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*.

On Writ of Certiorari to the United States
Court of Appeals for the Thirteenth Circuit

BRIEF FOR RESPONDENT

Team 2
Counsel for Respondent

QUESTIONS PRESENTED

I. Whether equity created post-petition, pre-conversion is property of the estate after conversion to Chapter 7 or inures to the benefit of the debtor under 11 U.S.C. § 348(f).

II. Whether a Chapter 7 trustee's right to avoid preferential transfers under 11 U.S.C. § 547 is property of the estate that can be sold by the trustee under 11 U.S.C. § 363.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

United States Supreme Court Cases

United States Courts of Appeal Cases

State Court Cases

Statutes

Rules

Secondary Sources

Other

STATEMENT OF JURISDICTION

The formal statement of jurisdiction is waived in accordance with the Rules of the Duberstein Bankruptcy Moot Court Competition.

STATEMENT OF FACTS

i. Factual Background

Eugene Clegg (the "Debtor") is a veteran of the United States Army and small business owner. R. at 4. The Debtor owned and operated a historic movie theater, The Final Cut ("Final Cut"), from approximately 2011 to 2021. R. at 5–6. A modest salary from Final Cut was the debtor's sole source of income during that time. R. at 5. In 2016, the Debtor caused Final Cut to borrow $850,000 from Eclipse Credit ("Eclipse") to renovate The Final Cut. R. at 5. The loan was secured with first priority liens on Final Cut's real and personal property, and the Debtor executed an unconditional, unsecured personal guaranty in an unlimited amount. R. at 5.

The Debtor received assistance with the renovation from local veterans who volunteered their labor. R. at 5. This caused the project to stay $75,000 under the total value of the loan. R. at 5. To show his appreciation, the Debtor donated the remaining $75,000 of the loan to the Veterans of Foreign Wars ("VFW") organization. R. at 5.

The Final Cut was inoperable for nearly a year at the beginning of the COVID-19 pandemic. R. at 6. On September 8, 2020, with no income from Final Cut, the Debtor was forced to borrow $50,000, unsecured, from his mother, Pink. R. at 6. And on December 8, 2021, the Debtor voluntarily filed a Chapter 13 plan to repay creditors over the span of three years. R. at 7. The Debtor's home was valued at $350,000 on the petition date. R. at 6.

Upon filing, the Debtor voluntarily disclosed that he made payments to Pink within one year of the petition date, totaling $20,000 of the $50,000 he borrowed from her. R. 7. The Chapter 13 trustee objected to the Debtor's plan because it did not factor in the alleged preferential transfers to Pink that could be recovered and distributed to creditors in Chapter 7. R. at 7. The Debtor amended the plan to pay creditors $20,000 over the plan period, the full amount of which he paid Pink. R. at 7. In turn, the trustee stipulated to not pursue the preference action. R. at 7–8.

At the meeting of creditors, Eclipse learned of Final Cut's $75,000 donation to the VFW to show the Debtor's appreciation for the local veterans' labor in renovating Final Cut. R. at 7. Eclipse sought to have the debt related to the $850,000 loan declared non-dischargeable and later objected to the Debtor's plan as not being proposed in good faith. R. at 7–8. Eclipse later withdrew its objection for an estimated claim of $150,000, $25,000 of which was non-dischargeable. R. at 8.

After successfully making payments for eight months, the Debtor fell victim to COVID-19 again, contracting long-COVID. R. at 8. The Debtor was unable to operate his struggling theater, and it permanently closed approximately one month later. R. at 8. Without income and unable to make payments in Chapter 13, the Debtor voluntarily converted his case to Chapter 7 and reaffirmed his mortgage debt on his residence to keep his home. R. at 9. However, the Debtor's residence appreciated by $100,000 during his Chapter 13 plan, so the home's value on the date of conversion was $450,000. R. at 9. There was $100,000 of non-exempt equity in the home. R. at 9. Despite the Debtor's wish to keep his residence, the Trustee sought to sell it to obtain the non-exempt equity. R. at 9. Eclipse offered to buy the Debtor's home and the alleged preference claim against Pink for $470,000. R. at 9.

ii. Procedural Background

The Trustee filed a Sale Motion to sell the Debtor's home and the alleged preference claim against Pink to Eclipse. R. at 9. The Debtor objected to the sale motion, asserting that: (1) any post-petition, pre-conversion increase in the equity of his home should inure to his benefit; and (2) the Trustee cannot sell their statutory right to avoid and recover transfers. R. at 10. The bankruptcy court denied the Sale Motion for the Debtor's home and preference action. R. at 10. The Trustee appealed the bankruptcy court's ruling to the Thirteenth Circuit. R. at 10.

The Thirteenth Circuit affirmed the bankruptcy court's rulings. R. at 24. On the first issue, the Thirteenth Circuit found Section 348(f)(1)(A) to be ambiguous when read in context and based their decision in the clear legislative history. R. at 15–16. On the second issue, the Thirteenth Circuit held the plain language of Sections 541(a) and 547(b) were unambiguous and do not allow a trustee to sell a preference action. R. at 21. Further, the court also found that bankruptcy policy implications supported its ruling. R. at 21–24. Judge Barrett dissented from the Majority's opinion, finding that Section 348(f)(1)(A) is unambiguous to include equity created post-petition, pre-conversion in the converted Chapter 7 estate. R. at 25. On the second issue, Judge Barrett concluded that a cause of action held by the debtor constitutes property of the estate, so the trustee may sell the preference action. R. at 31.

The Trustee timely appealed the Thirteenth Circuit's ruling to this Court.

SUMMARY OF THE ARGUMENT

This Court should affirm the Thirteenth Circuit's holding that post-petition, pre-conversion increase in equity in a debtor's home inures to the benefit of the debtor upon conversion from Chapter 13 to Chapter 7. *First*, Section 348(f)(1)(A) is ambiguous as to whether post-petition, pre-conversion equity inures to the benefit of the debtor or the estate. And applying Section 348(f) to include post-petition equity in the converted estate conflicts with Section 348(f)(2) and renders it superfluous, violating cardinal rules of statutory interpretation. Therefore, the Court should look to legislative history to determine the proper application of Section 348(f)(1)(A). *Second*, the legislative history of Section 348(f) explicitly contemplates post-petition, pre-conversion increase in equity and states that increase in equity inures to the benefit of the debtor. Recognized by many courts, Congress provided a specific example of a Chapter 13 debtor gaining equity in Chapter 13 before converting to Chapter 7. The example recognizes the absurdity of a Chapter 13 debtor losing their home upon conversion to Chapter 7 because of additional equity created while in Chapter 13. Accordingly, this Court should affirm the Thirteenth Circuit's holding that post-petition, pre-conversion equity insures to the benefit of the debtor upon conversion. Such holding is consistent with this Court's holding in *Harris v. Viegelahn*, holding a Chapter 13 debtor's post-petition wages are excluded from the converted Chapter 7 estate. 575 U.S. 510, 514 (2015).

Moreover, this Court should affirm the Thirteenth Circuit because it correctly found that a Trustee's right to avoid preferential transfers was not property of the estate that could be sold to a third party. *First*, the definition of property of the estate in Section 541(a) of the Bankruptcy Code does not include the Trustee's avoidance action as property of the estate. Furthermore, the definition creates a temporal spectrum of property of the estate, including in the definition interests that existed prior to filing and interest acquired by the estate after. As the Trustee's right to avoidance simultaneously vested in the Trustee upon filing, it is not property that existed before or arose after and is thus not included in the definition. *Second*, the Bankruptcy Code explicitly grants to the Trustee the right to avoid preferential transfers. As the code vests this power in the trustee, the statutory authority belongs only to the trustee and cannot be sold to or used by a third party. Thus, this Court should affirm the Thirteenth Circuit's denial of the Sale Motion.

ARGUMENT

Bankruptcy Code Section 348(f) addresses the "[e]ffect of conversion" and provides that when a case is converted from Chapter 13 to Chapter 7, "property of the estate in the converted case shall consist of the 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)(A) (emphasis added). In other words, "the Chapter 7 estate generally consists of the same interests in property that would have been included in the estate had the debtor originally filed under Chapter 7, so long as the debtor has possession or control of those interests at conversion." *In re Barrera*, 22 F.4th 1217, 1220–21 (10th Cir. 2022). While the plain language of Section 348(f)(1)(A) does not explicitly answer whether post-petition, pre-conversion increase in equity constitutes property of the estate upon conversion, its legislative history is instructive. Congress explicitly rejected the idea that a Chapter 13 debtor may lose their home when converting to Chapter 7 if equity in their home increases between petition and conversion. H.R. REP. NO. 103-835, at 57 (1994), reprinted in 1994 U.S.C.C.A.N 3340, 3366; *see In re Castleman*, 75 F.4th 1052, 1063 (9th Cir. 2023) (Tallman, J., dissenting) ("Clearly, Congress believed that home equity which accrued during the Chapter 13 proceedings should not be included in the converted estate.").

Addressing the second issue, Section 541 defines property of the estate all legal or equitable interests of the debtor. 11 U.S.C. § 541(a). Although this definition is to be broadly construed, Section 541 defines property through the inclusion of seven categories, explicitly enumerating what interests are to be included. Section 541(a)(1), for example, includes interests "in property as of the commencement of the case," whereas Section 541(a)(7) includes "any interest in property that the estate acquires after the commencement of the case." 11 U.S.C. §§ 541(a)1, 541(a)(7). A trustee can sell, for the benefit of the estate, certain property of the estate, as long as it meets the definition in Section 541. *See e.g.*, 11 U.S.C. § 363(b). Property recovered by the trustee under an avoidance action is included as property of the estate under 541(a). 11

U.S.C. § 547(b). However, the Code is noticeably silent on whether the trustee's interest in avoidance actions themselves are property of the estate. However, the plain language of the code indicates that trustee's interest in avoidance is excluded from the property of the estate. Furthermore, Section 547(b) grants the statutory right to avoid preferential transfers only to the trustee, indicating that this right is inalienable and cannot be sold.

This Court should affirm the Thirteenth Circuit's holdings for two reasons. *First*, the Thirteenth Circuit properly held that Section 348(f)(1)(A) is ambiguous, and legislative history explicitly answers that equity acquired post-petition and pre-conversion inures to the benefit of the debtor. *Second*, a Chapter 7 Trustee's right to avoid preferential transfers is not property of the estate, and it cannot be sold to a third party because it is an inalienable statutory grant of power.

I. THE THIRTEENTH CIRCUIT PROPERLY HELD THAT 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.

The first issue for the Court is whether 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 from Chapter 13 to Chapter 7. Individual debtors choose between petitioning under Chapter 7 (liquidation) or Chapter 13 (reorganization). *Harris v. Viegelahn*, 575 U.S. 510, 513–14 (2015). Under Chapter 7, a debtor exchanges non-exempt assets for an immediate discharge of pre-petition debts. *Id.* at 513. Chapter 7 debtors retain all of their future income and assets acquired post-discharge. 11 U.S.C. § 727; *In re Barrera*, 22 F.4th at 1220. In contrast, Chapter 13 debtors retain all of their assets and agree to repay creditors at least—oftentimes more than—what they would receive under Chapter 7. 11 U.S.C. 1325(a)(4), (5); *In re Barrera*, 22 F.4th at 1220. Both

Chapter 7 and Chapter 13 seek to grant a "fresh start to the honest but unfortunate debtor." *See Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 367 (2007).

Debtors who fail to complete a Chapter 13 plan have the option to convert their case to one under Chapter 7 at any time by filing a notice with the bankruptcy court. 11 U.S.C. § 1307(a); Fed. R. Bankr. P. 1017(f)(3); *Harris*, 575 U.S. at 514. Notably, "[c]onversion from Chapter 13 to Chapter 7 does not commence a new bankruptcy case. The existing case continues . . . in Chapter 7 . . . 'without effecting a change in the date of the filing of the petition.'" 11 U.S.C. § 348(a); *Harris*, 575 U.S. at 515.

Before Section 348(f) was enacted, courts were divided on whether assets or interests acquired by the debtor post-petition but pre-conversion were part of the Chapter 7 estate. *Id.* at 1220 (citing *In re Bobroff*, 766 F.2d 797 (3d Cir. 1985); *In re Lybrook*, 951 F.2d 136 (7th Cir. 1991)). Section 348(f) was enacted in 1994 to address the effect of conversion and provides that, upon good faith conversion from Chapter 13 to Chapter 7, "property of the estate in the converted case shall consist of the 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)(A) (emphasis added); *Id.* at 1220. In sum, "[i]f a debtor converts a case under Chapter 13 to a case under [Chapter 7], the property the debtor acquired between the petition date and the conversion date is not property of the converted case, unless the debtor sought to convert the case in bad faith." 11 U.S.C. § 348(f)(2); *In re Goetz*, 651 B.R. 292, 296 (B.A.P. 8th Cir. 2023). With the clause "as of the date of filing of the petition," Section 348(f)(1)(A) ensures that debtors who attempt to repay creditors through Chapter 13 but convert to Chapter 7 in good faith are "generally no worse off . . . than if they had originally filed under Chapter 7." *In re Barrera*, 22 F.4th 1217, 1221 (10th Cir. 2022).

This Court previously held that a Chapter 13 debtor's post-petition wages were not included in the converted Chapter 7 estate. *Harris v. Viegelahn*, 575 U.S. 510, 513 (2015). "[Section] 348(f)(1)(A) provides that in a case converted from Chapter 13, a debtor's postpetition earnings and acquisitions do not become part of the new Chapter 7 estate[.]" *Id.* at 517 (stating that "all agree" that Section 348(f) makes this issue clear). Similar to the issue here, the Bankruptcy Appellate Panel for the Tenth Circuit interpreted this Court's decision in *Harris* to not include any equity created through payments made from a debtor's post-petition income in the converted Chapter 7 estate. *See In re Barrera*, 2020 WL 5869458 at *8 (B.A.P. 10th Cir. 2020).

Still, courts are divided about the first question before the court—whether increases in equity created post-petition, pre-conversion inure to the benefit of the post-conversion Chapter 7 estate or the debtor. *See, e.g.*, *In re Castleman*, 75 F.4th 1052, 1060 n.3 (9th Cir. 2023) (Tallman, J., dissenting) (collecting cases). The Eighth and Ninth circuits held that post-petition, pre-conversion non-exempt equity accrues for the benefit of the converted Chapter 7 estate. *In re Goetz*, 651 B.R. at 299; *In re Castleman*, 75 F.4th at 1058. Both courts found the text of section 348(f) to be unambiguous because the debtor's home was in the original Chapter 13 estate and that additional equity is inseparable from the home. *See In re Castleman*, 75 F.4th at 1057; *also see In re Goetz*, 651 B.R. at 299–300; *but see In re Castleman*, 75 F.4th at 1063 (Tallman, J., dissenting) (finding section 348(f) to be ambiguous).

In contrast, the Tenth Circuit held that the post-petition, pre-conversion increase in equity was not property of the converted Chapter 7 estate when the debtors sold the home before conversion. *In re Barrera*, 22 F.4th at 1226. The Tenth Circuit avoided the exact question before the Court and instead decided the case on the grounds of proceeds from the sale being after-acquired property and therefore not part of the converted Chapter 7 estate. *In re Barrera*, 22 F.4th at 1222–24. However, in the same case, the Bankruptcy Appellate Panel for the Tenth Circuit found Section 348(f)(1)(A) is ambiguous because it does not state whether a debtor's equity interest is to be calculated at the date of petition or conversion. *In re Barrera*, 2020 WL 5869458 at *4. Looking to Section 348(f)'s legislative history, the Bankruptcy Appellate Panel held that post-petition, pre-conversion appreciation of a debtor's asset inures to the debtor. *Id.* at *9.

The Thirteenth Circuit properly held that 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. R. at 17. The court reasoned that, viewed in the context of other statutes, Section 348(f) is ambiguous. R. at 15. And the legislative history of Section 348(f)(1) indicates Congress did not intend to inure the benefit of post-petition, pre-conversion increase in equity in a debtor's home to the estate, and the purpose and policy of Chapter 13 bolsters that conclusion. R. at 16–17. Accordingly, the Thirteenth Circuit held that equity created post-petiton, pre-conversion is excluded from the converted Chapter 7 estate and inures to the benefit of the debtor.

This Court should adopt the Thirteenth Circuit's holding for two reasons. *First*, the plain language of Section 348(f)(1)(A) is ambiguous and reading it to include post-petition pre-conversion equity would render Section 348(f)(2) superfluous. *Second*, the legislative history of 348(f) and fundamental policy considerations of the Bankruptcy Code support finding that post-petition, pre-conversion equity inures to the benefit of the debtor.

A. The plain language of section 348(f)(1)(A) is ambiguous, and statutory context supports finding its ambiguity.

The Bankruptcy Code is interpreted in accordance with "well established principles regarding statutory construction." *RadLAX Gateway Hotel v. Amalgamated Bank*, 566 U.S. 639, 649 (2012) (citing *United States v. Ron Pair Enterprises*, 489 U.S. 235, 240–41 (1989)). This

Court's interpretation begins and ends with the text if the text is plain and unambiguous. *See Robinson v. Shell Oil Co.*, 519 U.S. 337, 340 (1997). In determining whether a statute is ambiguous, the Court should look to the language of the statute and the entire statutory context surrounding the statute. *See id.* at 341.

First, the plain language of Section 348(f)(1)(A) does not state whether a debtor's equity is to be valued at the time of petition or conversion, making it ambiguous. *Second*, Section 348(f)(2) would be rendered superfluous if post-petition, pre-conversion equity inured to the benefit of the estate upon good faith conversion.

i. <u>The text of section 348(f)(1)(A) is ambiguous because it does not answer the question of whether the petition or conversion date should be used to value a debtor's equity.</u>

The first step in interpretating a statute is determining whether the statute "has a plain and unambiguous meaning" to decide the particular issue at hand. *Robinson*, 519 U.S. at 340 (1997) (citing *Ron Pair Enterprises*, 489 U.S. 235, 240 (1989); *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 253–54 (1992)). "The plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole." *Id.* at 341 (citing *Estate of Cowart v. Nicklos Drilling Co.*, 505 U.S. 469, 477 (1992); *McCarthy v. Bronson*, 500 U.S. 136, 139 (1991)). In sum, if the language of the statute expressly answers the issue at hand, it is not ambiguous. *See Ron Pair Enterprises*, 489 U.S. at 240.

Section 348(f)(1)(A) provides that "property of the [Chapter 7] estate in the converted case shall consist of property of the estate, as of the date of filing the [initial Chapter 13] 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)(A); *Harris*, 575 U.S. at 517 (brackets in original). This Court recognized that "[a]bsent a bad-faith conversion, Section 348(f) limits a converted Chapter 7 estate to property belonging to the debtor "as of the date" the original Chapter 13 petition was filed." *Harris*, 575 U.S. at 517 (holding a debtor's post-petition wages earned in Chapter 13 were not part of the converted Chapter 7 estate).

Section 348(f)(1)(A) does not answer the issue at hand—whether equity created post-petition, pre-conversion belongs to the debtor or converted estate—and is therefore ambiguous.[1] In evaluating the plain text of Section 348(f)(1)(A), the trustee in *Barrera* argued that that "property of the estate" includes post-petition, pre-conversion appreciation of real property. *In re Barrera*, at *4. The trustee based his argument in the text of Section 541(a)(1) because it "includes 'all legal or equitable interests of the debtor in property' as property of the estate." *Id.* While accepting the trustee's argument as true, the court was still "left with the question of the date [(petition or conversion)] . . . to calculate a debtor's interest in the equity." *Id.* "Because neither § 348(f)(1)(A) nor any other Bankruptcy Code provision resolve this question, the statute is ambiguous." *Id.*

Section 348(f)(1)(A)'s plain language does not answer the question of whether a debtor's equity is to be valued at the time of petition or conversion. This answer to this question is necessary to determine the ultimate issue of how to treat post-petition, pre-conversion appreciation. If a debtor's interest in equity is calculated at petition, appreciation inures to the benefit of the debtor. If a debtor's interest in equity is calculated at conversion, appreciation inures to the benefit of the estate. "[N]either § 348(f)(1)(A) nor any other Bankruptcy Code

[1] *See Ron Pair Enterprises*, 489 U.S. at 240; *also see In re Barrera*, 2020 WL 5869458 at *4 (finding section 348(f)(1)(A) to be ambiguous); *also see In re Castleman*, 75 F.4th at 1063 (Tallman, J., dissenting) (finding section 348(f)(1)(A) to be ambiguous); *but see In re Castleman*, 75 F.4th at 1057 (finding section 348(f) to be unambiguous).

provision resolve[s] this question." Therefore, this Court should find that Section 348(f)(1)(A) is ambiguous. *Id.*

ii. <u>Reading Section 348(f)(1)(A) to include post-petition, pre-conversion equity in the converted estate would render Section 348(f)(2) superfluous.</u>

Statutory language is "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) (internal citations omitted). "A statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant . . . ." *Hibbs v. Winn*, 542 U.S. 88, 101 (2004) (quoting 2A N. Singer, Statutes and Statutory Construction § 46.06, pp. 181–186 (rev. 6th ed. 2000)); *see Corley v. U.S*, 556 U.S. 303, 314 (2009) (stating this is "one of the most basic interpretive canons").

Section 348(f)(2) provides an exception for debtors who convert from Chapter 13 to Chapter 7 in bad faith: "If the debtor converts a case under Chapter 13 . . . in bad faith, the 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); *Harris*, 575 U.S. 510, 517. In contrast, Section 348(f)(1)(A) dictates, upon good faith conversion, "property of the estate in the converted case "shall consist of the property of the estate *as of the date of petition*." 11 U.S.C. § 348(f)(1)(A) (emphasis added).

This Court found Section 348(f)(2) instructive when interpreting whether a debtor's post-petition wages in the Chapter 7 estate upon good faith conversion from Chapter 13:

> Section 348(f)(2) [] penalizes bad-faith debtors by making their postpetition wages available for liquidation and distribution to creditors. Conversely, when the conversion to Chapter 7 is made in good faith, no penalty is exacted. Shielding a Chapter 7 debtor's postpetition earnings from creditors enables the "honest but unfortunate debtor" to make the "fresh start" the Bankruptcy Code aims to facilitate.

Harris, 575 U.S. at 518 (citing *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 367 (2007)). This Court concluded that, in light of Congress differentiating between good and bad faith conversions, the "most sensible reading" of Section 348(f)(1)(A) provides that post-petition wages go to the debtor upon good faith conversion. *See id.* at 519. In sum, this Court suggested reading Section 348(f)(1)(A) to include a debtor's post-petition, pre-conversion wages would punish the debtor as if he converted in bad faith and therefore render Section 348(f)(2) superfluous. *See id.* at 518–19.

The same interpretive canon and reasoning applies to equity created post-petition, pre-conversion. Congress intended to punish debtors who convert in bad faith with the implementation of Section 348(f)(2). *See id.* at 518. In turn, Congress intended to protect debtors who convert in good faith. *See id.* If equity created post-petition, pre-conversion is held to be part of the converted estate, the good faith debtor would be punished, and Section 348(f)(2) would serve no purpose. Further, reading Section 348(f)(1)(A) to include post-petition, pre-conversion equity would be inconsistent with this Court's holding in *Harris*. If post-petition wages are excluded from the converted estate, equity gained by making payments from post-petition wages should also be excluded. Although the equity gained by the Debtor in this case was through market appreciation, he still would not have gained that equity without making payments to maintain ownership of his home.

This Court should maintain its reasoning articulated in *Harris*. 575 U.S. at 518–19. The "most sensible reading" of Section 348(f)(1)(A) is one that does not punish debtors who convert in good faith, thereby rendering Section 348(f)(2) superfluous. *See id.* at 519. This Court should not read Section 348(f)(1)(A) to include equity created post-petition, pre-conversion because doing so would render Section 348(f)(2) "inoperative or superfluous, void or significant." *See*

Hibbs, 542 U.S. at 101; *also see Harris*, 575 U.S. at 518–19. Holding post-petition, pre-conversion equity is property of the estate would also be inconsistent with this Court's holding in *Harris*. 575 U.S. at 518–19. As the plain language of Section 348(f) is ambiguous, this Court should look to the legislative history of Section 348(f) to ascertain its intended application.

B. The legislative history of Section 348(f) and canon against absurd results support any post-petition, pre-conversion equity to be excluded from the converted estate.

Where the plain language of a statute is ambiguous, this Court looks to legislative history to ascertain its intended meaning. *See Green v. Bock Laundry Mach. Co.*, 490 U.S. 504, 521–22 (1989). And this Court "must seek to avoid" a statutory construction that is "at odds with fundamental legislative purposes." *See U.S. v. Clark*, 445 U.S. 23, 31 (1980).

This Court should give effect to Congress's clear intent in enacting Section 348(f) by excluding post-petition, pre-conversion equity from the converted estate. *First*, the drafters of Section 348(f) acted intentionally to exclude post-petition, pre-conversion equity from the converted Chapter 7 estate. *Second*, reading Section 348(f) to include post-petition, pre-conversion equity in the converted estate circumvents fundamental goals of the Bankruptcy Code and produces absurd results.

i. <u>The legislative history of Section 348(f) expressly shows Congress's intent to exclude post-petition, pre-conversion equity from the converted estate.</u>

Legislative history is properly used to reach a conclusion where the plain language of a statute is ambiguous. *U.S. v. Public Utilities Commission of Cal.*, 345 U.S. 295, 315 (1953). 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). Legislative history is also used when the plain language of a statute "would bring about an end completely at variance with the purpose of the statute." *See Public Utilities Commission of Cal.*, 345 U.S. at 315. This Court elaborated on the use of legislative history in *American Trucking Ass'ns*:

> [E]ven when the plain meaning did not produce absurd results but merely an unreasonable one plainly at variance with the policy of the legislation as a whole this Court has followed that purpose, rather than the literal words. When aid to construction of the meaning of words, as used in the statute, is available, there certainly can be no rule of law which forbids its use, however clear the words may appear on 'superficial examination.'

U.S. v. Am. Trucking Ass'ns, 310 U.S. 534, 543–44 (1940).

Reading Section 348(f) to include post-petition, pre-conversion equity in the converted Chapter 7 estate is contrary to Congress's intent expressed in legislative history. *See Harris*, 575 U.S. at 517; *also see In re Barrera*, 2020 WL 5869458 at *7. An example listed in House Report 103-835 is particularly useful in ascertaining Congress's intent for Section 348(f):

> 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 of 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.

H.R.Rep. No. 103–835 at 57 (1994), reprinted in 1994 U.S.C.C.A.N. 3340, 3366.

Congress is addressing nearly the exact scenario of the Debtor in this case. The Debtor owned his home at the beginning of the case, claimed an exemption for the equity in his home, gained equity while in Chapter 13, and is losing his home upon conversion to Chapter 7. R. at 10. Congress clearly intended to avoid this absurd result. *See* H.R.Rep. No. 103–835 at 57 (1994), reprinted in 1994 U.S.C.C.A.N. 3340, 3366.

The majority of courts considering the legislative history of Section 348(f) have recognized it is "highly instructive" and hold that post-petition appreciation is excluded from the converted Chapter 7 estate:

> Congress added [§ 348] to the bankruptcy code . . . to provide debtors with an additional incentive to reorganize under chapter 13 rather than to immediately liquidate their assets under chapter 7. . . . Congress was concerned that transferring the benefits made by a debtor by diligently making payments under a chapter 13 plan to the unsecured creditors if the case converted to one under chapter 7 "would create a serious disincentive to chapter 13 filings because debtors would fear that property attained after filing, including equity created by payment of secured debts, could be lost if the case were converted. *The legislative history also states that equity created during the chapter 13 case is not property of the estate*." Collier on Bankruptcy ¶ 348.07[1] (15th ed. Rev'd 2004) (emphasis added).

See e.g., *In re Nichols*, 319 B.R. 854, 856 (S.D. Ohio 2004) (brackets in original) (emphasis added); *also see In re Barrera*, 2020 WL 5869458 at *7 (internal citations omitted) (stating "[th]e House Report is a sufficiently specific, clear and uniform . . . indicator of intent to suggest Congress intended to" not punish debtors converting to Chapter 7).

Given this legislative history, it would be absurd to read Section 348(f)(1)(A) to include equity obtained while in Chapter 13 in the converted Chapter 7 estate and thereby cause the honest but unfortunate debtor, who converts in good faith, to lose their home. In sum, as Judge Collier writes, "The legislative history [] states that equity created during the Chapter 13 case is not property of the estate." Collier on Bankruptcy ¶ 348.07[1] (15th ed. Rev'd 2004). This Court should conclude the same.

ii. <u>Including post-petition, pre-conversion equity as part of the converted Chapter 7 estate would produce absurd results.</u>

"[I]nterpretations of a statute which would produce absurd results are to be avoided if alternative interpretations consistent with the legislative purpose are available." *Griffin v. Oceanic Contractors*, 458 U.S. 564, 575 (1982). Even where language of a statute is plain, this

Court adopts the interpretation that follows the broader purpose of the legislation if following the plain language would produce "merely an unreasonable" result. *See Am. Trucking Ass'ns*, 310 U.S. at 543.

Including post-petition, pre-conversion equity in the converted Chapter 7 estate discourages debtors from initially filing under Chapter 13. The Bankruptcy Code incentivizes debtors to file Chapter 13 because creditors often receive more in Chapter 13 than they would have received in a Chapter 7 liquidation. *Harris*, 575 U.S. at 514. This Court reasoned that including a debtor's post-petition wages in the converted Chapter 7 estate would work against Congress's intent in enacting Section 348(f) and the fundamental goal of granting a fresh start to good faith debtors. *See id.* at 518.

Similarly, including post-petition, pre-conversion equity in the Chapter 7 estate discourages debtors from initially filing under Chapter 13 and limits a debtor's fresh start. While The Debtor's creditors may receive more in this case, creditors may receive less in future cases with less debtors filing under Chapter 13. On the other hand, the good faith debtor is left without a home for their "fresh start." This Court recognized Congress considered these results by allowing debtors to convert from Chapter 13 to Chapter 7 without penalty at any time. *See id.* at 517.

Further, including post-petition, pre-conversion equity in the converted Chapter 7 estate creates a "lose-lose" situation for debtors. If a debtor's home depreciates while in Chapter 13, they are more likely to keep their home upon conversion to Chapter 7, but their home lost value. If a debtor's home appreciates while in Chapter 13, they are more likely to lose their home upon conversion to Chapter 7. Therefore, a debtor who needs to convert to Chapter 7 is faced with two options in some scenarios—lose their home or decrease its value to avoid sale. It is absurd to conclude that the Debtor could keep his home upon conversion if he, for example, did not mow the grass for a month, tore down the fence, or smashed the walls in his home.

Congress did not intend such absurd results when enacting Section 348(f). Including equity gained while in Chapter 13 in the converted estate produces absurd results that go against fundamental legislative goals—incentivizing debtors to file under Chapter 13 and providing a fresh start to the honest but unfortunate debtor. Debtors in some scenarios are left with incentive to devalue their home. This Court should avoid such absurd results by excluding post-petition, pre-conversion equity from the converted Chapter 7 estate.

In conclusion, this Court should affirm the Thirteenth Circuit's holding for two reasons. The plain text of Section 348(f) nor any other Bankruptcy Code provision answers the question of how to treat equity created post-petition, pre-conversion. Thus, the statutory language is ambiguous, and the Court should look to the legislative history of Section 348(f). The legislative history explicitly states Congress's intent to exclude post-petition, pre-conversion equity from the converted estate. With ambiguous text and unambiguous legislative history, this Court should hold that post-petition, pre-conversion equity is excluded from the converted Chapter 7 estate and inures to the benefit of the debtor. Holding such is consistent with this Court's decision in *Harris v. Viegelahn*. 575 U.S. 510, 518–19.

II. THE THIRTEENTH CIRCUIT PROPERLY HELD THAT A CHAPTER 7 TRUSTEE'S RIGHT TO AVOID PREFERENTIAL TRANSFERS IS NOT PROPERTY OF THE ESTATE THAT CAN BE SOLD.

The second issue before this Court is whether the Chapter 7 Trustee's right to avoid preferential transfers is part of the estate that can be sold. This is an issue of first impression for this Court. Filing a petition under the bankruptcy code simultaneously creates the 'bankruptcy estate.' 11 U.S.C. § 541; *see also City of Chicago, Illinois v. Fulton*, 592 U.S. 154 (2021). The estate includes "all legal or equitable interests of the debtor" in property "as of the commencement of the case" or "any interest in property that the estate acquires after the commencement of the case." 11 U.S.C. §§541(a)(1), 541(a)(7). Where a debtor transfers property prior to the commencement of bankruptcy proceedings, the trustee can avoid that transfer of property under Section 547 and recover any transferred property under Section 550. 11. U.S.C. §§ 547(b), 550(a). The property recovered in an avoidance action is property of the estate under Section 541. 11 U.S.C. §§ 541(a)(3).

Section 363 grants the trustee the power to sell property of the estate that was recovered under Section 547. 11 U.S.C. §§ 363(b), 547(b). However, Section 363 does not explicitly grant the trustee the power to sell the trustee's avoidance action itself. *See id.* For an avoidance action to be transferrable under Section 363, that action must be property of the estate under Section 541. *See* 11 U.S.C. §§ 363(b), 541(a).

While not the issue before the Court, some courts have allowed Chapter 13 and Chapter 11 creditors to "step into the shoes" of the trustee and pursue avoidance actions with the permission of the Court. This action, known as derivative standing, is not uniformly accepted by the courts, and its application is further disputed in Chapter 7 proceedings. Even where it is accepted, derivative standing requires several elements not present in this case. Derivative standing, while not the issue in this case, is illustrative of the second issue before this Court.

Courts are divided about whether avoidance actions are property of the estate and thus transferrable by the trustee. Some courts have explicitly held that avoidance actions are property of the estate. *See, e.g., In re Murray Metallurgical Coal Holdings, LLC,* 623 B.R. 444 (Bankr. S.D. Ohio, 2021*)*; *see also In re Moore*, 608 F.3d 253 (5th Cir. 2010); *see also In re Simply Essentials*, *LLC*, 78 F.4th 1006, 1008 (8th Cir. 2023) (holding that "avoidance actions are causes of action, which are interests in property, and are therefore included in the bankruptcy estate").

However, the Second, Third, and Thirteenth Circuits, as well as a number of bankruptcy courts have, have held otherwise. *See In re Boyer*, 328 Fed. Appx. 711 (2nd Cir. 2009) (holding that a trustee generally cannot sell or assign avoidance rights because such assignment is not in the best interest of the estate); *see also In re Vogel Van & Storage, Inc*., 210 B.R. 27, 32 (N.D.N.Y. 1997)*, aff'd,* 142 F.3d 571 (2nd Cir. 1998) ("[I]t is a also a well settled principle that neither a trustee in bankruptcy, nor a debtor-in-possession, can assign, sell, or otherwise transfer the right to maintain a suit to avoid a preference."); *see also In re Cybergenics*, 226 F.3d 237 (3rd Cir. 2000) (holding that Chapter 5 causes of action are not property of the estate under Section 541 and thus could not be sold to a third party.); *see also In re Clements Mfg. Liquidation Co.*, 521 B.R. 231 (Bankr. E.D.Mich. 2014) (holding that a trustee's avoidance rights are not alienable); *see* also *In re Carragher*, 249 B.R. 817, 820 (Bankr. N.D.Ga. 2000) ("A trustee cannot sell a preference or fraudulent conveyance claim.").

This Court should affirm the Thirteenth Circuit's finding that the Trustee cannot sell an avoidance action to a creditor as property of the estate. *First*, the Trustee's avoidance powers are not property of the estate because they do not meet the definition of property of the estate under Section 541. *Second*, the Trustee's avoidance powers cannot be sold under Section 544 because they are an explicit grant of statutory power and are therefore inalienable.

A. The Trustee's right to avoid preferential transfers is not property of the bankruptcy estate.

The Bankruptcy Code carefully enumerates seven categories of interests that become property of the estate. *See* §§ 541(a)(1)–(a)(7). Section 541(a)(1) includes interests that the debtor holds upon commencement of the case. However, Section 541(a) does not include any interest that the debtor has transferred to another prior to filing and thus no longer holds at commencement. *See Beiger v. I.R.S.*, 496 U.S. 53, 59 (1990).

Section 547(b) allows the trustee to recover "certain preferential payments made before the debtor files for bankruptcy."11 U.S.C. § 547(b); *Beiger*, 496 U.S. at 58. Section 547(b) authorizes the trustee to avoid certain transfers of property if those transfers were made within 90 days of bankruptcy or, if the recipient is an insider, within one year of petition. 11 U.S.C. § 547(b); *see also Union Bank v. Wolas*, 502 U.S. 151, 152 (1991).

Any property recovered by the trustee in an avoidance action is property of the estate under Section 541(a)(3). 11 U.S.C. §§ 541(a)(3), 547(b), 550(a). Section 541(a)(3) notably distinguishes between the property recovered by the avoidance action and the avoidance action itself; while property recovered by the avoidance action is explicitly included in the estate under Section 541(a)(3), the avoidance action itself is not listed. 11 U.S.C. § 541(a)(3). If an interest is property of the estate under Section 541(a), then that interest can be sold as property under Section 363. 11 U.S.C. § 363. Thus, an avoidance power can only be sold by the trustee under Section 363 if that power is property of the estate under Section 541(a). *See id.*; *see also* 11 U.S.C. § 541(a).

This Court should affirm the Thirteenth Circuit's holding that an avoidance action is not property of the estate. *First*, Section 541(a) does not list the Trustee's avoidance action under Section 547 as property of the bankruptcy estate. *Second*, the Trustee's avoidance action is not property of the estate under Section 541(a) because the right vests in the Trustee at the moment of commencement.

i. <u>Section 547 avoidance actions are not property of the estate because they are not listed in Section 541(a).</u>

This Court's interpretation of the Bankruptcy Code "starts where all such inquiries must begin—with the language of the statute itself." *Lamar, Archer & Cofrin, LLP v. Appling*, 584 U.S. 709, 709 (2018). It is a "fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 809 (1989). The Court should not "read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such departure." *Hamilton v. Lanning*, 517 U.S. 505, 505 (2010).

Section 541(a) defines only the interests in property recovered by avoidance as property of the estate but not the avoidance action itself. The code explicitly provides that certain recoverable interests are property of the bankruptcy estate by definition but excludes the right to avoid preferential transfers. As Section 541(a) explicitly defines what property and interests make up the Bankruptcy estate, the omission of any reference to avoidance actions indicates that such actions are not to be included in property of the estate.

Furthermore, Section 541(a) cross references several sections of the Bankruptcy Code when including interests as property of the estate but does not reference Section 547. Notably, Section 541(a) cross references Section 550, which concerns the property interests recovered. Similarly, Section 541(a) references Section 363(n), ensuring property of the estate includes property that the Trustee recovered by avoidance of sale contract. However, Section 541(a) does not reference Section 547, which empowers the trustee to commence the action. Instead, Section 541(a), by reference to Section 550, defines only the interest recovered by avoidance as property of the estate and makes no mention of the avoidance action itself. In sum, the exclusion of any reference to the trustee's avoidance action in Section 541(a) is a clear indication that the avoidance action is not property of the estate.

The Code excludes the trustee's right to avoid preferential transfers in its detailed explanation of what constitutes property of the estate in Section 541(a). Accordingly, this Court should adopt the Thirteenth Circuit's holding that the Trustee's right to avoid preferential transfers is not included as property of the estate under the plain language of Section 541(a).

ii. Section 547 avoidance actions are not property of the estate under Section 541(a) because they are not an interest of the debtor existing before filing or an interest of the estate accruing after filing.

Sections 541(a)(1) and 541(a)(7) provide a temporal spectrum for estate property. *See* 11 U.S.C. § 541(a). Property of the estate, as defined in Section 541(a)(1), consists of "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1); *see also In re Cybergenics Corp.*, 226 F.3d at 246 (finding that the bankruptcy estate "consists solely of interests of [the] debtor in property as of the time of bankruptcy filing"). Avoidance actions commence when a debtor files a bankruptcy case but do not exist before filing. *See Myers v. Raynor*, 406 B.R. 375, 381 (B.A.P. 8th Cir. 2009). As avoidance actions commence at the time of filing, the debtor does not have an interest in the avoidance action prior to filing. *Id*. A cause of action becomes property of the estate under Section 541(a)(1) only if the "claim existed at the commencement of the bankruptcy filing and the debtor could have asserted the claim on his own behalf under state law." *In re Wilton Armetale, Inc.*, 968 F.3d 273, 280 (3rd Cir. 2020).

Similarly, Section 541(a)(7) includes as property of the estate any "interest in property that the estate acquires after the commencement of the case." 11 U.S.C. § 541(a)(7). To be an interest acquired post-filing, the interests must be "themselves traceable to property of the estate." *In re TMT Procurement Corp.*, 764 F.3d 512, 525 (5th Cir. 2014). Section 541(a)(7) is meant to be an extension of Section 541(a), but only for the purposes of ensuring that property of the estate includes "property interests that are themselves traceable to property of the estate or generated in the normal course of the debtor's business." *Id.* Notably, conversion from Chapter

13 to Chapter 7 "does not commence a new bankruptcy case," meaning that there is no "change in the date of the filing of the petition." *Harris,* 575 U.S. at 515.

The Trustee's avoidance action is not an interest that existed in the debtor prior to filing. The Debtor filed under Chapter 13 on December 8, 2021. R. at 6. Thus, the avoidance action under Section 547 matured on December 8, 2021. *See* R. at 6. However, the action was not a legal or equitable interest of the debtor prior to the filing date, because the avoidance action was not in existence until the time of filing. The Trustee's avoidance right thus only vested at the moment of filing on December 8, 2021. *See* R. at 6. As it did not exist nor belong to the debtor prior to filing, it is not property of the estate under Section 541(a)(1).

Although the Debtor converted from a Chapter 13 to a Chapter 7, the breadth of the bankruptcy estate related back to the petition date, which was December 8, 2021. R. at 6, 8. Even though the Chapter 7 trustee was appointed at conversion, the breadth of the bankruptcy estate under Section 541 is still governed by the petition date. As the right to avoid preferential transfers did not exist before December 8, 2021, it is not property of the estate under Section 541(a)(1).

Furthermore, the Trustee's avoidance action is not property that the estate acquires after commencement of the case. The Chapter 7 Trustee is statutorily granted the right to avoid preferential transfers at the moment of commencement, not at some indeterminate time after. The moment that the Debtor filed on December 8, the power to avoid the Debtor's transfer to Pink vested in the Trustee. Even though the Debtor later converted to a Chapter 7, the date of commencement still related back to the date of filing. As such, regardless of when the Trustee would file an avoidance action, the Trustee's legal right to an avoidance action is not an interest acquired after commencement of the case because that right instantaneously vests at commencement.

Similarly, an avoidance action cannot be an interest in property acquired by the estate after commencement under Section 541(a)(7), because the objective of an avoidance action is property that is not included in property of the estate. As discussed in *In re Wilton Armetale*, the property must relate back to existing property of the estate. 968 F.3d at 280. An avoidance action cannot be an interest acquired post-filing under the definition in Section 541(a)(7) because that interest does not relate to property of the estate but instead relates to property outside the estate.

The Debtor's transfer of the property to Pink removed that property from the reach of the Bankruptcy estate, hence the need for the avoidance action. Here, the Chapter 7 Trustee's avoidance action would be to recover the transfer of property made to Pink. R. at 7. As such, the avoidance action operates to recover property outside of the bankruptcy estate. Because that property is not part of the estate, the interest in the avoidance action would not be property of the estate under Section 541(a)(7), as the avoidance interest is not related to property of the estate.

For these reasons, the Chapter 7 Trustee's avoidance action is not property of the estate. As the Trustee's right of avoidance was created by the filing of the Bankruptcy petition, it could not be an interest that existed prior to the filing. Instead, the trustee's avoidance action is a right that is created by, and comes into existence on, the filing of the Bankruptcy petition. Thus, it does not meet the definition of property of the estate under Section 541(a)(1). Furthermore, the Trustee's right cannot definitionally be property of the estate under Section 541(a)(7) because it is not property that the estate gains after filing.

B. The Trustee's right to avoid preferential transfers cannot be sold to a third party because it is an inalienable statutory grant of power.

Section 547(b) states that "the trustee may… avoid any transfer of an interest of the debtor in property," subject to certain conditions. 11 U.S.C. § 547(b). Section 547 avoidance actions are statutory grants of authority, wherein Congress expressly granted to the trustee the right to avoid the transfer of property that would otherwise be unfair to unsecured creditors. *See In re Cybergenics Corp.*, 226 F.3d at 243–44*; see also Matter of Xonics Photochemical, Inc*., 841 F.2d 198, 202 (7th Cir. 1988) (finding that the right to assert avoidance actions "belongs not to a particular unsecured creditor… but to the trustee as the representative of all the unsecured creditors").

This Court constructs terms in a statute according to their "ordinary meaning at the time that Congress enacted the statute." *New Prime Inc. v. Oliveira*, 139 S.Ct 532, 539 (2019). This Court consistently finds that, where the text is clear, the statute applies as it is written. *See, e.g., id.* The Thirteenth Circuit properly applied this standard in finding that a statutory power granted to the Trustee could be used only by the Trustee.

Because this Court relies on the plain meaning of the text, this Court should affirm the Thirteenth Circuit's finding that only the trustee can avoid preferential transfers of property under Section 547. *First*, Section 547 clearly vests the avoidance power in the Trustee, leading to the conclusion that only the Trustee may act upon that power. *Also*, pre-bankruptcy code practice has consistently vested the power to avoid only in the Trustee. *Further*, to find that a creditor could avoid a transfer under Section 547 would be inconsistent with the Bankruptcy Code's policy goals.

i. Section 547 explicitly grants the right to avoid preferential transfers to the Trustee, so the exercise of that right is limited only to the Trustee.

As with all statutory interpretation, the inquiry begins with the text. *Lamar*, 584 U.S. at 709. Where a statute's language is clear and explicit, the "sole function of the courts' is to enforce it according to its terms." *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241 (1989). As such, "where a statute… names the parties granted the right to invoke its provisions, … such parties only may act." *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6–7 (2000). Where a statute "authorizes specific action and designates a particular party empowered to take it," it is not appropriate to read the statute as nonexclusive. *Id.*

When the Bankruptcy Code specifically delegates a power to the trustee, only the trustee may exercise that power. *Hartford Underwriters*, 530 U.S. at 7 (finding that where the Code plainly states that the trustee may invoke a right, it is a "proper inference that the trustee is the only party empowered to invoke the provision"). In *Hartford Underwriters,* the debtor, while in Chapter 11 reorganization, failed to make the monthly premium payments on worker's comp insurance to lender, Hartford Underwriters. Upon conversion to Chapter 7, Hartford Underwriters, as an unsecured creditor seeking recoupment for the premiums, attempted to charge the unpaid premiums to the collateral of a secured creditor under Section 506(c), which states that the "trustee may recover from property securing an allowed secured claim the reasonable, necessary cost … of preserving such property . . . ." This Court unanimously held that the use of the term "trustee" in the text of Section 506(c) excluded parties other than the trustee from using the power outlined Section 506(c). This Court reasoned that Section 506(c) specifically referred to the trustee when making a statutory grant of power, and such specificity in granting the power is determinative of who may use the power. *Id.* Thus, when Congress grants a power to the Trustee in the Code, Congress intends that power to be used only by the trustee. *Id.*

Here, Section 547 gives explicitly grants power only to the Trustee the power to avoid preferential treatments. The inclusion of the terms "the trustee" in Section 547 make it clear that the right to avoid a transfer belongs solely to the Trustee. This explicit grant of power to a delegated party is reminiscent of *Hartford Underwriters*, where this Court found that such an explicit indication of power to the trustee should be taken as a directive of Congress that such power is only to be wielded by the trustee. Therefore, the Chapter 7 Trustee's sale of the avoidance right to Eclipse is invalid because Eclipse cannot bring the avoidance action under Section 547.

Allowing third parties to bring avoidance actions under Section 547 directly contradicts the plain language of the statute. Section 547 explicitly grants the Trustee the right to avoid a transfer by the debtor of property. This grant of power to the Trustee cannot be read in light of *Hartford Underwriters* as an open grant of authority; instead, it must be understood as a limited grant only to the named party—in this case, the Trustee. To read otherwise would be to read Section 547 beyond its plain meaning, which this Court does not do when the language is plain.

As the text of Section 547 clearly grants the right to avoid preferential transfers only to the Trustee, the Trustee cannot sell that right to Eclipse. Thus, this Court should affirm the Thirteenth Circuit's holding that the Chapter 7 Trustee cannot sell the right to avoid preferential transfers.

ii. <u>The Trustee's sale of the right to avoid preferential transfers is inconsistent with the history and purpose of the avoidance right.</u>

Generally, where the "meaning of the bankruptcy code's text is itself clear … its operation is unimpeded by contrary… prior practice." *Hartford Underwriters*, 530 U.S. at 10.

However, pre-Bankruptcy Code practice is applied to the construction of provisions which are "subject to interpretation." *Id.* In this case, it is a "well-settled principle that neither a trustee in bankruptcy, nor a debtor-in-possession, can assign, sell, or otherwise transfer the right to maintain a suit to avoid a preference." *In re Sapolin Paints, Inc.*, 11 B.R. 930, 937 (Bankr.E.D.N.Y. 1981); *see also Belding-Hall Mfg. Co. v. Mercer & Ferdon Lumber Co*., 175 F. 335, 340 (6th Cir. 1909) ("[The trustee] may not transfer to another the right of avoidance."); *see also Texas Consumer Finance Corp. v. First Nat'l City Bank*, 365 F.Supp. 427, 430 (S.D.N.Y. 1973). Furthermore, this Court "assumes that Congress is aware of existing law when it passes legislation." *Miles v. Apex Marine Corp.*, 498 U.S. 19, 32 (1990). Similarly, Congress is "presumptively aware of the longstanding judicial interpretation of [a] phrase and intend[s] for it to remain its established meaning" when it uses the "materially same language." *Lamar*, 584 U.S. 711.

Pre-code practice reinforces the principal that only the trustee may bring an avoidance action. Prior to the enactment of the Bankruptcy code, courts consistently denied the right of third parties to bring avoidance actions, noting that it was a right of the trustee and thus not assignable. Congress is presumably aware of the established principal among courts that a trustee cannot transfer their right of avoidance, and as such, the codification of the Bankruptcy Code and the drafting of Section 547 should be interpreted in light of Congress's knowledge of the historical background. As pre-codification courts consistently found that a trustee could not sell their right to avoid preferential transfers, the post-codification interpretation of Section 547 should reflect not only the pre-codification interpretation but also Congress's awareness of this precedent.

The text of Section 547 is in accordance with the pre-codification precedent, which firmly established that trustee's cannot sell their right to avoidance. Thus, this Court should consistently hold the same.

iii. The Trustee's sale of the right to avoid preferential transfers is inconsistent with Bankruptcy policy.

A "paramount duty of a trustee…in a bankruptcy case is to act on behalf of the bankruptcy estate, that is, for the benefit of the creditors." *In re Cybergenics Corp.*, 226 F.3d at 242; *see also Moore v. Bay*, 284 U.S. 4, 5 (1931) (holding that the trustee's rights and powers are "to be enforced for the benefit of the estate"). Accordingly, the trustee's power to avoid the debtor's prepetition transfers is meant to "maximize the bankruptcy estate for the benefit of creditors." *In re Cybergenics Corp.*, 226 F.3d at 243–44. As such, the purpose of an avoidance action is so the trustee can avoid a transfer "in its entirety for the benefit of all creditors, not just to the extent necessary to satisfy the individual creditor actually holding the avoidance claim." *Id.* A trustee "cannot maintain an avoidance action… unless the estate would be benefitted…" *Wellman v. Wellman*, 933 F.2d 215, 218 (4th Cir. 1991). Alongside protecting the estate, avoidance actions also protect the creditors. *See Union Bank v. Wolas*, 502 U.S. at 161. Not only do avoidance actions discourage creditors from "racing to the courthouse," but they also "facilitate the prime bankruptcy policy of equality of distribution among creditors." *Id.*

In some limited cases, Courts have allowed creditors to file avoidance actions on behalf of the estate when the trustee is unwilling to pursue the action. *See* 11 U.S.C. § 503(b)(3)(B), (b)(4)*; see also, e.g., Official Committee of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery*, 330 F.3d 548 (3rd Cir. 2003). Known as derivative standing, these Courts, alongside others, have granted in-equity to creditors the permission to "sue derivatively to recover property for the benefit of the estate." *Ex rel Cybergenics Corp.,* 330 F.3d at 567.

Creditors already have a way to assert their rights in an avoidance action. As discussed in *Ex rel Cybergenics*, a court may assign derivative standing to a third-party creditor and allow that creditor to pursue, with the court's permission, an avoidance action for the benefit of the creditors of the estate. 330 F.3d at 567. Therefore, Eclipse is not without recourse if the Chapter 7 Trustee does not bring an avoidance action. While not the issue here, the existence of derivative standing as a remedy is illustrative of the policy concerns at issue. Derivative standing requires the permission of the Court, which is only granted when a creditor can show that such recovery is for the benefit of the estate. Notably, derivative standing exists as a way to maximize recovery for the class of creditors in furtherance of the policy goal of protecting the class of creditors.

Outside of derivative standing, allowing Eclipse to bring an avoidance action treats similarly situated creditors differently. Eclipse is not acting as a representative for all creditors, but instead only for its own gain. Allowing Eclipse to undertake the avoidance action champions the benefit to one creditor at the expense of the others. Although the $470,000 that Eclipse paid for the action enters the estate as consideration for the sale the benefit to the estate in this case is outweighed by the harm of the benefit to the creditors in other cases. R. at 9. As discussed in *Union Bank*, an important policy concern in bankruptcy is equality of creditors. 502 U.S. at 152.

While the consideration for the sale of the action may be equitably distributed amongst the creditors here, there are certain intangible benefits that Eclipse may receive from its role in the avoidance action that are not shared amongst the creditor class. Eclipse purchased the avoidance action "perhaps looking for retribution." R. at 9. Regardless of what Eclipse recovers under the avoidance action, Eclipse is not undertaking the action solely for the maximization of the estate and the benefit of all creditors. Instead, Eclipse is likely acting in its own self-interest.

Perhaps Eclipse seeks to use the rights to bring the preference action to bargain with the Debtor to be paid other debts. Eclipse having the sole right to bring the avoidance action situates them differently, not similarly, to other similarly situated creditors. This disturbs a core principle of bankruptcy.

To allow a creditor to bring an avoidance claim for these reasons would be to set a different standard for avoidance actions—where the trustee could only bring the action if it benefits the entire class of creditors, a creditor can bring the action even if it benefits only itself. Eclipse is thus fostering the avoidance action not as a method of recovery for the pool of unsecured creditors, but in advancement of its own individual goals, which is directly contradictory to established bankruptcy policy. Allowing a creditor to pursue a trustee's avoidance action is contrary to established bankruptcy policy.

CONCLUSION

This Court should affirm the Thirteenth Circuit's holding that equity created while in Chapter 13 is not included in the converted Chapter 7 estate. Section 348(f)(1)(A) is ambiguous, as it does not state whether equity created post-petition, pre-conversion is included in the converted estate. Reading post-petition equity to be included in the converted estate would render Section 348(f)(2) superfluous because the good faith debtor would be punished as if they converted in bad faith. This Court found similarly in *Harris*, where a debtor's post-petition wages were not part of the converted Chapter 7 estate under Section 348(f)(1)(A). Accordingly, this Court should look to the legislative history of Section 348(f) which clearly indicates Congress's intent to not include post-petition equity in the converted estate. Specifically, Congress sought to avoid the absurd result of a debtor losing their home upon conversion because they obtained equity while in Chapter 13. This Court should adhere to the clear legislative history—and their holding in *Harris*—and affirm the Thirteenth Circuit's holding that post-petiton, pre-conversion equity is not included in the Chapter 7 estate.

Furthermore, the Chapter 7 Trustee cannot sell the right to avoid preferential transfers because that right is not property of the estate as defined in Section 541(a). In addition, Congress vested the right to avoid transfers to the Trustee through statutory grant in Section 547(b), which makes that right an inalienable power of the Trustee that cannot be transferred. To find otherwise would be contrary to fundamental bankruptcy policy, which champions the equality of creditors and the order of bankruptcy proceedings. For these reasons, this Court should affirm the Thirteenth Circuit.