**No. 23-0115**

IN THE

# Supreme Court of the United States

IN RE EUGENE CLEGG, DEBTOR

VERA LYNN FLOYD, CHAPTER 7 TRUSTEE, PETITIONER

V.

EUGENE CLEGG, RESPONDENT.

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ON WRIT OF CERTIORARI FOR THE
UNITED STATES COURT OF APPEALS
FOR THE THIRTEENTH CIRCUIT

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**BRIEF IN SUPPORT OF RESPONDENT**

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Team 4
Counsel for Respondent

## QUESTIONS PRESENTED

1. Whether a post-petition, pre-conversion increase in equity in a debtor's property belongs to that debtor upon conversion from chapter 13 to chapter 7 pursuant to 11 U.S.C. §§ 348 and 541.
2. Whether a trustee may sell its power to avoid and recover preferential transfers pursuant to 11 U.S.C. §§ 547 and 550 as property of the bankruptcy estate.

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## JURISDICTION STATEMENT

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

## STATEMENT OF FACTS

*Background*

Eugene Clegg, a retired Army corporal, filed for chapter 13 bankruptcy on December 8, 2021, facing the possibility of losing his home due to the closure of his small business in the City of Moot during the COVID-19 pandemic.

When Mr. Clegg retired from military service in 2011, his mother, Emily "Pink" Clegg ("Pink"), transferred her 100% membership interest in The Final Cut, LLC ("Final Cut") to her son, making Mr. Clegg the sole member. R. at 5. Final Cut owned and operated a historic, single-screen movie theater in the City of Moot. R. at 5. Final Cut had no liabilities and generated a net profit yearly. R. at 5. The salary Mr. Clegg received from Final Cut each year constituted his sole source of income. R. at 5.

Final Cut received an $850,000 loan from Eclipse Credit Union to finance the renovation of the theater. R. at 5. In return, Eclipse was granted first priority liens on Final Cut's real and personal property, which were properly perfected, as well as an unconditional, unsecured, personal guaranty from Mr. Clegg in an unlimited amount. R. at 5. The theater renovation was a community affair. R. at 5. Mr. Clegg and local volunteer veterans performed much of the renovation, allowing Final Cut to fully renovate the theater without using $75,000 of the loan proceeds. R. at 5. Following the completion of the renovations in early 2017, Mr. Clegg expressed his gratitude for the veterans by donating the unused loan proceeds to the Veterans of Foreign Wars. R. at 5.

The community loved the newly renovated theater, and Final Cut remained profitable for the next three years. R. at 6. But in March 2020, a government-issued stay-at-home order due to COVID-19 forced the theater to remain closed for almost a whole year, preventing Mr. Clegg from receiving any salary or income. R. at 6. To make ends meet, Mr. Clegg borrowed $50,000 on an

unsecured basis from his mother, Pink, on September 8, 2020. R. 6. He made $20,000 in payments to Pink between December 2020 and December 2021. R. at 7

The theater reopened in February 2021, but revenue fell well-below pre-pandemic standards. R. at 6. Mr. Clegg once again went without a salary, causing him to incur credit card debt and preventing him from paying his home mortgage for several months. R. at 6. Following the lack of payments, the mortgage servicer ("Servicer") commenced foreclosure proceedings. R. at 6.

*Chapter 13 Petition*

Faced with losing his home, Mr. Clegg filed a petition under chapter 13 of the Bankruptcy Code[1] on December 8, 2021. He disclosed the following information:

- Schedule A/B: home value of $350,000;
- Schedule C: maximum homestead exemption of $30,000;
- Schedule D: non-contingent, liquidated, undisputed secured debt to Servicer of $320,000;
- Schedules E/F and Schedule H: contingent, unliquidated unsecured debt to Eclipse in an unknown amount; and
- Statement of Financial Affairs: aggregate of $20,000 in payments to Pink within the year prior to the Petition Date.

The chapter 13 plan (the "Plan") followed the national model plan, where Mr. Clegg would pay creditors over a three-year period. R. at 6. Notably, the Plan stated that Mr. Clegg maintained no equity in his home as of the Petition Date because Mr. Clegg's home had a value of $350,000, but he owed $320,000 to the Servicer and had a $30,000 homestead exemption. R. at 6-7. Mr. Clegg proposed to cure the pre-petition arrears on the mortgage loan by making payments to the Servicer through the chapter 13 trustee solely through Final Cut's future earnings. R. at 6. All

[1] Specific sections of the Bankruptcy Code are identified herein as "section _." The Bankruptcy Code is also sometimes referred to as "the Code." All statutory citations are to the Bankruptcy Code.

parties in interest accepted this proposal, anticipating that Final Cut would soon regain profitability. R. at 6.

Eclipse learned of Mr. Clegg's donation to the Veterans of Foreign Wars for the first time at the section 341 meeting of creditors. R. at 7. Believing that Mr. Clegg mismanaged the loan proceeds, Eclipse immediately commenced an adversary proceeding to declare the loan non-dischargeable under section 523(a)(2)(A). R. at 7. Additionally, Eclipse spent weeks objecting to the Plan as not being proposed in good faith but finally withdrew its objection in exchange for an estimated claim of $150,000, of which $25,000 could not be discharged, even in the event of conversion. R. at 8.

The chapter 13 trustee also sought a settlement with Mr. Clegg, where the trustee would not seek to avoid and recover pre-petition payments made to Pink in exchange for Mr. Clegg increasing aggregate payments to creditors by $20,000, the preference claim amount, over the applicable commitment period. R. at 7. This settlement was incorporated by reference into the Plan. R. at 8.

The bankruptcy court confirmed the Plan on February 12, 2022. R. at 8. The court entered a separate order approving Mr. Clegg's settlement offer with Eclipse. R. at 8. Mr. Clegg made timely payments, including $10,000 of payments to the Servicer, under the Plan for eight months. R. at 8. In September 2022, Mr. Clegg fell victim to long-COVID. R. at 8. This illness rendered him unable to work, and he was forced to permanently close the theater the following month, losing his sole source of income. R. at 8. Once the theater closed, Eclipse commenced foreclosure proceedings against Final Cut. R. at 8.

*Chapter 7 Conversion*

Following the theater closure, Mr. Clegg, now without any income, chose to convert his bankruptcy case to chapter 7 to avoid outright dismissal of his chapter 13 case. R. at 8. The bankruptcy court entered a generic conversion order and appointed Vera Lynn Floyd (the "Trustee") as the chapter 7 trustee. R. at 9. The conversion documents stated that Mr. Clegg owed Eclipse approximately $200,000 due to the deficiency with respect to his guarantee of the loan, following Eclipse's post-conversion completion of the theater foreclosure. R. at 9. Mr. Clegg's statement of intention indicated that he planned to reaffirm the mortgage debt owed to the Servicer so that he could remain in his home. R. at 9.

Initially, the estate seemed bereft of assets. R. at 9. Mr. Clegg mentioned at the chapter 7 section 341 meeting of the creditors that other homes in his neighborhood were selling at a premium. R. at 9. Only then did the Trustee commission an appraisal of Mr. Clegg's home, which showed that Mr. Clegg's non-exempt home equity had increased by $100,000 since Mr. Clegg first filed his chapter 13 petition. R. at 9. Following this discovery, the Trustee marketed Mr. Clegg's home for sale. R. at 9.

*Sale Motion*

Unsettlingly, Eclipse approached the Trustee and offered to purchase the home at its full appraisal value of $450,000 and the alleged preference claim against Pink at one hundred cents on the dollar for $20,000, for a total of $470,000. R. at 9. The Trustee then filed a motion (the "Sale Motion") to sell the home and the alleged preference claim to Eclipse. R. at 9.

Mr. Clegg objected to the Sale Motion. R. at 10. He contended that the increase in equity of his home that accrued post-petition and pre-conversion should inure to his benefit, not to the benefit of the estate. R. at 10. Because the estate had no available equity as of the Petition Date,

the Trustee should not be able to sell his home. R. at 10. Mr. Clegg also argued that the Trustee could not sell her statutory ability to avoid and recover preferential transfers under sections 547 and 550. R. at 10.

The bankruptcy court ruled in Mr. Clegg's favor on both objections, denying the Sale Motion. R. at 10. The Thirteenth Circuit affirmed on both issues. R. at 4. The Trustee timely appealed, and this Court granted certiorari as to both issues. R. at 10.

## SUMMARY OF THE ARGUMENT

This Court should affirm the Thirteenth Circuit and deny the Sale Motion to prevent Mr. Clegg from losing his home and to preclude a vindictive creditor from hijacking the bankruptcy to settle a personal score. Mr. Clegg, a veteran who pursued small business ownership post-retirement, lost his business due to the COVID-19 pandemic and now faces losing his home. Mr. Clegg filed for chapter 13 bankruptcy and later converted to chapter 7 in good faith. The Trustee now seeks to sell Mr. Clegg's home on the assumption that a post-petition, pre-conversion increase in equity of his home belongs to the bankruptcy estate, not to Mr. Clegg. In addition to selling Mr. Clegg's home, the Trustee seeks to sell her own ability to avoid and recover preferential transfers pursuant to sections 547 and 550.

Both issues before this Court share practical ramifications concerning the size of the bankruptcy estate. Specifically, just as the Trustee's interpretation of section 348(f)(1)(A) has the potential to increase the size of the bankruptcy estate, so too does the Trustee's interpretation of sections 547 and 550. The Thirteenth Circuit recognized that all that glitters is not gold. While the Trustee has a fiduciary duty to maximize the value of the estate for the benefit of the creditors, she cannot do so to the detriment of Mr. Clegg's rights under the Code. This Court should affirm the

decision of the Thirteenth Circuit, thereby giving effect to the boundaries of the bankruptcy estate that Congress instituted in the Code.

The Thirteenth Circuit correctly decided that when equity in the property of a debtor increases after the petition date, but before the debtor has converted, such increase belongs to the debtor upon conversion. Section 348(f)(1)(A) attempts to provide a uniform date for courts to determine what constitutes property of the converted estate, but it is ambiguous as to what is included within "property of the estate." This section is ambiguous because a plain reading of the text reveals two possible meanings, as evidenced by the Trustee and Mr. Clegg's differing interpretations and the circuit split regarding the issue. The Trustee argues that the newly acquired equity in Mr. Clegg's home belongs to the estate, but Mr. Clegg maintains that the equity is not part of the bankruptcy estate because it did not exist at the petition date. The Trustee reaches her interpretation of section 348(f)(1)(A) by reading it in isolation, while Mr. Clegg's reading of the section in tandem with related sections honors the canon of statutory interpretation that the Code should be read as a whole. Resolving the apparent ambiguity requires an analysis of the legislative history, context, and policy decisions surrounding the enactment of section 348(f)(1)(A).

These tools of statutory interpretation reveal that while the plain text of section 348(f)(1)(A) is ambiguous, its intended meaning unambiguously aligns with Mr. Clegg's position: a post-petition, pre-conversion increase in equity of a debtor's property belongs to the debtor. The legislative history behind section 348(f) demonstrates that Congress intended to resolve a circuit split that emerged concerning what constituted property of the estate upon conversion from chapter 13 to another chapter. Congress explicitly gave chapter 13 debtors a right to convert to chapter 7 without repercussion and wanted to preserve this right by determining that debtors who had acquired property post-petition were able to keep the property upon conversion. Moreover, the

legislative history explicitly acknowledges an equity increase in property after the petition date as belonging to the debtor upon conversion.

Related provisions of the Code also support Mr. Clegg's position, as his interpretation of section 348(f)(1)(A) renders Code sections neither surplus nor contradictory. Mr. Clegg preserves the distinction between sections 348(f)(1)(A) and 348(f)(2) where the Trustee's disregard of whether a debtor converts in good or bad faith causes redundancy. Mr. Clegg reads the Code harmoniously by acknowledging that sections 522 and 348(f)(1)(A)'s explicit references to the petition date should have the same result in valuation; the Trustee's interpretation causes contradiction. Finally, Mr. Clegg's interpretation honors Congress' policy goal behind enacting section 348(f)—to encourage debtors to file under chapter 13. Allowing debtors to keep equity acquired post-petition incentivizes debtors to file under chapter 13. The Trustee would leave debtors who convert uniquely disadvantaged and thus dissuades them from filing under chapter 13.

The Thirteenth Circuit correctly defined the parameters of the bankruptcy estate further by holding that the ability to avoid and recover preferential transfers pursuant to sections 547 and 550 of the Code is not property of the estate. Section 541(a) of the Code provides the general boundary of what constitutes the bankruptcy estate, and it fails to capture the Trustee's preference avoidance power. In addition to section 541(a), other Code sections can extend the estate's boundaries to include property not otherwise contemplated by section 541(a).[2] The plain language of sections 547 and 550 show that they are not such estate-expanding sections. Instead, section 547 describes

[2] Notably, other sections of the Code can also narrow the scope of the bankruptcy estate by excluding property from the estate. Section 348(f)(1)(A) necessarily limits the extent of the property included in the estate upon conversion to the exact interest the debtor had at the time of the petition date, as discussed further in the first issue before this Court. Regardless, a debtor does not have any interest in the Trustee's power to avoid and recover preferential transfers at any point.

the power to avoid and recover preferential as belonging solely to the trustee. Section 550(a) further clarifies that preferential transfers may only be recovered for the benefit of the estate.

Even if the Court determines that the meaning of sections 541(a), 547, and 550 are ambiguous, the canons of statutory construction and legislative history bolster the Thirteenth Circuit's position as aligning with Congress' intent in enacting these sections. Because the Court must read Code sections considering the overall statutory scheme, it must interpret each section in a way that honors the effect and intent of other sections. Mr. Clegg's interpretation preserves the meaning of corresponding Code sections. By contrast, the Trustee's position would render some sections superfluous and, worse, others absurd. The Trustee's position further defiles the Code by dismissing centuries of pre-Code practice that Congress preserved in sections 547 and 550. In drafting sections 547 and 550, Congress perpetuated the well-established principle that a trustee cannot sell its power to avoid preferential transfers. The legislative history surrounding the enactment of sections 547 and 550 make clear that Congress did not intend such a sweeping change.

The Thirteenth Circuit's holding also exemplifies Congress' stated purposes of preference actions. Here, Eclipse sought to purchase the preference action against Pink, Mr. Clegg's mother, for 100 cents on the dollar. Eclipse stands to lose money in administrative costs in pursuing the action, presumably so that Eclipse can effectuate revenge on Mr. Clegg for the perceived mismanagement of Eclipse's funds. This runs directly contrary to Congress' intent that only a neutral trustee should have the power to avoid and recover preferential transfers—for the benefit of the estate, not to accomplish vengeful ends. Further, even where a creditor seeks to purchase a preference action without malintent, this would permit creditors to buy preference actions for a profit. In this scenario, the Trustee's position would thwart Congress' principal goal in creating

preference actions: to ensure that creditors in the same class receive equal distributions. The bankruptcy court correctly denied the Trustee's Sale Motion, recognizing that the Trustee cannot sell a power that belongs solely to her in her role as a trustee.

## ARGUMENT

### I. THIS COURT SHOULD AFFIRM THE THIRTEENTH CIRCUIT BECAUSE INCREASES IN EQUITY OF A DEBTOR'S PROPERTY ACCRUING POST-PETITION, BUT PRE-CONVERSION, INURE TO THE BENEFIT OF THE DEBTOR UPON CONVERSION.

After contracting long-COVID and losing his ability to work, Mr. Clegg was forced to convert his chapter 13 bankruptcy to chapter 7. R. at 8. As a result, the bankruptcy court faced the first question now before this Court as to whether equity that accrued in Mr. Clegg's home post-petition, but prior to conversion, belonged to the bankruptcy estate or Mr. Clegg. R. at 10. It determined that the equity inured to the benefit of Mr. Clegg, and the Thirteenth Circuit affirmed. R. at 4. Section 348(f)(1)(A) is ambiguous as to this issue, but the legislative history, contextual Code provisions, and policy considerations illustrate that the lower courts' conclusions are correct. An increase in equity of the debtor's property that occurs post-petition inures to the benefit of the debtor.

While section 348(f)(1)(A) may seem plain on its face, it is ambiguous when properly construed. Section 348(f)(1)(A) dictates that when a debtor converts from chapter 13 to another chapter, the property of the estate upon conversion is the property that was included in the estate as of the *petition* date. 11 U.S.C. § 348(f)(1)(A). The Trustee made a cursory determination that because Mr. Clegg's home was property of the estate as of the petition date, it became property of the estate upon conversion in its entirety. R. at 12. As such, the Trustee moved to sell the home to maximize distributions to creditors, but all that glitters is not gold. R. at 6. The Trustee's superficial conclusion ignores the complexity of the issue before this Court: whether an increase in the *equity* of the home is included in the estate, despite accruing post-petition.

Reading the Code as a whole reveals that the Thirteenth Circuit's conclusion was correct: section 348(f)(1)(A) is ambiguous as to whether an increase in equity occurring post-petition belongs to the bankruptcy estate or the debtor upon conversion. Given the legislative history, context, and policy considerations concerning section 348(f)(1)(A), this Court should resolve that ambiguity in favor of Mr. Clegg and deny the Trustee's Sale Motion, allowing Mr. Clegg to keep his home. *See* R. at 10.

**A. Section 348(f)(1)(A) is ambiguous.**

When reading the Code as a whole, it is apparent that section 348(f)(1)(A) is ambiguous as to whether an increase in equity accruing post-petition would be included in the bankruptcy estate upon conversion. Ambiguity exists in a statute where two possible meanings can be gleaned from a plain reading of the text. *Chickasaw Nation v. U.S.*, 534 U.S. 84, 90 (2001). A critical canon of statutory construction is that statutory text must be read as a whole to discern plain meaning. *See U.S. v. Atl. Rsch. Corp.*, 551 U.S. 128, 135 (2007). This Court has, on numerous occasions, warned against interpreting sentences of statutes without regard to their context. *See, e.g.*, *Roberts v. Sea-Land Servs., Inc*., 566 U.S. 93, 101 (2012); *King v. St. Vincent's Hosp*., 502 U.S. 215, 221 (1991); *Kelly v. Robinson*, 479 U.S. 36, 43 (1986). The Trustee's perfunctory analysis makes this very mistake. While the issue may appear to be simply whether the home itself was part of the estate as of the chapter 13 petition date, this interpretation ignores the nuance of the issue before this Court and the necessary context other Code provisions provide. The Code is a comprehensive statutory scheme created by Congress and designed to provide specific solutions to specific problems. *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645 (2012). It follows that a critical first step in discerning the plain meaning of a section in that scheme is to read it in context with other relevant Code provisions.

Sections 348(f)(2), 522, 541(a)(1), and 541(a)(6) provide the context necessary to interpret 348(f)(1)(A). When read together, these sections support Mr. Clegg's position that section 348(f)(1)(A) is ambiguous. Section 348(f)(2) provides that where a debtor has converted in bad faith, the estate consists of all property in the debtor's possession as of the date of conversion. 11 U.S.C. § 348(f)(2). The teeth of the statute lie in the phrase "as of the date of conversion." *Id*. This language suggests that a debtor who converts in bad faith to conceal assets acquired post-petition will not be able to do so. *See id.* The consequence of attempting to convert in bad faith is that all assets acquired post-petition will be included in the estate upon conversion. *See id*. A critical difference exists between 348(f)(1)(A) and 348(f)(2) based on whether a debtor converted in good or bad faith: the date used to determine what property interests belong to the estate. 11 U.S.C. §§ 348(f)(1)(A), 348(f)(2). No party contends that Mr. Clegg converted in bad faith. R. at 8 n.8. Thus, the plain meaning for which the Trustee argues contradicts 348(f)(2)'s directive to only use the date of conversion to determine what property is included in the estate where a debtor has converted in bad faith. Mr. Clegg's interpretation comports with that directive. The two parties' interpretations demonstrate that section 348(f)(1)(A) is ambiguous as to whether the increase in equity belongs to the estate or Mr. Clegg upon conversion.

The Trustee's interpretation of 348(f)(1)(A) is also at odds with section 522 of the Code. Section 522(a)(2) specifies that the value of property for exemption purposes should be measured as the fair market value of the home "as of the date of the filing of the petition." 11 U.S.C. § 522(a)(2). As one bankruptcy court recognized, there are multiple sections within the Code that, when triggered, will freeze the parties' rights. *In re Barrera (Barrera I)*, 620 B.R. 645, 652 (Bankr. D. Colo. 2020), *aff'd*, No. BAP CO-20-003, 2020 WL 5869458 (10th Cir. BAP (Colo.) Oct. 2, 2020), *aff'd*, 22 F.4th 1217 (10th Cir. 2022). But the kind of contradiction that would arise from

the Trustee's interpretation is one not contemplated by the Code: Mr. Clegg's home would be valued at $350,000 for purposes of section 522 but valued at $450,000 in the converted estate. R. at 14. The Thirteenth Circuit recognized that freezing a property's value at the petition date for the purpose of a homestead exemption, but freezing a property's value at the conversion date for the purpose of determining the extent of the estate upon conversion, is "non-sensical." R. at 14. Consequently, the court held that the property should not be valued differently for exemption purposes and conversion purposes but that the extent of the property that constitutes part of the estate upon conversion is the same as was used for exemptions, $350,000. R. at 4, 14. This divergence in interpretation demonstrates the ambiguity that arises from a post-petition, pre-conversion increase in equity.

Section 541(a)(1) also demonstrates the multiplicity of interpretations when read in context with section 348(f)(1)(A). Section 541(a)(1) defines what constitutes "property of the estate" as "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). While Mr. Clegg does not dispute that his home is property of the converted estate, the question remains whether the increase in equity in his home is also property of the estate. The chapter 13 Plan confirmed that Mr. Clegg had no equity in his home at the time the case commenced. R. at 7. Thus, it is unclear whether the post-petition increase in equity is a "legal or equitable interest" that constitutes part of the estate upon conversion, "given that post-petition earnings and property acquired before conversion are not considered property of the estate." *In re Boyum*, No. 04-31695-ELP7, 2005 WL 2175879, at *2 (D. Or. Sept. 6, 2005).

Section 541(a)(6) also establishes section 348(f)(1)(A)'s ambiguity. Section 541(a)(6) excludes Mr. Clegg's future earnings from its definition of property of the estate. 11 U.S.C. § 541(a)(6). The Code is silent, however, as to whether future earnings used to create equity through

paydowns are property of the estate. *See In re Nichols*, 319 B.R. 854, 857 (Bankr. S.D. Ohio 2004). The Trustee's argument that section 348(f)(1)(A) is plain cannot be reconciled with the fact that some debtors create equity by using wages earned post-petition to pay down their loans, and section 541(a)(6) excludes future earnings from the estate. *See id*. Mr. Clegg paid $10,000 to the Servicer as part of the Plan. R. at 8-9. Though it is unclear whether his payments contributed to the overall increase in equity, this problem generally demonstrates how section 348(f)(1)(A) is not plain. Future earnings could conceivably be used to purchase "equity," and there is not a "straightforward reading" of section 348(f)(1)(A) that would resolve this question. *In re Nichols*, 319 B.R. at 857.

Ambiguity is also evident not only from reading section 348(f)(1)(A) in context with other Code provisions, but also from the split in authority in interpreting section 348(f)(1)(A). *In re Barrera (Barrera II)*, No. BAP CO-20-003, 2020 WL 5869458, at *5 (10th Cir. BAP (Colo.) Oct. 2, 2020), *aff'd*, 22 F.4th 1217 (10th Cir. 2022). Courts are split concerning whether section 348(f)(1)(A) should be interpreted to mean that post-petition, pre-conversion equity becomes part of the estate upon conversion. *See, e.g., Castleman v. Burman (Matter of Castleman)*, 75 F.4th 1052, 1055 n.3, 1058 (9th Cir. 2023); *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 (Barrera III)*, 22 F.4th 1217, 1222 (10th Cir. 2022). Therefore, the plain meaning of section 348(f)(1)(A) cannot be discerned. *See Chickasaw*, 534 U.S. at 90.

### B. Legislative history, context, and policy support the Thirteenth Circuit's determination that post-petition, pre-conversion equity is not property of the estate upon conversion.

Because the plain meaning of section 348(f)(1)(A) is unclear, this Court must use tools of statutory interpretation to determine whether Mr. Clegg or the bankruptcy estate receives the benefit of post-petition, pre-conversion increases in equity. Courts resolve ambiguities by looking

to the legislative history, context, and policy considerations behind the statute to determine its intended meaning. *See, e.g., In re Todd*, 585 B.R. 297, 302 (Bankr. N.D.N.Y. 2018) (stating that if the term of a statute is ambiguous, the court may rely on "legislative history and other tools of interpretation"). These tools reveal that the Thirteenth Circuit was correct in its determination that the increase in equity belongs to Mr. Clegg.

**1. The legislative history of section 348(f) makes Congress' intent plain: post-petition, pre-conversion equity belongs to the debtor.**

Section 348(f)(1)(A) must be construed in a way that honors Congress' intent, allowing the benefit of appreciation post-petition to inure to the honest debtor who attempted to repay his debts. It is the Court's ultimate purpose in interpreting statutes to give effect to Congress' intent. *U.S. v. Am. Trucking Ass'ns*, 310 U.S. 534, 542 (1940). When that intent is unclear due to ambiguity, courts may look to legislative history to determine the meaning of a statute. *See, e.g., In re Todd,* 585 B.R. at 302.

Congress enacted 348(f) to address a prior circuit split that emerged as to what property was included in the estate when a debtor converted from chapter 13 to chapter 7. H.R. REP. NO. 103-835, at 57 (1994), *as reprinted in* 1994 U.S.C.C.A.N. 3340, 3366. The legislative history explicitly mentions the cases of *Matter of Lybrook* and *In re Bobroff* as demonstrating the split. *Id*. In *Lybrook*, the Seventh Circuit determined that property the debtors inherited post-petition was included in the estate after conversion from chapter 13 to chapter 7. *Matter of Lybrook*, 951 F.2d 136, 138 (7th Cir. 1991). The Seventh Circuit reached this conclusion because the property was originally included in the chapter 13 estate and because the court was concerned with a calculated debtor attempting to keep a windfall of property while his position in chapter 13 deteriorated. *Id*. at 137-38. The Third Circuit in *Bobroff* reached the opposite conclusion: tort claims accrued post-petition but pre-conversion were not part of the estate upon conversion. *In re Bobroff*, 766 F.2d

797, 804 (3d Cir. 1985). The Third Circuit determined that because the debtor's causes of action did not accrue and become property interests until after commencement, they were not property of the estate under the definition of "property of the estate" given in section 541. *Id*. at 803. Further, that determination was "consonant with the Bankruptcy Code's goal of encouraging the use of debt repayment plans rather than liquidation." *Id*. In enacting section 348(f), Congress adopted the reasoning of *Bobroff*, concluding that the Third Circuit's approach encouraged debtors to file under chapter 13 and attempt to pay off their debts without fear of liquidation. H.R. REP. NO. 103-835 at 57.

Congress' rationale for adopting the reasoning of *Bobroff* concerning property the debtor acquired after the chapter 13 petition date is applicable to the split that has emerged regarding post-petition, pre-conversion increases in equity of a debtor's property. The purpose of chapter 13 is to allow debtors to retain their property while paying their debts. *See Barrera III*, 22 F.4th at 1220. Increases in equity of property can occur from market conditions, debtors paying off their loans, or a combination of both. Concluding that an increase in equity, whether from market conditions or debtors' own paydowns, will not belong to debtors if they convert from chapter 13, disincentivizes debtors from starting out in chapter 13. That is the exact result Congress attempted to prevent by enacting 348(f). *See* H.R. REP. NO. 103-835 at 57.

Congress specifically attempted to address the situation presently before the court by enacting 348(f). *See id.* To demonstrate its intent in enacting 348(f), Congress included a hypothetical in the House Report. *Id*. The hypothetical explains that without section 348(f), converting from chapter 13 to chapter 7 could cause a debtor to lose both their home and any equity created in it:

> 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.* This illustration repudiates the very result the Trustee is asking this Court to reach. Congress concluded that an increase in equity occurring post-petition belongs to the debtor upon conversion. *See id.* It did so because it wanted to continue to encourage debtors to file under chapter 13. *See id.* The court in *In re Goetz* asserted that Congress must have intentionally chosen *not* to incorporate the aim of this illustration into section 348(f) because the court determined that the plain language of section 348(f) included post-petition equity in the converted estate. *In re Goetz,* 651 B.R. at 299. This reasoning fails as circular—the court determined that section 348(f)(1)(A) plainly meant that post-petition equity belonged to the estate and, because the illustration contradicts that determination, Congress must have intended to abandon its conclusion. *See id*. The court's contention also undermines this Court's direction that the function of statutory interpretation is to ascertain legislative intent, and that is done by looking to the legislative history. *See Am. Trucking Ass'ns*, 310 U.S. at 542. Congress previously memorialized its desire to incentivize chapter 13 filings by giving debtors a non-waivable right to convert from chapter 13 to chapter 7 "at any time." 11 U.S.C. § 1307. Congress was careful not to punish debtors who attempted to repay under chapter 13, allowing them to convert to chapter 7. *See id.* Thus, the Thirteenth Circuit correctly recognized that a decision in favor of the Trustee runs contrary to that very intent by allowing debtors to lose more by converting to chapter 7 than they would if they had started out in chapter 7. R. at 17.

In enacting section 348, Congress included section 348(f)(2) to ease the concern of courts like that of *Lybrook*. *See Matter of Lybrook*, 951 F.2d at 137-38. Section 348(f)(2) provides a

solution to the problem of the debtor who attempts to convert to conceal assets: using the date of conversion, not the petition date, to determine the extent of the estate. *See* 11 U.S.C. § 348(f)(2). This section makes clear that Congress intended to make the date of the petition the point for determining the extent of a debtor's property interests, absent bad faith. *See Harris v. Viegelahn*, 575 U.S. 510, 517 (2015). The Trustee's attempt to use Congress' solution to a debtor who converts in bad faith—using the date of conversion to determine the extent of the estate—in this instance, where Mr. Clegg strived to repay his debts under chapter 13 and failed due to a global pandemic, amounts to a gross perversion of the Code. R. at 8. The legislative history condemns that attempt and confirms that equity accrued post-petition should benefit Mr. Clegg, not the estate.

**2. The Code provides context demonstrating that post-petition equity belongs to the debtor upon conversion**.

In addition to legislative history, relevant sections of the Code reveal that the post-petition increase in equity should belong to Mr. Clegg. Just as sections 348(f)(2) and 522 demonstrate section 348(f)(1)(A)'s ambiguity, their language likewise suggests that Mr. Clegg's interpretation is correct.

Mr. Clegg's interpretation of 348(f)(1)(A) preserves the purpose of 348(f)(2). Section 348(f)(2) specifies that the date of conversion, as opposed to the date of the petition, should be used to determine what constitutes the estate if a debtor converts in bad faith. 11 U.S.C. § 348(f)(2). Statutory interpretation demands that Code sections not be read to render other sections superfluous. *See, e.g., Hibbs v. Winn,* 542 U.S. 88, 101 (2004) ("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."). As both the Thirteenth Circuit and the Ninth Circuit's Bankruptcy Appellate Panel recognized, if interests in property acquired post-petition were included in the converted estate regardless of whether a debtor converts in good or bad faith as the Trustee proposes, section

348(f)(2) would be redundant. R. at 13; *In re Lynch*, 363 B.R. 101, 107 (B.A.P. 9th Cir. 2007). Preservation of section 348(f)(2)'s purpose dictates that Mr. Clegg's property interests as of the petition date is the correct point to use to determine what constitutes the estate upon conversion. The Trustee's position disregards the critical distinction between sections 348(f)(1) and 348(f)(2), the date to be used upon whether the debtor converts in good or bad faith, ultimately rendering section 348(f)(2) superfluous. 11 U.S.C. §§ 348(f)(1)(A), 348(f)(2). According to the canon against surplusage, the Trustee's interpretation is untenable.

Additionally, Mr. Clegg's position harmonizes Code sections while the Trustee creates conflict among them. It is a well-recognized rule of statutory construction that courts are to read statutory texts as a "harmonious whole," giving effect to each part of the text in a way that harmonizes them. *Food & Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000) (citations omitted). Section 522 freezes the debtor's property value at the petition date for purposes of exemptions. 11 U.S.C. § 522(a)(2). Section 348(f)(1)(A) freezes the extent of property included in the estate upon conversion at the petition date. 11 U.S.C. § 348(f)(1)(A). Both sections make explicit reference to freezing property at the petition date. *Id.*; 11 U.S.C. § 522(a)(2). The Trustee's position creates discord, as it would have Mr. Clegg's home valued at $350,000 for exemption purposes, but $450,000 for estate purposes, ignoring both sections' explicit references to the petition date. *Id.*; R. at 14. It is more consistent within the context of the Code that section 348(f)(1)(A) would freeze the debtor's property interests as they existed on the petition date, just as section 522 would freeze that same property's value for exemption purposes.

The Trustee points to *Matter of Castleman* to argue that her position does not create discord. R. at 14. In *Castleman*, the Ninth Circuit concluded that increased equity belonged to the bankruptcy estate, pointing to section 541(a) and ignoring all relevant Code provisions which

would discredit it. *See Matter of Castleman*, 75 F.4th at 1055-56. It reasoned that because section 541(a)(6) includes "proceeds, product, offspring, rents, or profits" of the debtor's property as property of the estate, section 541(a)(6) extends to "appreciation in the property." *Id.* at 1056. Regrettably, the Ninth Circuit failed to explain how this determination is harmonious with the explicit reference to the petition date that exists in both sections 522(a)(2) and 348(f)(1)(A). *See* 11. U.S.C. §§ 348(f)(1)(A), 522(a)(2). Even if this Court was persuaded that an increase in equity falls under section 541(a)(6), the Ninth Circuit's analysis exhibits three glaring flaws. *See Matter of Castleman*, 75 F.4th at 1055-56. First, section 348(f)(1)(A) explicitly references the petition date as the point in time in which the extent of the converted estate's property is determined, which would not include post-petition appreciation by the very nature of the "snapshot" it takes. *See* R. at 14; *see also* 11. U.S.C. § 348(f)(1)(A). Second, section 522(a)(2), known as the snapshot rule, explicitly references the petition date, and it would be contradictory to treat the two references to the petition date differently, violating the canon favoring statutory harmony. *See* R. at 14; 11. U.S.C. § 522(a)(2). Third, section 541(a)(6) specifically excludes future earnings of the debtor from the estate, which could be used to effectively 'purchase' equity through making payments, the purpose of chapter 13. *In re Nichols*, 319 B.R. at 857. As such, the Thirteenth Circuit was correct in its dismissal of the Trustee's reliance on the Ninth Circuit's reasoning.

**3. The Thirteenth Circuit's holding favors the policy behind incentivizing debtors to file under chapter 13**.

Holding that Mr. Clegg receives the benefit of equity accrued post-petition preserves the policy considerations that Congress sought to advance by incentivizing debtors to file under chapter 13. *See In re Lynch*, 363 B.R. at 107. Debtors who file under chapter 13 do so with the assurance that, should they be unable to fulfill their repayment plan, they can convert to chapter 7 without repercussion. 11. U.S.C. § 1307. Preserving the ability to do so without being penalized

was the primary motivation behind Congress' enactment of 348(f). *See* H.R. REP. NO. 103-835 at 57. Congress specifically noted that determining that property acquired post-petition belongs to the estate upon conversion, a result occurring only *because* the debtor converted, "would create a serious disincentive to chapter 13 filings." *Id.* Consequently, Congress chose not to make such a determination.

A decision in favor of the Trustee would disincentivize debtors from filing under chapter 13 because it produces an inequitable result predicated *only* on the event of conversion. Filing under chapter 13 allows debtors to retain ownership of their property in exchange for adhering to a confirmed plan of repayment that would give creditors at least as much as they would have received upon liquidation. *See Harris*, 575 U.S. at 514; *see also* 11 U.S.C. § 1325(a)(4). Had Mr. Clegg been able to continue in chapter 13, as long as he made his payments to the Servicer under the Plan, he would have been able to reap the benefit of appreciation should he have chosen to sell. *See* 11 U.S.C. § 1327(b) (vesting all property of the estate in the debtor unless the plan states otherwise). Moreover, if Mr. Clegg had initially filed under chapter 7, his house would have been entirely exempt from the estate due to the state of Moot's homestead exemption and the Servicer's liens. R. at 7. Upon sale, Mr. Clegg would have received the proceeds not owed to the Servicer. 11 U.S.C. § 522(c). It is only upon conversion from chapter 13 to chapter 7 that the issue of who benefits from increased equity in a debtor's property arises. The Trustee's position would cause Mr. Clegg and debtors like him to be left in a worse position because they attempted repayment. *See In re Brown*, 953 F.3d 617, 620 (9th Cir. 2020). Deciding that an increase in equity, which occurred only because a debtor attempted repayment, inures to the benefit of the estate runs contrary to Congress' decision to provide debtors with a non-waivable right to convert to chapter

7. Such a decision would cause well-intentioned debtors to lose their homes, clearly disincentivizing them from filing under chapter 13.

While it may seem as though a debtor like Mr. Clegg may receive a windfall as a result of market conditions or payments increasing his equity in the home, this Court has dismissed that concern as unfounded. *See Harris*, 575 U.S. at 521. In *Harris*, this Court decided that plan payments created by a debtor's wages, undistributed by a chapter 13 trustee, should return to the debtor after converting to chapter 7. *Id*. at 513. This Court averred it would not regard as a "'windfall' a debtor's receipt of a fraction of the wages he earned and would have kept had he filed under Chapter 7 in the first place." *Id*. at 521. Similarly, it would not be a windfall to allow Mr. Clegg to keep what would have been his had he filed in chapter 7 in the first place, or otherwise stayed in chapter 13. Further, this Court acknowledged the "fortuity" of the chapter 13 trustee not yet paying out the distributions prior to conversion and thus the debtor receiving them. *Id*. But this Court recognized that such a result flowed from Congress' decision to keep post-petition wages out of the converted estate and give debtors the right to convert at any point. *Id*. The same rationale applies here: regardless of whether the increase in equity was the fortuitous result of market conditions or the result of the debtor's own payments on the lien, Congress intended for the equity to belong to the debtor.

It is antithetical to the legislative history, context, and policy considerations surrounding section 348(f)(1)(A) to read the section to mean that a post-petition increase in equity belongs to the bankruptcy estate. Whether the increase in equity comes as a result of market conditions or a debtor attempting to make payments, this Court should continue to incentivize chapter 13 filings by using the date of the petition to determine the extent of the property interests that belong to the estate upon converting in good faith. As Mr. Clegg did not have any equity in his home as of the

petition date, the increase in equity occurring post-petition inures to his benefit upon conversion. R. at 7. Accordingly, this Court should affirm the opinion of the Thirteenth Circuit.

## II. THIS COURT SHOULD AFFIRM THE THIRTEENTH CIRCUIT BECAUSE SECTIONS 547 AND 550 OF THE CODE DO NOT PERMIT THE TRUSTEE TO SELL THE POWER TO AVOID AND RECOVER PREFERENTIAL TRANSFERS.

While the meaning of section 348(f)(1)(A) remains ambiguous in the broader context of the Code, the meaning of sections 547 and 550 is plain: only the Trustee has the power to avoid and recover preferential transfers. Here, Eclipse agreed to buy a preference claim against Pink, Mr. Clegg's mother, for 100 cents on the dollar. R. at 9. Approval of the Sale Motion would have allowed the estate to recover 100% of the preferential transfer amount without expending any administrative costs. R. at 9. This outcome seems undeniably favorable to the estate and its creditors—but once again, not all that glitters is gold. The bankruptcy court and Thirteenth Circuit saw the Sale Motion for what it was: a vindictive attack on Mr. Clegg's mother as retribution for Mr. Clegg's previous perceived mismanagement of Eclipse's funds.

Such a sale would only augment the bankruptcy estate at the expense of the plain language of the Code and the legislature's intent in enacting sections 547 and 550. The allure of increasing distributions to creditors has proven too tempting for the majority of courts that have addressed whether the Trustee's avoidance powers constitute property of the estate, resulting in a divergence of precedent across the country on this issue. *See, e.g.*, *Silverman v. Birdsell*, 796 F. App'x 935, 937 (9th Cir. 2020); *Morley v. Ontos, Inc.* (*In re Ontos, Inc.*), 478 F.3d 427, 431 (1st Cir. 2007); *Pitman Farms v. ARKK Food Co.* (*In re Simply Essentials, LLC*), 78 F.4th 1006, 1011 (8th Cir. 2023), *but see Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery* (*In re Cybergenics Corp.*), 226 F.3d 237 (3d Cir. 2000). Most prominently, the Eighth Circuit recently addressed the precise issue before this Court and incorrectly decided that the Trustee's preference

avoidance powers are property of the estate.[3] *In re Simply Essentials, LLC*, 78 F.4th at 1011. Thus, while the language of sections 547 and 550 is clear, the prevalence of opposing authority necessitates a rigorous analysis. The related Code sections, the relevant canons of statutory construction, the legislative history of sections 547 and 550, as well as the purpose and policy of preference actions substantiate the Thirteenth Circuit's holding that the Trustee cannot sell her power to avoid and recover preferential transfers.

### A. The Trustee's power to avoid and recover preferential transfers is not property of the estate.

For the Trustee to have the power to include a preference claim in a sale motion under section 363(b)—as she attempted to do in this case—preference claims must constitute property of the estate. *See* 11 U.S.C. § 363(b) (explaining that the trustee may only sell "property of the estate"). It follows that this Court must determine whether a trustee's *power* to avoid and recover preferential transfers is property of the bankruptcy estate. The starting point for interpreting the Code is an examination of the plain meaning of the text. *Lamie v. U.S. Tr.*, 540 U.S. 526, 534 (2004). Section 541(a) generally marks the boundaries of the bankruptcy estate. *See* 11 U.S.C. § 541(a). However, this Court has held that other Code sections relevant to the specific interest at issue in a case can extend the boundaries of the bankruptcy estate and include property in the estate not otherwise contemplated by section 541(a). *U.S. v. Whiting Pools, Inc.*, 462 U.S. 198, 198 (1983). Therefore, determining whether the Trustee's preference avoidance power constitutes property of the estate requires an analysis of section 541(a), as well as sections 547 and 550, the Code sections that specifically govern the Trustee's preference avoidance power. *See* 11 U.S.C.

[3] While the Trustee also possesses the power to avoid and recover *fraudulent* transfers under sections 548 and 550, the issue before this Court is limited to whether the Trustee can sell her *preference* avoidance power pursuant to sections 547 and 550.

§§ 541(a)(1), (7), 547, 550. The plain meaning of sections 547, 550, 541(a)(1), and 541(a)(7) reveal that the Trustee's power to avoid and recover preferential transfers is not property of the estate.

**1. Sections 547 and 550 do not include the Trustee's power to avoid and recover preferential transfers in the bankruptcy estate.**

This Court held in *Whiting Pools* that Code sections outside of 541(a) can work in tandem with section 541(a) to bring property into the bankruptcy estate. *See Whiting Pools*, 462 U.S. at 198 (holding that section 542(a) brings into the estate property that a secured creditor repossessed prior to the bankruptcy case). Thus, as a threshold matter, this Court must consider whether Code sections outside of 541(a) bring the Trustee's power to avoid and recover preferential transfers into the bankruptcy estate.

Sections 547 and 550 do not include the Trustee's preference avoidance powers in the bankruptcy estate. *See* 11 U.S.C. §§ 547, 550. Sections 547 and 550 only grant the *trustee* the power to avoid and recover preferential transfers. *See* 11 U.S.C. §§ 547, 550. This Court has held that when the 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*"). *Hen House* examined section 506(c) which, similar to sections 547 and 550, refers solely to the trustee without reference to any other person or entity. *See id.* at 7; *see also* 11 U.S.C. §§ 547, 550. Thus, sections 547 and 550's references to the trustee denote that the power to avoid and recover preferential transfers rests solely in the trustee and the trustee *alone. See Hen House,* 530 U.S. at 6-7.

Moreover, section 550(a) explicitly states that preferential transfers can only be recovered "for the benefit of the estate." 11 U.S.C. § 550(a). This limitation on the exercise of the Trustee's avoidance power further repudiates the notion that someone other than the Trustee could recover a preferential transfer. *See id.* If the Trustee could sell her power to recover a preferential transfer,

the transfer would be recovered for the benefit of the purchaser, not for the benefit of the estate as section 550(a) requires. *See id.* Therefore, section 550(a)'s explicit limitation on the Trustee's avoidance power indicates that it may not be sold. *See id.* This limitation intimates that section 550 does not operate to include a trustee's preference avoidance power in the estate. *See id.*

**2. Section 541(a)(1) does not include the Trustee's power to avoid and recover preferential transfers in the bankruptcy estate.**

Section 541(a)(1) includes "all legal or equitable interests of the debtor in property *as of the commencement* of the case" as property of the estate. 11 U.S.C. § 541(a)(1) (emphasis added). The plain language of section 541(a)(1) reflects the longstanding bankruptcy principle that "the estate cannot possess anything more than the debtor itself did outside of bankruptcy." *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1663 (2019). Consequently, section 541(a)(1) only brings into the estate property in which the debtor possessed some kind of interest prior to the petition date. *See id.*

A trustee's power to avoid and recover preferential transfers is a creature of bankruptcy law. This power is created by the Code and is granted to the Trustee upon the commencement of the case. *See* 11 U.S.C. §§ 547, 550. Furthermore, when this power is created upon commencement, the plain language of sections 547 and 550 explains that the power may only be used to benefit the estate, not to benefit the debtor. *See* 11 U.S.C. §§ 547, 550. Therefore, the debtor does not have an interest in the Trustee's preference avoidance power before or at the time of the commencement as required by the plain language of section 541(a). *See* 11 U.S.C. § 541(a)(1). Consequently, section 541(a) does not include the Trustee's preference avoidance power as property of the estate. *See id.*

The Eighth Circuit, in a hollow analysis of section 541(a)(1), relied on *Whiting Pools* to conclude that section 541(a)(1) brings the Trustee's power to avoid and recover preferential

transfers into the estate.[4] *In re Simply Essentials*, 78 F.4th at 1009. The Eighth Circuit reasoned that *Whiting Pools'* pronouncement that there is no requirement that the "debtor hold a possessory interest in the property at the commencement [for property to be included in the estate]" bolstered the court's conclusion that the trustee's preference avoidance power is included in the estate pursuant to section 541(a)(1). *See id.* at 1008-09. This characterization critically misunderstands this Court's holding in *Whiting Pools* in two key respects.

First, although *Whiting Pools* held that the debtor does not need to hold a *possessory* interest in property as of the commencement of the case, it did not nullify section 541(a)(1)'s clear mandate that the debtor have *an* interest in the property at the time of commencement for that property to be included in the estate. *See Whiting Pools,* 462 U.S. at 204-206. In *Whiting Pools*, the IRS repossessed the property of the debtor prior to the commencement of the case, meaning that at the time of commencement, the debtor lacked a possessory interest in the property. *Id* at 200. This Court held that a possessory interest was not necessary for the property to come into the estate and that the debtor's remaining legal interest was sufficient. *See id.* at 206. Here, the issue concerning section 541(a) is not whether the debtor specifically held a possessory interest in the Trustee's preference avoidance powers; it is whether the debtor had *any* interest in those powers. Thus, *Whiting Pools'* clarification that a possessory interest is not necessary to bring property into the bankruptcy estate is of no avail to the Trustee's section 541(a)(1) argument.

Second, the Eighth Circuit fails to account for the most consequential part of the *Whiting Pools* holding: that section 541(a)(1) "is intended to include in the estate any property made

[4] The Eighth Circuit also relied on *Segal v. Rochelle*, a case interpreting a section of the Bankruptcy Act of 1898 governing property of the estate that contained vastly different language than its eventual successor, section 541(a), in the Code. *See In re Simply Essentials,* 78 F.4th at 1009; *see Segal v. Rochelle*, 382 U.S. 375, 382 (1966). The proposition that the Eighth Circuit awkwardly pulls from *Segal* is ill-suited to support its overall conclusion for the same reasons concerning the Eighth Circuit's regrettable reliance on *Whiting Pools. See id.*

available to the estate by other provisions of the Bankruptcy Code." *Id.* at 205. Contrary to the Eighth Circuit's holding, *Whiting Pools* does not stand for an unbridled application of 541(a)(1) that allows the Trustee to work anything of value into a section 363(b) sale motion. *See id.* Instead, *Whiting Pools* merely clarifies that section 541(a)(1) does not prevent other Code provisions from *including* property in the estate. *See id.* For example, in *Whiting Pools*, this Court found that section 542(a) works in conjunction with section 541(a)(1) to grant the estate a possessory interest in certain property that the debtor lacked such interest in at the commencement of the case, and thus brings that property into the bankruptcy estate. *See id.* The Eighth Circuit and the dissent in the Thirteenth Circuit both fail to point to any Code section that can be read in tandem with section 541(a)(1) to bring a trustee's preference avoidance power into the estate. *See In re Simply Essentials*, 78 F.4th; R. at 24. This failure is inevitable because there is no such Code section. Therefore, *Whiting Pools* does little to alleviate the impediment the plain language of section 541(a) presents to the Trustee's position.

**3. Section 541(a)(7) does not include the Trustee's power to avoid and recover preferential transfers in the bankruptcy estate.**

The plain language of section 541(a)(7) similarly fails to include the Trustee's preference avoidance powers in the bankruptcy estate. *See* 11 U.S.C. § 541(a)(7). Section 541(a)(7) includes in the estate "[a]ny interest in property that the estate acquires after the commencement of the case." *Id.* First, 541(a)(7) presents a temporal barrier to the Trustee's position. *See id.* Section 541(a)(7) only includes property in the estate that is acquired "after" commencement. *Id.* As the Thirteenth Circuit pointed out, the Trustee's avoidance powers are created at the moment the bankruptcy case commences, not "after." R. at 21. More importantly, any argument advanced by the Trustee concerning section 541(a)(7) presupposes the Trustee's conclusion. Section 541(a)(7) expressly includes in the estate property that the *estate* acquires. 11 U.S.C. § 541(a)(7). The crux

of the second issue on appeal to this Court is *who* has an interest in the Trustee's preference powers. For the Trustee to be correct in her determination that section 541(a)(7) brings into the estate the Trustee's preference avoidance power, that power must have already been acquired by the estate. *See id.* Thus, the Trustee's argument is aimlessly circular and presumes that the estate had an interest in the preference avoidance power in the first place.

### B. The canons of statutory construction and legislative history support the Thirteenth Circuit's interpretation of sections 541(a), 547, and 550.

While Mr. Clegg maintains that the meaning of sections 541(a), 547, and 550 is plain, if this Court determines that these Code sections are ambiguous, the debtor's interpretation is only strengthened by the relevant canons of statutory construction and legislative history. Specifically, Mr. Clegg's interpretation gives meaning to corresponding Code sections without rendering any part of the Code superfluous or absurd. Conversely, the Trustee's interpretation renders entire Code sections redundant and incomprehensible. Moreover, Mr. Clegg's position honors centuries of pre-Code practice, while the Trustee's position departs from it without reason.

#### 1. The Thirteenth Circuit's interpretation preserves the meaning of corresponding Code sections without rendering Code language superfluous or absurd.

The Thirteenth Circuit rightly observed that statutory text "cannot be construed in a vacuum" and must instead be read in context with a "view to ... the overall statutory scheme." *Roberts*, 566 U.S. at 101 (2012) (citation omitted). The Thirteenth Circuit went on to find that the Trustee's interpretation would render Code sections corresponding to sections 547 and 550 superfluous while rendering other sections absurd or incomprehensible. R. at 21-22. Conversely, the debtor's interpretation of sections 547 and 550 preserves the integrity of corresponding Code sections.

This Court has held out the canon against superfluous language as a touchstone of statutory construction. *See, e.g., Hibbs,* 542 U.S. at 101. Section 541(a)(3) includes a cross-reference to section 550, stating that "[a]ny interest in property that the *trustee* recovers under section … 550" is property of the estate. 11 U.S.C. § 541(a)(3) (emphasis added). Section 541(a)(3) explicitly brings into the estate any property the *trustee* recovers in a preference action. *See id.* But, under the Trustee's interpretation, a *purchaser* could also recover under section 550. In that instance, where a purchaser recovers under section 550, section 541(a)(3) would be robbed of its only function: to bring the trustee's recovery under section 550 into the estate. Therefore, the Trustee's interpretation would render section 541(a)(3) superfluous.

The Eighth Circuit overlooked the inevitable decimation of section 541(a)(3) by dismissing the canon against surplusage as a rule that is not "absolute." *In re Simply Essentials,* 78 F.4th at 1009. Nevertheless, the Eighth Circuit conceded that the canon against surplusage must be given more weight when an interpretation would cause a "positive repugnancy" between statutes. *Id.* at 1009 (quoting *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253 (1992)). The Eighth Circuit failed to realize that its own interpretation, also advanced by the Trustee in this case, would cause such "positive repugnancies" that require a closer adherence to the ca3non against surplusage. Specifically, the Trustee's interpretation would render sections 554, 349(b)(1)(B), and 349(b)(2) absurd. *See* 11 U.S.C. §§ 554, 349(b)(1), 349(b)(2).

The Trustee's interpretation would render sections of the Code incomprehensible. This Court has stated that courts should presume that Congress did not intend "absurd" results when construing sections of the Code. *See Lamie,* 540 U.S. at 527. Section 554 vests property of the estate in the debtor upon the trustee's abandonment. 11 U.S.C. § 554. If the Trustee's preference avoidance powers are property of the estate, section 554 would "absurdly" purport to vest those

powers in the debtor upon abandonment. R. at 21. Additionally, section 349 details the effect of dismissal under section 742. 11 U.S.C. § 349. Section 349(b)(1)(B) states that upon dismissal, a transfer avoided pursuant to section 547 will be reinstated. 11 U.S.C. § 349(b)(1)(B). Moreover, section 349(b)(2) "vacates any order, judgment, or transfer ordered" under section 550. 11 U.S.C. § 349(b)(2). In a world where the Trustee can sell her preference avoidance power, both section 349(b)(1)(B) and section 349(b)(2) would be incomprehensible. The Code would no longer possess the power to reinstate transactions avoided under section 547 or vacate any judgment recovered under section 550—rendering the aim of sections 349(b)(1)(B) and 349(b)(2) "inconsequential, if not incomprehensible." R. at 21. Therefore, the Trustee's interpretation flagrantly violates the canon against absurd results, while Mr. Clegg's interpretation preserves a harmonious reading of the Code.

**2. Congress did not intend to disrupt the well-settled pre-Code principle that the Trustee cannot sell her preference avoidance powers.**

This Court has long held that when Congress drafts bankruptcy legislation, it "does not write 'on a clean slate.'" *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992) (quoting *Emil v. Hanley*, 318 U.S. 515, 521 (1943)). Further, this Court has been reluctant to accept an interpretation of the Code that is violative of pre-Code practice where Congress did not materially amend the relevant statutory language and where the legislative history is silent concerning Congress' intent to effect such a change. *See id.*; *see also Lamar, Archer & Cofrin, LLP v. Appling*, 138 S. Ct. 1752, 1762 (2018). The Thirteenth Circuit faithfully heeded this principle. R. at 21-22. In contrast, the Eighth Circuit neglected to examine the history of sections 547 and 550. S*ee In re Simply Essentials*, 78 F.4th at 1010. Instead, the Eighth Circuit chose to champion the righteousness of the echo chamber, stating, "[e]ven if there were any ambiguity in the statutory language we are persuaded by the consensus of courts across the country: avoidance actions are property of the estate." *See id.* As

the Thirteenth Circuit's opinion elucidates, the Eighth Circuit's decision to ignore pre-Code practice and the legislative history of sections 547 and 550 was detrimental to the viability of the Eighth Circuit's holding. *See* R. at 21-22.

As highlighted by the Thirteenth Circuit, the power to avoid preferential transfers has been recognized by the bankruptcy practice since the 1700s. See *id.*; *see also Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 372-73 (2006) (citations omitted). Under the Bankruptcy Act of 1898, the predecessor of the Code, the trustee's power to avoid preferential transfers was inextricably intertwined with the well-settled principle that this power could not be sold. *United Cap. Corp. v. Sapolin Paints, Inc.* (*In re Sapolin Paints, Inc.*), 11 B.R. 930, 937 (Bankr. E.D.N.Y. 1981) (collecting cases). Notably, Congress chose to preserve the Bankruptcy Act's operative language concerning the trustee's preference powers when it wrote sections 547 and 550. *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)). Both the Bankruptcy Act and the Code state that only the "trustee" has the power to avoid and recover preferential transfers. *Id.* Moreover, the legislative history is not only silent concerning any intent to deviate from pre-Code practice—it specifically indicates that Congress intended to *preserve* the pre-Code practice of allowing only the trustee to avoid and recover preferential transfers. Congress stated that under the new Code sections the "trustee" would have the power to avoid preferential transfers. H.R. REP. NO. 95-595, at 177-78, (1977).

Additionally, Congress explicitly explained the two changes to pre-Code practice it *did* intend to make with the new Code sections. *Id.* Congress stated that it wanted to remove the requirement that the trustee prove the debtor's insolvency at the time of the preferential transfer and the requirement that the trustee prove that the receiving creditor had reasonable cause to

believe that the debtor was insolvent at the time of the transfer. *Id.* Congress made no mention of changing the pre-Code practice of disallowing the Trustee to sell its preference avoidance power, indicating that it did not intend to make such a change. *See id.*

### C. The Thirteenth Circuit's holding aligns with Congress' intended purpose of preference actions.

The Thirteenth Circuit wisely observed that the most persuasive arguments in favor of the Trustee's interpretation of sections 547 and 550 are policy considerations. R. at 22. Increasing the assets of the bankruptcy estate to maximize distributions to creditors is a laudable goal, but the decision concerning how best to achieve that goal lies with Congress—not the courts. *See, e.g., Dodd v. U.S.*, 545 U.S. 353, 359-60 (2005). Even if a policy decision has unforeseen consequences, such as depriving the estate of an asset, the judiciary cannot nullify the legislature's decision and replace it with one it believes the legislature should have made instead.[5] *See Union Bank v. Wolas*, 502 U.S. 151, 158 (1991). Thus, if this Court decides that the relevant Code sections are ambiguous, policy should only be considered to ascertain the intent of the legislature, not as a means of creating the most advantageous result for the Trustee.

The Thirteenth Circuit honored the stated intent of the legislature in enacting sections 547 and 550, but the Trustee seeks to defy that intent. Most obviously, the Trustee's proposed interpretation inoculates the legislature's intent that avoidance power belongs solely to the trustee. More insidiously, the Trustee's interpretation defiles the legislature's foremost purpose in creating preference actions: "to facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor." H.R. REP. NO. 95-595, at 177-78; *Wolas*, 502 U.S. at 160-61 (1991).

[5] However, as the Thirteenth Circuit noted, Congress did account for the situation of an unwilling trustee, or other existential circumstances that could potentially deprive creditors of otherwise available recovery from preference actions by allowing creditors to pursue preference actions *derivatively* on behalf of the bankruptcy estate. R. at 23; *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). The availability of derivative standing further vitiates any concern the Trustee has concerning the availability of tools to allow just distributions to creditors.

The bleak consequences of the Trustee's interpretation are illustrated by the hypothetical of two purchasers: the vindictive creditor and the bargain creditor. Eclipse represents the vindictive creditor. Eclipse stands to *lose* money in administrative costs in a recovery action against Pink because Eclipse purchased the claim for 100 cents on the dollar. R. at 9. Eclipse believed Mr. Clegg mismanaged a portion of Eclipse's funds, and in addition to pursuing a section 523(a) action against Mr. Clegg, Eclipse creatively sought revenge on Mr. Clegg by attempting to buy the right to sue his mother. *See* R. at 7, 9. Thus, the Trustee's interpretation of sections 547 and 550 would strip preference actions of their intended virtue and permit vindictive creditors like Eclipse to exploit the tools of bankruptcy for personal ends. *See* Brendan Gage, *Is There a Statutory Basis for Selling Avoidance Actions?*, 22 J. Bankr. L. & Prac. 3 Art. 1 (2013). Conversely, Mr. Clegg's interpretation honors Congress' intent and ensures that the power to avoid and recover preferential transfers remains solely in the province of the Trustee and is only exercised for the benefit of the estate.

Next, it is helpful to consider the scenario of a bargain creditor. Bargain creditors are creditors who would purchase a preference claim at a discounted rate, paying less than 100 cents on the dollar for the claim. These creditors, unlike vindictive creditors, stand to make a profit after recovering against the preferred creditor. These types of purchasers would likely be far more common than the vindictive creditors, such as Eclipse, who stand to suffer a net loss by purchasing a preference claim. Congress' foremost purpose in enacting sections 547 and 550 was to ensure equality of distribution among similarly situated creditors. H.R. REP. NO. 95-595, at 177-78. Bargain creditors, in addition to violating Congress' intent that only a trustee exercise preference avoidance power, represent another ominous consequence of the Trustee's position. Where a creditor buys a preference claim for a bargain and pursues the preferred creditor for a profit, the

bargain creditor will retain that profit in addition to any distribution it receives from the bankruptcy estate. *See* Gage, *supra*. Therefore, the bargain creditor in this scenario would receive more than similarly situated creditors in the bankruptcy litigation. *See id.* This result directly contradicts the legislature's intent that preference actions facilitate the penultimate goal of bankruptcy for creditors of the same class to receive equal distributions. H.R. REP. NO. 95-595, at 177-78. Therefore, the Trustee's interpretation of sections 547 and 550 runs contrary to the legislature's intent in creating preference actions.

The Thirteenth Circuit's holding honors the plain meaning of sections 547 and 550 and the legislature's intent in creating preference actions. Conversely, the Trustee's interpretation disregards the plain meaning of sections 547 and 550 and the legislature's stated purpose in enacting those Code sections. The Trustee touts the perceived benefits of maximizing the bankruptcy estate, but any such benefit would come at an insurmountable cost: robbing preference actions of their intended virtue and jeopardizing the foremost goal of the bankruptcy process. Accordingly, this Court should affirm the Thirteenth Circuit.

## CONCLUSION

For the aforementioned reasons, this Court should affirm the decision of the Thirteenth Circuit, allowing the debtor, Eugene Clegg, to benefit from post-petition, pre-conversion equity in his home upon conversion and prohibiting the Trustee from selling her preference avoidance powers.