapter 7 case, even though the statutory provisions making it property of the estate do not apply to chapter 7. Other courts have held that the property of the estate in a converted case is the property the debtor had when the original chapter 13 petition was filed.

H.R. REP. NO. 103-835, at 57 (1994), *as reprinted in* 1994 U.S.C.C.A.N. 3340, 3366. The legislative history further explains that such interests in property explicitly include increases in equity, as illustrated in the following hypothetical:

> These later courts have noted that to hold otherwise would create a serious disincentive to chapter 13 filings. For example, a debtor who had $10,000 equity in a home at the beginning of the case, in a State with a $10,000 homestead exemption, would have to be counseled concerning the risk that after he or she paid off a $10,000 second mortgage in the chapter 13 case, creating $10,000 in equity, there would be a risk that the home could be lost if the case were converted to chapter 7 (which can occur involuntarily). If all the debtor's property at the time of conversion is property of the chapter 7 estate, the trustee would sell the home, to realize the $10,000 in equity for the unsecured creditors and the debtor would lose the home.

Id. As if the aforementioned example wasn't enough to concretely establish the true meaning of section 348(f), the legislative history drives this point home by overruling the contrary interpretation and expressly distinguishing between good and bad faith conversions:

> This amendment overrules the holding in cases such as *Matter of Lybrook*, 951 F.2d 136 (7th Cir. 1991) and adopts the reasoning of *In re Bobroff*, 766 F.2d 797 (3d Cir. 1985). However, it also gives the court discretion, in a case in which the debtor has abused the right to convert and converted in bad faith, to order that all property held at the time of conversion shall constitute property of the estate in the converted case.

Id.; *see also* Keith M. Lundin, Lundin on Chapter 13, § 143.2, at ¶¶ 1, 26, LundinOnChapter13.com (last visited Oct. 16, 2023).

The legislative history shows that Congress intended to address the very issue before us today when it enacted section 348(f), unequivocally rejecting the Trustee's interpretation in the process. *In re Barrera*, 620 B.R. 645, 653 (Bankr. D. Colo. 2020), *aff'd sub nom*. *Rodriguez v. Barrera (In re Barrera)*, 2020 WL 5869458, at *5-7 (B.A.P. 10th Cir. Oct. 2, 2020), *aff'd*, *In re Barrera*, 22 F.4th at 1219; *see also United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 242 (1989) (internal quotation omitted) ("The plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.'"). Because the facts in this appeal are similar, if not identical, to the example included in section 348(f)'s legislative history, it is clear that the Debtor, not the chapter 7 estate, is entitled to any post-petition, pre-conversion increase in equity in the Debtor's home.

Our conclusion is further supported by the purpose and policy behind chapter 13, which is designed to allow a debtor to retain, without penalty, his home, car and other property in exchange for regular payments to creditors. *See Harris*, 575 U.S. at 514. Chapter 13 is thus intended to incentivize a debtor to repay his debts with assurances that a chapter 7 trustee will not be able to seize any post-petition, pre-conversion equity for the benefit of the estate upon conversion. *In re Hodges*, 518 B.R. at 448-50 (citations omitted). As one court has observed:

> Congress has given the debtor who attempts to repay his debts in chapter 13, albeit unsuccessfully, a sort of guarantee that he will be no worse off for having tried a repayment plan, as long as he converts in good faith. This guarantee comes in the form of allowing the debtor to retain his postpetition assets, which of course he would never have had to contribute if he had originally filed a chapter 7 case.

In re Barrera, 620 B.R. at 648.

Here, the Debtor elected to accept the grand bargain of chapter 13, which allowed him to retain his home and other property while paying his creditors, over time, at least as much as they would otherwise receive in a hypothetical chapter 7. *See* 11 U.S.C. §§ 1325(a)(4), 1327(b). He dutifully made payments under his confirmed plan for almost a year, resulting in a significant reduction of the debts he owed to creditors. Through no fault of his own, the Debtor could not satisfy the obligations under his confirmed plan and thereafter converted his case in good faith as opposed to dismissing it outright. Consistent with the purpose of chapter 13, the Debtor should be rewarded, not punished, for seeking to repay his creditors. This is particularly true because the Debtor likely would have been able to keep his home had he simply decided to file for relief under chapter 7 in the first place.

For the foregoing reasons, we hold that a post-petition, pre-conversion increase in equity in property inures to the benefit of the debtor, not the chapter 7 estate, upon a good faith conversion. We therefore affirm the decision of the bankruptcy court.

III. The Trustee Cannot Sell the Power to Avoid and Recover Transfers Under Sections 547 and 550

The second issue on appeal today, like the first, requires us to consider what constitutes property of the estate. As we briefly explained above, upon the filing of a voluntary petition for relief, an estate comprised of certain property "wherever located and by whomever held" is created.

11 U.S.C. §§ 301, 541(a). While property of the estate under section 541(a) has generally been described as broad in scope, it is confined to seven carefully enumerated subsections. *Compare* 11 U.S.C. § 541(a) ("following") *with* 11 U.S.C. § 541(b) ("include"); *see also* 11 U.S.C. § 102(3).

Sections 544 – 553 discretely set forth a trustee's "avoidance powers," which allow a trustee to avoid and recover certain transfers made by a debtor. *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1663 (2019) (citations omitted). Under section 547, the trustee is granted the discretion to avoid, subject to certain defenses, transfers of property a debtor made within ninety days (or, in the case of insiders like Pink, one year) prior to the petition date. 11 U.S.C. § 547(b), (c). Section 547 serves two primary purposes:

> First, by permitting the trustee to avoid prebankruptcy transfers that occur within a short period before bankruptcy, creditors are discouraged from racing to the courthouse to dismember the debtor during his slide into bankruptcy…. Second, and more important, the preference provisions facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor. Any creditor that received a greater payment than others of his class is required to disgorge so that all may share equally.

Union Bank v. Wolas, 502 U.S. 151, 160-61 (1991) (citation and quotation omitted). Section 550(a) complements section 547, among others, by providing that in the event that the trustee avoids a transfer, the trustee may then "recover, for the benefit of the estate, the property transferred, or if the court so orders, the value of such property…." 11 U.S.C. § 550(a). To be clear, avoidance is a condition precedent to recovery under section 550(a). *See id*.

We are required to determine whether a trustee's avoidance powers constitute property of the estate. Courts, including our sister circuits, have adopted differing interpretations. *Compare, e.g.*, *Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery (In re Cybergenics Corp.)*, 226 F.3d 237 (3d Cir. 2000) and *In re Clements Mfg. Liquidation Co., LLC*, 558 B.R. 187 (Bankr. E.D. Mich. 2016) *with, e.g.*, *Pitman Farms v. ARKK Food Co., LLC (In re Simply*

Essentials, LLC), 78 F.4th 1006 (8th Cir. 2023); *see also* Brendan Gage, *Is There a Statutory Basis for Selling Avoidance Actions?*, 22 J. Bankr. L. & Prac. 3 Art. 1 (2013).

Again, our inquiry begins, as it must, with the plain meaning of the text. *Lamie v. U.S. Tr.*, 540 U.S. 526, 534 (2004) ("[W]hen the statute's language is plain, the sole function of the courts – at least where the disposition required by the text is not absurd – is to enforce it according to its terms."). As a threshold matter, we note the United States Supreme Court has previously held, in the context of section 506(c), that when the Bankruptcy Code uses the word "trustee," it means the trustee and no one else. *See Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6-7 (2000) ("*Hen House*"). Like section 506(c), sections 547 and 550 expressly state, without reference to any other person, that the "trustee," and thus only the trustee, is authorized to exercise the powers of avoidance and recovery. *See Hartford Underwriters*, 530 U.S. at 7. We reject the Trustee's argument that she can sell her avoidance powers given that, pursuant to *Hen House*, Eclipse cannot ever use them.[14]

The absence of any reference to section 547 in section 541(a) is also telling. When it enacted the Bankruptcy Code, Congress clearly knew how to include a cross-reference to section 547, as it did so in over fifteen sections. *See* 11 U.S.C. §§ 303, 349, 362, 502, 521, 522, 546, 550-552, 749, 764, 901, 926, 1521, 1523. However, the text of section 541(a) contains no such cross-reference. We conclude that Congress's omission of section 547 was intentional, meaning that the trustee's power to avoid a preferential transfer is not property of the estate.

The Trustee asks us to overlook *Hen House* as well as the overt omission of section 547 from the text of section 541(a) by unilaterally expanding section 541(a)(1). Unlike the Trustee,

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[14] Section 550(a), which allows a trustee to recover an avoided transfer, contains its own textual trap for the Trustee, in that it provides that an avoided transfer can be recovered "for the benefit of the estate." But if a trustee's avoidance power can be sold, avoided transfers would not be recovered "for the benefit of the estate;" they would be recovered for the benefit of the purchaser.

we are not so comfortably numb as to the text of the statute. Section 541(a)(1) includes as property of the estate "all legal or equitable interests of the debtor in *property as of the commencement of the case*." 11 U.S.C. § 541(a)(1) (emphasis added). The reference to the phrase "property as of the commencement of this case" plainly means that section 541(a)(1) only pulls into the estate claims that existed prior to the petition date, not the avoidance powers granted to a trustee only upon the bankruptcy filing.

The Trustee directs us to *In re Simply Essentials*, 78 F.4th at 1009, wherein the Eighth Circuit Court of Appeals summarily concluded that a debtor purportedly retains an inchoate or contingent interest in property transferred prepetition. While *Simply Essentials* is certainly creative, we must respectfully decline to adopt its strained reasoning in light of at least three inherent flaws.

First, the Debtor disposed of the funds he transferred to Pink, meaning that he no longer had any interest in them under section 541(a)(1). *See, e.g.*, *Beiger v. IRS*, 496 U.S. 53, 58-59 (1990); *100 Lindbergh Boulevard Corp. v. Gurnett Rock, Inc. (In re 100 Lindbergh Boulevard Corp.)*, 128 B.R. 53, 56-59 (Bankr. E.D.N.Y. 1991) (down payments were not estate property where debtor maintained no prepetition interest) (Duberstein, C.J.); *see also* 11 U.S.C. § 101(54). Second, the relevant inquiry is not, as *Simply Essentials* seems to suggest, whether the funds the Debtor transferred to Pink remain property of the estate; it is whether the Trustee's avoidance powers themselves are property of the estate. Third, if the Debtor did in fact retain an interest in the funds, there would be no need for recovery under section 550(a), as the Trustee could simply compel turnover under section 542(a). *See United States v. Whiting Pools, Inc.*, 462 U.S. 198, 207-09 (1983).

The Trustee fares no better under section 541(a)(7), which provides that property of the estate includes "[a]ny interest in property that the estate *acquires after* the commencement of the case." 11 U.S.C. § 541(a)(7) (emphasis added). We find this subsection to be a non-sequitur, as the Bankruptcy Code expressly grants "rights and powers" to the trustee. 11 U.S.C. §§ 546(c)(1), (d), (h), 547(b), 550(a). Nor are avoidance powers "acquired" in the ordinary sense – they are statutorily created by operation of law. *See, e.g.*, *Taniguchi v. Kan Pac. Saipan, Ltd.*, 566 U.S. 560, 566-67 (2012) (ascribing ordinary meaning to undefined terms). Finally, from a temporal perspective, the trustee's avoidance powers arise *upon* the commencement of the case, not at some indeterminant point *after* it.

While we believe that the plain meaning of section 541(a) renders our inquiry complete, we are mindful that "statutory language … 'cannot be construed in a vacuum'" and must instead be read in context with a "view to … the overall statutory scheme." *Roberts v. Sea-Land Servs., Inc.*, 566 U.S. 93, 101 (2012) (citation omitted). Take, for example, the relationship between a trustee's avoidance powers and section 554. If, as the Trustee contends, a trustee's avoidance powers constitute property of the estate, then section 554 would absurdly vest those powers in the debtor upon abandonment. 11 U.S.C. § 554. Relatedly, the Trustee's interpretation would render inconsequential, if not incomprehensible, numerous other sections of the Bankruptcy Code. *See, e.g.*, 11 U.S.C. §§ 349(b)(1)(B), (2), 502(d), (h), 522(h)(1). Surely that cannot be the case.

Our interpretation is also supported by pre-Bankruptcy Code practice, which has recognized the power to avoid preferential transfers since the 18th century. *Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 372-73 (2006) (citations omitted). Under the Bankruptcy Act, the predecessor to the Bankruptcy Code, courts overwhelmingly adopted the "well-settled principle" that a trustee cannot sell or otherwise assign avoidance powers. *United Capital Corp. v. Sapolin*

Paints, Inc. (In re Sapolin Paints, Inc.), 11 B.R. 930, 937 (Bankr. E.D.N.Y. 1981) (collecting cases). When Congress enacted the Bankruptcy Code in 1978, it did not materially amend the statutory language or otherwise indicate an intent to deviate from this pre-Code practice. *Compare* 11 U.S.C. §§ 547, 550 *with* Bankruptcy Act of 1898, ch. 541, sec 50, 30 Stat. 562 (codified as amended at 11 U.S.C. § 96 (1958)); *see also Lamar, Archer & Cofrin, LLP v. Appling*, 138 S. Ct. 1752, 1762 (2018) ("When Congress used the materially same language in [a section of the Bankruptcy Code], it presumptively was aware of the longstanding judicial interpretation of the phrase and intended for it to retain its established meaning."). We therefore see no reason to depart from this "well-settled principle" today.

The canon against surplusage further corroborates our interpretation. *See, e.g.*, *Hibbs v. Winn*, 542 U.S. 88, 101 (2004). Section 541(a)(3) includes a cross-reference to section 550. However, the text of that subsection makes it clear that it is not the power to recover under section 550 that constitutes property of the estate. 11 U.S.C. § 541(a)(3).[15] Instead, only the "interest in property that the trustee [actually] recovers" becomes property of the estate. *Id*. Section 541(a)(3) would thus be rendered superfluous if we were to determine, as the Trustee argues, that section 541(a)(1) includes a trustee's avoidance powers.[16]

Our colleague in dissent and the Trustee devote significant attention to policy considerations, all of which are matters for Congress, not the courts. *See, e.g.*, *Dodd v. United States*, 545 U.S. 353, 359-60 (2005); *see also Wolas*, 502 U.S. at 158 (citation omitted) ("The fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a

[15] The same can be said with respect to section 551, which allows a trustee to preserve the interest in the transferred property for the benefit of the estate after avoidance. 11 U.S.C. § 551; *see* 11 U.S.C. § 541(a)(4).

[16] We acknowledge that the Supreme Court has loosely intimated that section 550 is a claim that constitutes property of the estate. *United States v. Nordic Vill., Inc.*, 503 U.S. 30, 37 (1992). We view this statement as *dicta* and taken out of context for purposes of this appeal. Besides, *Nordic Village* was superseded by the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106.

sufficient reason for refusing to give effect to its plain meaning."). Yet even if we were to perceive ambiguity in the text of section 541(a), the purpose and policy of the Bankruptcy Code actually favor the Debtor.

The Trustee and dissent proclaim that unless a trustee's avoidance powers constitute property of the estate, creditors could, for a variety of reasons, be deprived of an otherwise available recovery. We disagree. Congress presciently accounted for such situations by allowing a creditor to derivatively assert a trustee's avoidance powers for the benefit of the estate to ensure that its value is maximized. *See, e.g.*, 11 U.S.C. § 503(b)(3)(B), (b)(4); *Hyundai Translead, Inc. v. Jackson Truck & Trailer Repair, Inc. (In re Trailer Source, Inc.)*, 555 F.3d 231, 238-45 (6th Cir. 2009). In doing so, Congress also ensured equality of distribution among all creditors in a particular creditor class. *Republic Credit Corp. I v. Boyer (In re Boyer)*, 372 B.R. 102, 106 (D. Conn. 2007); *see Wolas*, 502 U.S. at 161. Here, the Trustee proposed to sell her powers under section 547 and 550, thereby allowing Eclipse to recover *for its own benefit*, not for the estate and its creditors.

Lastly, we are not persuaded that the Trustee can sell her avoidance powers given her "unique role" as a fiduciary. *Hartford Underwriters*, 530 U.S. at 7; *see* 11 U.S.C. § 704(a). As one court explained:

> [M]any creditors feel defrauded, in a preference action, by having to return to the bankruptcy estate the receipt of an otherwise lawful payment. However, this belief is certainly tempered by the fact that the party bringing the preference action is a neutral party specifically designated by law to act impartially on behalf of a debtor's bankruptcy estate, and not simply another creditor who may possibly have ulterior motives for pursuing the preference action.

In re Bargdill, 238 B.R. 711, 721 (Bankr. N.D. Ohio 1999) (citation omitted); *see Miller v. Stone (In re Waterford Funding, LLC)*, 2017 WL 439308, at *3 (Bankr. D. Utah Feb. 1, 2017); *see also* 11 U.S.C. § 547(b) (requiring trustee to conduct due diligence). We cannot adopt an interpretation that compromises the integrity of the bankruptcy system by allowing creditors like Eclipse to pursue personal vendettas using powers intended to be utilized by a neutral trustee.

Conclusion

For the foregoing reasons, we AFFIRM the decisions of the bankruptcy court below.

Barrett, Circuit Judge, dissenting:

With due respect to the majority, its rulings on both issues today are contrary to the statutory text and the recent, well-reasoned decisions from our sister circuits. Accordingly, I must respectfully dissent.

I. Post-Petition, Pre-Conversion Appreciation in the Equity in a Debtor's Property Belongs to the Chapter 7 Bankruptcy Estate

The first issue before the court is whether post-petition, pre-conversion increases in equity in a debtor's property inures to the benefit of the debtor or to the bankruptcy estate upon conversion of a case from chapter 13 to chapter 7.[17] If the equity is property of the estate, then the Debtor's home can be sold by the Trustee for the benefit of his creditors, of which there are many. Conversely, if the post-petition equity inures to the benefit of the Debtor, then there is no non-exempt estate property for the Trustee to administer, the home will remain with the Debtor, and there will be no sale proceeds to distribute.

Proper analysis of this issue begins and ends with the statutory text. *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989) ("The task of resolving the dispute … begins where all such inquiries must begin: with the language of the statute itself…. [I]t is also where the inquiry

[17] This is an important and frequently litigated issue in bankruptcy courts today because of the considerable increase in home values nationwide in recent years. *See* Christopher G. Bradley, *Rising Home Values and Chapter 13: Who Gets the Benefits?*, 43 No. 6 BANKRUPTCY LAW LETTER NL 1, June 2023 (noting that from mid-2020 through mid-2022, home values increased 40% nationwide).

should end, for where … the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'"). Here, the relevant statutory provision is section 348(f)(1), which states:

> (1) Except as provided in paragraph (2), when a case under chapter 13 of this title is converted to a case under another chapter under this title—
>
> (A) property of the estate in the converted case shall consist of *property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion*;

11 U.S.C. § 348(f)(1) (emphasis added).

Although section 348(f)(1) does not itself define "property of the estate," the generally accepted definition of the phrase is set forth in section 541(a). Section 541(a)(1) provides that the filing of a bankruptcy petition creates an estate which broadly includes "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1).

In this case, the Debtor's home unquestionably constitutes property of the chapter 7 bankruptcy estate pursuant to section 348(f)(1). It was property of the chapter 13 estate on the Petition Date. And it remained in the possession and control of the Debtor as of the date that he converted his case to chapter 7. The question, then, becomes whether the non-exempt[18] equity resulting from market appreciation and payments made to the Servicer during the chapter 13 case is likewise property of the estate or, alternatively, property of the Debtor.

There is no distinction between the post-petition appreciation in the value of the home and the home itself. The appreciation is not a distinct property interest that the Debtor acquired. *See, e.g.*, *In re Adams*, 641 B.R. 147, 151-52 (Bankr. W.D. Mich. 2022) (citation omitted) ("The court

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[18] The fact that the Debtor properly took a state law homestead exemption does not remove the home from property of the estate. Rather, the Supreme Court has made clear that when a debtor claims an exemption in property of the estate, he or she is simply claiming an interest in estate property up to a certain dollar amount, not removing the entire asset from the estate. *See, e.g.*, *Schwab v. Reilly*, 560 U.S. 770, 782 (2010).

regards the value of any property as an attribute or incident of the property, not a separate right or interest in the property."); *see also Goetz v. Weber (In re Goetz)*, 651 B.R. 292, 298 (B.A.P. 8th Cir. 2023) (quoting *Potter v. Drewes (In re Potter)*, 228 B.R. 422, 424 (B.A.P. 8th Cir. 1999) ("Nothing in Section 541 suggests that the estate's interest is anything less than the entire asset, including any changes in its value which might occur after the date of filing.")). Rather, the value of the home is a characteristic or attribute of the home that is "inseparable" from the home itself. *See In re Goins*, 539 B.R. 510, 516 (Bankr. E.D. Va. 2015). Such value is appurtenant to the property interest that vested in the chapter 7 estate when the Debtor's case converted.

The vesting of property in the debtor upon confirmation of the chapter 13 plan does not change this result. Section 1327 provides: "Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor." 11 U.S.C. § 1327(b). It is undoubtedly true that, upon confirmation of his chapter 13 plan, the home vested in the Debtor. But it is equally true that, pursuant to the unambiguous language of section 348(f)(1), the home became property of the chapter 7 estate upon conversion from chapter 13. Pursuant to accepted canons of statutory construction, the more specific (*i.e.*, section 348(f)(1)) governs over the more general (*i.e.*, section 1327). *See Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384-85 (1992) (citation omitted) ("[I]t is a commonplace of statutory construction that the specific governs the general…."). In any event, upon conversion of the case to chapter 7, neither the provisions of chapter 13 nor the order confirming the Debtor's plan are relevant. *See* 11 U.S.C. § 103(j) ("Chapter 13 of this title applies only in a case under such chapter."); *Harris v. Viegelahn*, 575 U.S. 510, 520 (2015) (citation omitted) ("When a debtor exercises his statutory right to convert, the case is placed under Chapter 7's governance, and no Chapter 13 provision holds sway.").

Although there is a deep split in the caselaw on this issue, the view that is most harmonious with the statutory text holds that the post-petition appreciation in the value of estate property belongs to the estate. This view was most recently adopted by the Ninth Circuit Court of Appeals in *Castleman v. Burman (In re Castleman)*, 75 F.4th 1052 (9th Cir. 2023). In that case, eighteen months after confirming a chapter 13 plan, a couple was forced to convert their case to chapter 7. As in this case, there was no equity in the home on the petition date. Post-petition, the property appreciated in value such that there was $200,000 in equity at the time of conversion. Thus, the trustee filed a motion for authority to sell the home, which motion was opposed by the debtors.

The Ninth Circuit held that the plain language of section 348(f)(1) dictates that any property of the estate at the time of the original filing that is still in debtor's possession at the time of conversion becomes property of the chapter 7 estate. The court further held that any change in the value of the home was also part of the estate. Acknowledging that the outcome may seem harsh, the court noted that although the property had increased in value in that case, in other cases, the value might decline. "This is simply a happenstance of market conditions, which sometimes will benefit the debtor and sometimes benefit the estate."[19] *Id.* at 1058.

In reaching its conclusion today, the majority grasps at policy arguments and legislative history. As the Supreme Court has frequently stated, "when the statute's language is plain, the sole function of the courts … is to enforce it according to its terms." *Lamie v. United States Tr.*, 540 U.S. 526, 534 (2004). It is equally axiomatic that it is only appropriate to look to legislative history for guidance where a particular statute is ambiguous. *Ratzlaf v. United States*, 510 U.S.

[19] This point is worth highlighting. If, as the majority holds, the debtor gets the benefit of the post-petition appreciation in a home, what happens when the home decreases in value during that same period? Would a debtor be responsible to the chapter 7 trustee for the depreciation in the value of the home occurring during the time his or her chapter 13 plan was pending and prior to conversion? *See, e.g.*, *In re Lang*, 437 B.R. 70, 72 (Bankr. W.D.N.Y. 2010).

135, 147-48 (1994) (Courts "do not resort to legislative history to cloud a statutory text that is clear.").

Here, there is no ambiguity in the statute. Section 348(f)(1)(A) plainly dictates that any property of the estate at the time of the original filing that is still in the debtor's possession or control at the time of conversion is property of the chapter 7 estate. The statute does not limit the subsequent chapter 7 estate to the "equity in" or the "value of" the property as of the filing of the chapter 13 petition. *See In re Peter*, 309 B.R. 792, 795 (Bankr. D. Or. 2004). Indeed, section 348(f)(1)(A) does not talk about valuation of the property at all.[20]

Even if I agreed with my colleagues that section 348(f)(1) was ambiguous, the legislative history does not mandate a different outcome. The legislature's intent in enacting section 348(f)(1) was to overrule an interpretation of the statute by some courts who had held that property that the debtor *first acquired* during the course of his or her chapter 13 case became property of the chapter 7 estate upon conversion. *See* H.R. REP. NO. 103-835, at 57 (1994), *as reprinted in* 1994 U.S.C.C.A.N. 3340, 3366. Such an interpretation, it was feared, would disincentivize debtors from attempting to pay their creditors over time under chapter 13. *See In re Castleman*, 631 B.R. 914, 919 (Bankr. W.D. Wash. 2021). Section 348(f)(1)(A), quite plainly, addresses this concern.

Admittedly, as noted by the majority, the House Report discussed a factual scenario where a home's value appreciates during the course of a chapter 13 case. For reasons that are unclear, however, that concept was not incorporated into the final statutory text. With respect to this language, I concur with the reasoning of *In re Goetz*, which stated:

> Congress's failure to address the example included in the legislative history does not mean this omission was inadvertent. Recognizing that statutes are often the result of compromise, we decline to accept [the debtor's] invitation to assume that Congress intended that debtors may retain postpetition preconversion market

[20] Contrary to the majority's conclusion, section 348(f)(1)(B) seems to instruct courts not to rely on valuation determinations made in chapter 13 cases that are later converted to chapter 7.

> appreciation and equity resulting from debt payments without language articulating this intent.

651 B.R. at 299.

Finally, my conclusion is bolstered by the fact that when Congress wanted to exclude assets from the bankruptcy estate, it did so with specificity. One need only to look to section 541(a)(6), which excludes post-petition earnings by an individual from the definition of property of the estate. 11 U.S.C. § 541(a)(6); *see also* 11 U.S.C. § 541(b) ("Property of the estate does not include…."). If Congress had intended to exclude post-petition appreciation from being property of the estate in a converted case, it could easily have said that in either section 348(f) or section 541. It did not do so, leading to the inescapable conclusion that such an exclusion was not intended.

This is not an easy issue. The outcome may seem harsh for individuals like Mr. Clegg who are struggling to pay their creditors and keep their homes. I wholeheartedly agree with the majority that debtors should not, in any way, be disincentivized from trying to pay creditors what they can through a chapter 13 plan. If Congress enacted into law something different from what it intended with section 348(f)(1), then it should amend the statute one of these days to conform it to its intent.[21] It is, however, "beyond [the courts'] province to rescue Congress from its drafting errors, and to provide for what we might think ... is the preferred result." *Lamie*, 540 U.S. at 542 (citation omitted). Rather, it is the judicial branch's duty to interpret and apply the statutes that the legislative branch has enacted. Because the plain language of section 348(f)(1) dictates that the post-petition appreciation in the value of estate property belongs to the bankruptcy estate upon conversion to chapter 7, I must respectfully dissent.

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[21] At least one scholar has recently proposed amendments to section 348(f) that would resolve this dispute. *See* Lawrence Ponoroff, *Allocation of Property Appreciation: A Statutory Approach to the Judicial Dialectic*, 13 WM. & MARY BUS. L. REV. 721, 756-57 (2022).

II. Preference Actions Are Property of the Estate That Can Be Sold By the Trustee

The Trustee is also seeking to sell to Eclipse a preference cause of action against Pink. The Debtor has objected to the sale of this asset as well, asserting that chapter 5 causes of action are not property of the estate that can be sold. With today's ruling, the majority makes it substantially more difficult for a bankruptcy trustee to fulfill his or her statutory duties to maximize the distribution to creditors. The statutory text, case law and the realities of bankruptcy practice counsel against this conclusion. Thus, I once again respectfully disagree with my colleagues.

Upon the commencement of a bankruptcy case, a trustee is vested with the ability to bring various causes of action to avoid and recover transfers made by the debtor. These actions are colloquially referred to as chapter 5 causes of action, because they reside in chapter 5 of the Bankruptcy Code. Among the most frequently litigated chapter 5 causes of action are preference actions. Generally speaking, a trustee may, under section 547(b), avoid a transfer of an interest in the debtor's property made within ninety days (or one year where, as here, the transfer is to an insider) before the petition date. 11 U.S.C. § 547(b). The concept is that when a debtor makes a payment to a creditor shortly before its bankruptcy filing, the payment results in such creditor being preferred vis-à-vis other creditors. *See Begier v. IRS*, 496 U.S. 53, 58 (1990). Once avoided under section 547(b), a trustee in bankruptcy can recover the payment under section 550(a) so that the funds can be shared pro rata among all creditors. 11 U.S.C. § 550(a).

Section 704(a) provides that a chapter 7 trustee has a statutory duty to "collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest." 11 U.S.C. § 704(a)(1). In furtherance of this goal, section 363(b) provides that a trustee may sell property of the estate with court approval. 11 U.S.C. § 363(b)(1). The common thread in both provisions is "property of the estate." Simply put, if a preference cause of action constitutes property of the estate then, pursuant to section 704(a)(1), the trustee is charged with reducing such cause of action to money and, pursuant to section 363(b)(1), the trustee is authorized to sell it subject to court approval. The gating issue, therefore, is whether a preference cause of action constitutes "property of the estate."[22]

Once again, section 541(a)(1) answers this question. That section includes in the estate "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). The Supreme Court has explained that section 541(a)'s definition of "property of the estate" was intended to be "broad." *Patterson v. Shumate*, 504 U.S. 753, 757 (1992). Indeed, the legislative history describes the scope of a debtor's estate as "all embracing." *See* H.R. REP. NO. 95-595, at 549 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6455.

Courts have regularly found that causes of action held by the debtor constitute property of the estate. *See, e.g.*, *Parker v. Goodman (In re Parker)*, 499 F.3d 616, 624 (6th Cir. 2007) (citation omitted) ("As 'legal and equitable interests,' causes of action . . . constitute property of the estate under § 541(a)(1)."). Further, the Supreme Court has characterized the avoidance powers in chapter 5 as causes of action. *See, e.g.*, *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 53-54 (1989) (describing the "right to recover a fraudulent conveyance under 11 U.S.C. § 548(a)(2)" as a "statutory cause of action."). Indeed, the Bankruptcy Code itself describes the avoidance powers as causes of action in section 926, which provides that if the debtor in a municipal bankruptcy "refuses to pursue a *cause of action* under section 544, 545, *547*, 548, [or] 549(a)…" then the court,

[22] The majority over-emphasizes *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, wherein the Supreme Court intentionally did not determine whether another party in interest can "act in the trustee's stead." 530 U.S. 1, 13 n.5 (2000). Besides, the Trustee did seek approval from the bankruptcy court in order to allow Eclipse to pursue the preference claim, directly benefiting the Debtor's estate through the sale proceeds.

on the request of a creditor, "may appoint a trustee to pursue such cause of action." 11 U.S.C. § 926(a) (emphasis added).

Putting it all together, a preference cause of action which, as noted, is created under section 547(b), is quite plainly a "legal or equitable interest" that the trustee acquires "as of the commencement of the case." *See, e.g.*, *Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec., LLC*, 460 B.R. 106, 114 (Bankr. S.D.N.Y. 2011) (internal citations omitted) ("Property of the estate therefore includes any cause of action the debtor had on the petition date, as well as avoidance actions created on the petition date.").[23] Indeed, the Supreme Court has expressly stated, albeit in a slightly different context, that chapter 5 causes of action are property of the estate. *United States v. Nordic Vill., Inc.*, 503 U.S. 30, 37 (1992) ("[T]he right to recover a postpetition transfer under § 550 is clearly a 'claim' … and is 'property of the estate….'").

The majority concludes that chapter 5 causes of action are mere statutory powers vested in a trustee,[24] not property of the estate, because no provision of section 541(a) expressly references preference actions.[25] But this conclusion is belied by yet another Supreme Court opinion, *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203, 205 (1983), where the court instructed that section 541(a) acts "as a definition of what is included in the estate, rather than as a limitation," and held that property of the estate includes "any property made available to the estate by other provisions

[23] The majority argues that chapter 5 causes of action do not fall within the scope of section 541(a)(1) because they did not exist prior to the petition date but, rather, are created on the petition date. Even if that were true, then such causes of action would fall within the scope of section 541(a)(7), which includes in the estate "[a]ny interest in property that the estate acquires after the commencement of the case." 11 U.S.C. § 541(a)(7).

[24] The argument that chapter 5 causes of action are mere statutory powers granted exclusively to a trustee in bankruptcy is challenged by the generally accepted notion that creditors can obtain derivative standing to pursue such causes of action where the trustee declines to do so. *See, e.g.*, *Canadian Pac. Forest Prods. Ltd. v. J.D. Irving, Ltd. (In re Gibson Grp., Inc.)*, 66 F.3d 1436, 1442 (6th Cir. 1995).

[25] Presumably, if Congress intended to exclude chapter 5 causes of action from property of the estate, it would have expressly done so in section 541(b), which identifies eleven categories of property that are not property of the estate. 11 U.S.C. § 541(b).

of the Bankruptcy Code," including "property in which the debtor did not have a possessory interest at the time the bankruptcy proceedings commenced." This is precisely what the chapter 5 causes of action do; they claw back payments that the debtor had a mere equitable or contingent interest in prior to the bankruptcy filing.

Although the statutory text resolves this question, my conclusion is once again supported by a recent opinion from one of our sister circuits. In *Pitman Farms v. ARKK Food Co. (In re Simply Essentials, LLC)*, 78 F.4th 1006, 1011 (8th Cir. 2023), the Eighth Circuit Court of Appeals held that chapter 5 causes of action are property of the estate that a chapter 7 trustee can sell. There, the chapter 7 trustee of a corporate debtor had what he believed to be meritorious avoidance claims against the owner. Because the trustee lacked the funds to prosecute the causes of action, he proposed to sell them to a creditor. The target of the claims objected, arguing that chapter five causes of action are not property of the bankruptcy estate that can be sold.

In reaching its conclusion, the Eighth Circuit focused on *Whiting Pools*, where the Supreme Court held that estate property includes property that the estate no longer had a possessory interest in because it had been repossessed prepetition. *Id.* at 1009 (citing *Whiting Pools*, 462 U.S. at 209). The court also relied on *Segal v. Rochelle*, 382 U.S. 375, 379 (1966) for the proposition that "property of the estate includes inchoate or contingent interests held by the debtor prior to the filing of bankruptcy." *Id.* Ultimately, the *Simply Essentials* court held that avoidance actions are property of the estate under section 541(a)(1) because "the debtor has an inchoate interest in the avoidance actions prior to the commencement of the bankruptcy proceedings." *Id.*

The Eighth Circuit is not alone. Other circuits have held that chapter 5 causes of action are property of the estate under section 541(a)(1). *See, e.g.*, *Silverman v. Birdsell*, 796 F. App'x 935, 937 (9th Cir. 2020) (holding that a "bankruptcy trustee may sell an estate's avoidance claims");

Cadle Co. v. Mims (In re Moore), 608 F.3d 253, 262 (5th Cir. 2010) ("We conclude, therefore, that the fraudulent-transfer claims are property of the estate under § 541(a)(1)…."); *Morley v. Ontos, Inc. (In re Ontos, Inc.*), 478 F.3d 427, 431 (1st Cir. 2007) (internal citation omitted) ("The Bankruptcy Code broadly defines the property of the estate to be comprised of all 'legal or equitable interests of the debtor in property as of the commencement of the case.' It is well established that a claim for fraudulent conveyance is included within this type of property.").

The only arguably contrary circuit court authority is *Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery (In re Cybergenics Corp.)*, 226 F.3d 237, 245 (3d Cir. 2000), where the Third Circuit stated that state law fraudulent transfer claims that could be pursued by a trustee under section 544 had not been sold to a purchaser of the estate's assets because they "were never assets of [the debtor]." The majority fails to note, however, that the Third Circuit itself recently described its statements in *Cybergenics* as *dicta*. *See Artesanias Hacienda Real S.A de. C.V. v. North Mill Capital, LLC (In re Wilton Armetale, Inc.)*, 968 F.3d 273, 285 (3d Cir. 2020) (citing *In re Cybergenics Corp.*, 226 F.3d at 244-45) ("*Cybergenics* does not hold that trustees cannot transfer causes of action. It leaves that question open because the asset transfer at issue did not reach the creditors' claims.").

Even if the statutory text and case law didn't resolve this issue, holding that chapter 5 causes of action are estate property that can be sold by a trustee makes sense for practical reasons. First, allowing the sale of chapter 5 causes of action provides a mechanism for a chapter 7 trustee to obtain a recovery for creditors in cases where there might not otherwise be sufficient funds in the estate to fund litigation of the claim. "To allow parties otherwise facing meritorious Chapter 5 avoidance claims to escape those claims because the Trustee cannot afford to pursue them and they cannot be sold or transferred would be an absurd result." *In re Simply Essentials, LLC*, 640 B.R. 922, 930 (Bankr. N.D. Iowa 2022).

Second, in chapter 11 cases, courts regularly approve sale motions where the assets sold include chapter 5 causes of action. This common practice makes good sense because buyers in business bankruptcy sales frequently want to maintain control over potential avoidance actions against vendors with whom they will continue to do business. *See, e.g.*, *In re Murray Metallurgical Coal Holdings, LLC*, 623 B.R. 444, 506-07 (Bankr. S.D. Ohio 2021).

Third, allowing a quick sale of chapter 5 causes of action is consistent with a trustee's aforementioned statutory duty under section 704(a). Courts have described this duty as requiring a trustee to "maximize the value of the estate" or maximize the "distribution to the creditors" of the estate. *See Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 352 (1985); *IRS v. Luongo (In re Luongo)*, 259 F.3d 323, 340 n.16 (5th Cir. 2001). This means that while a trustee should strive to collect as much as possible with respect to estate causes of action, he or she also has a duty to minimize the administrative expenses associated with the pursuit of such causes of action. *See In re Taxman Clothing Co.*, 49 F.3d 310, 315 (7th Cir. 1995). Here, all agree that the purchase price offered by Eclipse for the preference cause of action is fair and reasonable. Because the sale eliminates the need for the Trustee to incur administrative expenses investigating and litigating the preference claim, the ultimate distribution to creditors is maximized. In short, with the proposed transaction, the Trustee has fulfilled her statutory duties in spades.

Chapter 5 causes of action are not mere statutory powers granted to a trustee. Rather, for the reasons set forth herein, chapter 5 causes of action are property of the bankruptcy estate within the scope of section 541(a)(1) that can be sold, subject to court approval, by a trustee in bankruptcy pursuant to section 363(b). As such, I must once again respectfully dissent.