No. 23-0115

IN THE

SUPREME COURT OF THE UNITED STATES

MARCH TERM, 2024

IN RE EUGENE CLEGG, DEBTOR

VERA LYNN FLOYD, CHAPTER 7 TRUSTEE,
PETITIONER,
V.

EUGENE CLEGG, RESPONDENT.

Brief for Petitioner

Team Number 15
Counsel for Petitioner

QUESTIONS PRESENTED

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

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

TABLE OF CONTENTS

TABLE OF AUTHORITIES

<u>United States Supreme Court Cases</u>

<u>United States Court of Appeals Cases</u>

United States Bankruptcy Court Cases

United States Statutes

Other Authorities

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

Eugene Clegg (the "Debtor") wholly owned and operated a single-screen movie theater in the City of Moot through his sole membership interest in The Final Cut, LLC ("Final Cut"), an entity transferred to him by his mother Emily "Pink" Clegg ("Pink"). (R. 4-5). Debtor received Final Cut from Pink within a year of him retiring from a distinguished military career in 2011 and he has relied on a modest salary from Final Cut as his sole source of income for the past several years. (R. 5). Prior to Debtor's ownership of Final Cut, it had no liabilities, and it consistently generated a net profit year after year, but then the theater temporarily closed in 2016. (R. 5).

In 2016, Debtor had Final Cut borrow $850,000 (the "Loan") from Eclipse Credit Union ("Eclipse"), a local lender, to renovate the theater and give it an ornate ceiling. (R. 5). Eclipse properly perfected first priority liens on all of Final Cut's property and "Debtor executed an unconditional, unsecured personal guaranty in an unlimited amount" to Eclipse. (R. 5).

Though Debtor did much of the renovation work himself, local veterans volunteered to help him which saved Final Cut money on labor costs to such an extent that it did not need to exhaust the funds from the Loan. (R. 5). Rather than pay the surplus Loan funds back, approximately $75,000, Debtor had Final Cut donate the funds to a veteran's organization to show his appreciation for the local veterans' help. (R. 5). Eclipse did not know of this donation. (R. 5).

Final Cut resumed operations upon completion of the renovation in 2017 and brought in a profit for the next three years. (R. 6). In 2020, the COVID-19 pandemic caused the State of Moot to shut down after a state-wide executive order required everyone in Moot to stay home. (R. 6).

Final Cut was thus unable to operate for nearly a year and borrowed \$50,000 from Pink on an unsecured basis to stay in business. (R. 6). Final Cut reopened its theater in 2021 but attendance did not go back to pre-pandemic levels leaving Final Cut with cash flow problems that led Debtor to forego his salary. (R. 6). Without his salary, Debtor incurred significant credit card debt and fell behind on his home mortgage; his mortgage lender commenced foreclosure proceedings. (R. 6). In response, Debtor filed for chapter 13 bankruptcy to try and save his home. (R. 6). Debtor's home appraised at \$350,000 days before he filed for bankruptcy, and he disclosed that he made a \$20,000 payment to Pink within a year prior to the Petition Date. (R. 6-7).

Before Debtor's chapter 13 confirmation, the chapter 13 trustee objected to the Debtor's plan for failing to ensure that creditors would receive no less than they would under a chapter 7 liquidation because the alleged preferential transfers to Pink would be recovered and distributed to creditors in a chapter 7 liquidation. (R. 7). Debtor amended the plan to increase payments to creditors by \$20,000 to satisfy the chapter 13 trustee's concerns. (R. 7-8). The bankruptcy court confirmed Debtor's payment plan in February 2022.

Debtor made timely payments under his confirmed plan for eight months but then he contracted "long-COVID" leaving him unable to work. (R. 8). A month later, Final Cut's theater permanently closed which caused Eclipse to commence foreclosure proceedings against Final Cut. (R. 8). In response, Debtor converted his chapter 13 case to a chapter 7 case. (R. 8). Vera Lynn Floyd ("Floyd") was appointed as the Trustee for Debtor's chapter 7 estate. (R. 9). Floyd initially thought the estate lacked assets, but Debtor brought the increase in his home value to Floyd's attention, after which she had his home appraised which confirmed that the Debtor's home equity did increase by \$100,000 since the Petition Date. (R. 9). Moot's homestead exemption is \$30,000 and so Floyd began marketing Debtor's home for sale. (R. 6, 9).

Eclipse offered to buy Debtor's home and the alleged preference claim against Pink for $470,000. (R. 9). Floyd believed Eclipse's offer maximized the estate's value for its creditors and filed a motion "to sell both the home and the alleged preference claim to Eclipse." (R. 9). Debtor objected to the motion arguing that the post-petition, pre-conversion increase in his home equity should inure to his benefit and that a Trustee's ability to avoid and recover transfers cannot be sold, both or which the bankruptcy court and the court of appeals agreed with. (R. 10, 24).

We timely appealed the circuit court's ruling to respectfully request this Court to reverse their affirmation of the bankruptcy court's ruling for the reasons below.

SUMMARY OF THE ARGUMENT

This Court should overturn the Thirteenth Circuit Court of Appeals because post-petition, pre-conversion increases in a debtor's equity inures to benefit the estate and chapter 7 trustees have the ability to sell preference actions upon court approval to benefit the estate.

Post-petition, pre-conversion equity increased on an asset inures to the chapter 7 estate because the plain language of 348(f)(1) indicates so. "Proper analysis of this issue begins and ends with the statutory text." *United States v. Ron Pair Enters.*, Inc., 489 U.S. 235, 241 (1989). Here the relevant statutory language in 348(f)(1) states "(A) property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion;" 11 U.S.C. § 348(f)(1)(A). Both requirements set out in the plain language of the statute are met in classifying post-petition, pre-conversion increases in equity as property of the chapter 7 estate. Furthermore, "property of the estate" is a term of art used thought the Bankruptcy Code. *See* §§ 541, 554(a), 726(a), 1306(a). This term of art is most clearly defined in section 541(a)(6) which defines property of the estate as including "[p]roceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case." 11 U.S.C. § 541(a)(6). Here, it is proper to resolve the ambiguity of 348(f)(1) by cross referencing the term of art used in other sections of the Code.

Furthermore, there is no legal difference between property and its post-petition, pre-conversion increases in equity in conversion cases. This is because "the Trustee is entitled to the post-petition appreciation in the property because the real estate was always property of the estate under Section 541(a) of the Code. *In re Goins*, 539 B.R. 510 (Bankr. E.D. Va. 2015). The rationale for this lack of distinction between the increased equity and property itself is clearly iterated in *Matter of Castleman*, 75 F.4th 1052 (9th Cir. 2023). There the Ninth Circuit indicates that the ambiguity of what constitutes property of the estate in post-petition, pre-conversion cases was not resolved by the 348(f)(1) amendment. *Id.* at 1056. Because of this lack of overt differentiation between the increased equity and the property itself within 348(f)(1), previous rationale existing in other sections of the Code and previously established precedent remain valid in determining that the increased equity inures to the chapter 7 estate.

Avoiding and recovering a transfer under 11 U.S.C. §§ 547 and 550 is known as a preference cause of action because it allows a bankruptcy estate to recover transfers a debtor made to a creditor pre-petition that, if not avoided and recovered, would give preferential payment to that creditor at the expense of all other creditors. The Bankruptcy Code provides that "all legal or equitable interests of the debtor in property as of the commencement of the case" and "[a]ny interest in property that the estate acquires after the commencement of the case" is property of the bankruptcy estate. 11 U.S.C. § 541(a)(1), (7). Section 541(a)'s definition of "property of the estate" is "broad." *Patterson v. Shumate*, 504 U.S. 753, 757 (1992). Causes of action are generally the property of the party who can bring the claim, even if that party is a bankruptcy estate. *See, e.g.*, *United States v. Nordic Vill., Inc.*, 503 U.S. 30, 37 (1992). Thus, a chapter 7 trustee can sell a preference action as property of the estate under the Bankruptcy Code's plain language.

Further supporting a finding that a chapter 7 trustee can sell preference actions as property of the estate is case law across federal Court of Appeals, though there is a circuit split on the issue. Most noteworthy of these circuit decisions is *Pitman Farms v. ARKK Food Co. (In re Simply Essentials, LLC)*, 78 F.4th 1006 (8th Cir. 2023) because it is the latest and most thoroughly reasoned case law dealing with whether a Trustee can sell an avoidance action as property of the estate. The *Pitman Farms* court uses reasoning from the United States Supreme Court to find that a preference action is property of a bankruptcy estate and concludes that allowing the sale of an avoidance action upon court approval may best fulfill the goals of the Bankruptcy Code. *Id.* at 1011.

The policy goals of the Bankruptcy Code include maximizing the value of bankruptcy estates to increase equitable payments to all creditors. *Union Bank v. Wolas*, 502 U.S. 151, 160-61 (1990). Bankruptcy courts are courts of equity that are given leeway to flexibly apply equitable remedies in bankruptcy proceedings. *Young v. United States*, 535 U.S. 43, 50 (2002). Thus, if a chapter 7 trustee believes that selling an avoidance action is the best way to fulfill their statutory duties and if the Trustee can show the court that selling an avoidance action is the best thing for the estate under the case's specific circumstances, then the sale should be approved.

Because the Bankruptcy Code's plain language, compelling case law, and public policy all support allowing a chapter 7 trustee to sell a preference action as property of the estate, we respectfully request that this Court reverse the Thirteenth Circuit Court's finding and hold that a chapter 7 trustee can sell a preference action as property of the estate.

ARGUMENT

I. <u>Post-petition, pre-conversion increases in equity in a debtor's property inures to the benefit of the chapter 7 estate upon conversion from chapter 13 to chapter 7.</u>

A debtor has a non-waivable right to convert their case to a chapter 7 proceeding. *See* 11 U.S.C. § 1307(a). In accordance with section 348(f)(1)(A), "property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion." 11 U.S.C. § 348(f)(1)(A). Property that meets the requirements to be considered part of the chapter 7 estate and that has gained equity in the time after the chapter 13 petition's filing but before the chapter 7 conversion shall inure that interest to the chapter 7 estate. This conclusion is supported by a plain meaning interpretation of the statutory language, and a finding of harmony with other statutory definitions found in the Bankruptcy Code.

A. A debtor's increased equity inures to the benefit of the chapter 7 estate because the plain language of Section 348(f)(1)(A) indicates so and is further supported by definitions provided in other portions of the Code.

The plain language of Section 348(f)(1)(A) indicates that post-petition, pre-conversion increases in equity on the debtor's home falls squarely within the inuring interests of the chapter 7 estate. Courts have consistently held that "Proper analysis of this issue begins and ends with the statutory text." *United States v. Ron Pair Enters.*, Inc., 489 U.S. 235, 241 (1989) ("The task of resolving the dispute … begins where all such inquiries must begin: with the language of the statute itself…. [I]t is also where the inquiry should end, for where … the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'") *see also Republic of Sudan v. Harrison*, 139 S. Ct. 1048, 1056 (2019) ("When interpreting a statute, all "inquiries must begin with the language of the statute itself.").

The Bankruptcy Code allows for an individual debtor to pursue two different paths of bankruptcy. The first of which is through liquidation under chapter 7 and the second is through reorganization under chapter 13. *Harris v. Viegelahn*, 575 U.S. 510, 512 (2015). In instances where the debtor (under a chapter 13 proceeding) does not successfully complete their payment plan, “Congress [has] accorded debtors a nonwaivable right to convert a Chapter 13 case to one under Chapter 7 ‘at any time.’” *Id*. (quoting § 1307(a)). The language determining what property belongs to a chapter 7 estate at the time of conversion is found in section 348(f)(1)(A). The statute reads, “(A) property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion;” 11 U.S.C. § 348(f)(1)(A). Based solely on the language of the statute, there is no distinction drawn between types of property that belong to the chapter 7 estate so long as it was property of the estate at the time of filing the petitions and is within the possession of the debtor at the time of the conversion from chapter 13 to chapter 7. By focusing solely on the plain meaning of the statute, the debtor’s home (and its increased value) clearly meets both of these criteria. Moreover, “the Supreme Court has consistently admonished that where a statute's text is plain, the court is to apply it as written, unless its application would lead to absurd results.” *In re Peter*, 309 B.R. 792, 794–95 (Bankr. D. Or. 2004) (citing *Lamie v. U.S. Trustee*, 540 U.S. 526 (2004)). Here, the plausible outcomes of relying solely on the plain meaning of the statute do not approach the levels of “absurdity” to which would necessitate a different approach to interpretation. An application of the plain meaning of the statute simply places the entire property within the rights of the chapter 7 estate, a proposition consistent with other sections of the Code, and a concept not at all absurd.

Even if a court chooses to look beyond the plain meaning of 348(f)(1)(A), the phrase "property of the estate" is a term of art defined in other sections of the Code. *See* §§ 541, 554(a), 726(a), 1306(a). It would be erroneous to conclude that because 348(f)(1) does not itself define "property of the estate," an analysis is then precluded from looking for clarity in other portions of the Code. It is even more problematic when the ambiguity is itself a term of art. Thus, "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*." Matter of Castleman*, 75 F.4th 1052, 1056 (9th Cir. 2023) (citing *Robinson v. Shell Oil Co.*, 519 U.S. 337, 340 (1997). Here, Section 348(f)(1)(A) is silent on the definition of "property of the estate," yet section 541(a)(1) includes that an estate created through a bankruptcy petition includes "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). 541(a)(6) further clarifies that property of the estate includes "[p]roceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case." 11 U.S.C. § 541(a)(6). Any ambiguity of 348(f)(1) revolves around a term of art which is resolved in reading other sections of the code, particularly 541(a). Thus, post-petition, pre-conversion equity in a debtor's home inures to the benefit of the chapter 7 estate. Both a plain meaning reading of the statutory language in 348(f)(1) and a further look into other relevant portions of the Code both inform this conclusion.

B. There is no legal difference between the property itself and its change in equity in a conversion case.

Under Section 541(a)(6)'s plain meaning, any increase in post-petition equity is inseparable from the asset and inures to the chapter 7 estate. There is no legal difference between the property in question (here, the debtor's home) and its increased value post-petition, pre-conversion. *In re Goins*, 539 B.R. 510, 515 (Bankr. E.D. Va. 2015). The court in *In re Goins* dealt with a debtor who converted their chapter 13 case to a chapter 7 in good faith and sought to capture the benefit of the increased equity in their home which was now property of the chapter 7 estate. The court held that "the Trustee is entitled to the post-petition appreciation in the property because the real estate was always property of the estate under Section 541(a) of the Code. *Id*. The court further elaborated that "Section 541(a)(1) broadly defines property of the estate to include "all legal or equitable interests of the debtor in property as of the commencement of the case," "wherever located and by whomever held." *Id*. (quoting § 541(a)(1)). This paired with section 541(a)(6)'s language that the estate possesses all "proceeds, product, offspring, rents or profits of or from property of the estate" provides clear proof of Congress's intent to include appreciation within the chapter 7 estate, regardless of any perceived ambiguity within 348(f)(1)(a). Furthering this proposition, the court in *Matter of Castleman*, stated that "post-petition increase in the property's equity is the 'proceeds, product, offspring, rents or profits' of the estate's original property under § 541(a)(6), and so became part of the estate when the case commenced." 75 F.4th 1052, 1056 (9th Cir. 2023) (citing *In re Potter*, 228 B.R. 422, 424 (B.A.P. 8th Cir. 1999) and *In re Peter*, 309 B.R. 792 (Bankr. D. Or. 2004)).

Furthermore, this conclusion is diametrically opposed to the application of the "snapshot" valuation of property at the time of the filing of a debtor's chapter 13 petition. The primary issue with this methodology is that it deprives the chapter 7 estate of its full ownership authority over the asset by bifurcating the asset's "snapshot value" and its appreciation amount prior to conversion. *See In re Goetz*, 647 B.R. 412, 416 (Bankr. W.D. Mo. 2022), *aff'd*, 651 B.R. 292 (B.A.P. 8th Cir. 2023) (holding that "This broad definition captures the debtor's entire ownership interest in each asset that exists on the petition date without fixing the estate's interest to the precise characteristics the asset has on that date"). The only counter argument offered by existing case law is that the definitions set forth in section 541(a) are not applicable to conversion cases and are limited chapter 7 cases. As *Castleman* points out, "There is no textual support for concluding that § 541(a) has a different meaning upon conversion from Chapter 13." 75 F.4th at 1056. Without any precedent indicating that Congress intended for there to be difference conceptions of what is part of the Chapter 7 estate in a conversion case, it is prudent to apply the well accepted definition in section 541(a).

Moreover, critiques of *Castleman* do not overcome its rationale. The three major critiques of the arguments in *Castleman* include that (1) *Castleman* relies on Ninth Circuit precedent, which is either dated by recent statutory amendments or is an incorrect analogizing of facts, (2) *Castleman* ignores the underlying tension of 348(f) with other provisions of the Code and (3) the "snap shot" valuation rule undermines its reliance on definitions found elsewhere in the Code.

In response to the first contention, the underlying Ninth Circuit precedent is not entirely negated by the presence of the 348(f) amendment. First, the rationale and reasoning of the opinion in *In re Reed* is still valid as it relies on the definition of estate property set out in section 541(a)(6). 940 F.2d 1317, 1323 (9th Cir. 1991) (stating "We interpret this language to mean that appreciation [i]nures to the bankruptcy estate, not the debtor."). Once again, the primary contention with the use of definition of estate property in 541(a)(6) is the presence of the 348(f)(1) amendment, which, itself is silent on the matter of post-petition pre-conversion assets. Not only is 348(f)(1) silent on the specific matter, but as the *Castleman* court highlights, "There is no textual support for concluding that § 541(a) has a different meaning upon conversion from Chapter 13." 75 F.4th at 1056. This dual reasoning not only bolsters the use of *In re Reed* but is also the exact same reasoning as to why *Castleman's* use of *Wilson v. Rigby* is also still relevant.

A possible counter argument to the use of the rationale in *Rigby* is that it involves a chapter 7 bankruptcy wherein a conversion from a chapter 13 case never existed. The issue with this reasoning is that there is no contrary precedent to disallow the use of definitions found in 541(a)(6) in applying those to a conversion case. As stated previously, "property of the estate" is a term of art used throughout the Code. *See* §§ 541, 554(a), 726(a), 1306(a).

Section 341(f)(1)'s silence on the specific issue of property of the estate further informs the continued relevance of the Ninth Circuit precedent, which sought to clarify the ambiguity that persists even after the passing of the 341(f) amendment. In fact, using this rationale, much of the precedent that has historically guided the discussion surrounding the issue of post-petition, pre-conversion equity ownership prior to the 2005 amendments still is persuasive and guiding in the matter at hand. *See In re Paolella*, 85 B.R. 974, 977 (Bankr.E.D.Pa.1988) (holding "Postpetition appreciation in the value of property, except to the extent of the debtor's potential exemption rights pursuant to 11 U.S.C. § 522, accrues for the benefit of the trustee until the property is liquidated or abandoned); *In re Hyman,* 123 B.R. at 346-48 (B.A.P. 9th Cir. 1991) ("The "excess value" in a California homestead, the value above encumbrances and the exemption amount, has always been available to creditors."). Thus, critiques of *Castleman's* reliance on "inapposite" Ninth Circuit precedent and cases implicating a non-conversion case do not hold water because the underlying rationale is never contested with either opposing reasoning or contrary precedent.

In response to the second contention with *Castleman*, the tension between 348(f)(2) and section 522(a)(2) is simply not significant enough to ignore the rationale of a plain meaning interpretation of the statute. The primary issue with identifying tension between 348(f)(2) and 348(f(1)(A) is that it ignores the nuanced difference between newly acquired property and an increase in value of preexisting property. As previously argued, when both statutes are read in conjunction with the definitions set out in section 541(a)(6) it is made clear that there is no substantive difference between a property and its increased interest, the ownership rights were always part of the chapter 7 estate. *In re Goins*, 539 B.R. 510, 515 (Bankr. E.D. Va. 2015). Thus, both 348(f)(1) and 348(f)(2) can coexist without creating a wholly new rule not seen in the plain language of the statute.

Finally, the existence of 522(a)(2), colloquially known as the "snapshot rule," is not relevant to the ambiguity of 348(f)(1). In *Rockwell v. Hull*, the court states the "snapshot rule" "establishes, with limited exceptions not applicable here, the petition date as the date upon which property interests are valued for the purpose of a debtor's exemptions." 968 F.3d 12, 17 (1st Cir. 2020). While this is potentially the respondent's strongest argument in the matter, it is reductive. The answer to resolving this issue lies in the very purpose of the "snapshot" rule." It is used for the purposes of determining exemptions. The issue in *Rockwell* was whether or not the debtor could properly retain the homestead exemption he had taken now that he had converted to chapter 7 bankruptcy from chapter 13. 968 F.3d at 20. In those facts the trustee of the chapter 7 estate had taken issue with the debtor's use of his exemption funds and his lack of compliance with Maine's requirements to properly reinvest his homestead exemption. *Id.*at 18. The resolution of the case was facilitated though the use of the "complete snapshot" rule. The Court concluded that,

> that the complete snapshot rule applies to homestead exemptions taken pursuant to § 522, where none of the statute's enumerated exceptions applies. None of these explicit exceptions applies to Rockwell's case, nor does Hull contend that one does, so Rockwell's homestead exemption taken on the day he filed for bankruptcy must be viewed as unchanging, even in the face of his later sale of the property.

Id. at 20. Here, it is made clear that the "snapshot" rule is not meant to be cross applied to locking in the values of the home at the time of the petition but rather is used to secure and protect the debtors right to any exemption taken properly at the time of the petition. To extend the 522 rules beyond this purpose would not only be incorrect but also problematic as it deprives the chapter 7 estate of the full property rights that are attached to the home, which includes the inseparable potential of increasing equity. Furthermore, limiting the “snapshot rule to the purpose of protecting the right to assets taken through exemption laws is in harmony with the other relevant statutes in conversion cases including 541(a)(6).

This conclusion is further informed by the court in *In re Paolella*, stating “Because sale does not generally, if ever, occur simultaneously with formation of a bankruptcy estate, § 541(a)(6) mandates that the estate receive the value of the property at the time of the sale. This value may include appreciation or be enhanced by other circumstances creating equity which occur post-petition.” 85 B.R. 974, 977 (Bankr. E.D. Pa. 1988). A potential concern about the existence of two valuation methods is that it would create two entirely different values for the same property, creating a great deal of contradiction within the Bankruptcy Code. This concern is not relevant as both valuations serve different purposes. The “snapshot rule” is for the purpose of determining and protecting a debtor’s exemption-based assets. The final valuation is for the purpose of liquidating the asset and inuring its benefit to the chapter 7 estate, something that can only be done at the time of sale.

Thus, for reasons stated above we respectfully request that this Court find that there is no statutory definitional difference between an asset and its post-petition, pre-conversion increase in equity.

II. **A chapter 7 trustee may sell the ability to avoid and recover transfers pursuant, to 11 U.S.C. §§ 547 and 550, as property of the estate.**

The ability to avoid and recover transfers pursuant to sections 547 and 550 is called a preference cause of action. A preference action allows a trustee to avoid property transfers a debtor made within ninety days, or within one year when the transfer is to an insider, prior to the bankruptcy petition date. 11 U.S.C. § 547(b), (c). Such actions are 'preferential' because they give a creditor who receives the transfer more while leaving the debtor's other creditors with less. *See Begier v. IRS*, 496 U.S. 53, 58 (1990). After such transfers are avoided under section 547(b), the trustee recovers the funds so that the money can be shared pro rata by all of the debtor's creditors. 11 U.S.C. § 550(a). A chapter 7 trustee can sell a bankruptcy estate's preference action under the Bankruptcy Code's plain language, under the latest and most thoroughly reasoned case law, and in line the Congress's policy reasons for enacting the Bankruptcy Code for the reasons below.

A. Preference actions are property of the estate that a chapter 7 trustee may sell with court approval because the Bankruptcy Code's plain language allows it.

Chapter 7 bankruptcy trustees can sell preference actions as property of the estate under the Bankruptcy Code's plain language. Under chapter 5 of the Bankruptcy Code, a trustee has the power to bring various causes of action to avoid and recover property transfers made by a debtor. *See generally* 11 U.S.C. §§ 544–553. The cause of action at issue here is a preference action.

Preference actions are property of a bankruptcy estate because language within the Bankruptcy Code plainly defines property of the estate as "all legal or equitable interests of the debtor in property as of the commencement of the case" unless otherwise provided for in section 541. 11 U.S.C. § 541(a)(1). Section 541(a)'s definition of "property of the estate" is "broad." *Patterson v. Shumate*, 504 U.S. 753, 757 (1992); *see also* H.R. REP. NO. 95-595, at 549 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6455 (describing the property of a bankruptcy estate as "all embracing"). As a cause of action, preference actions constitute property of a bankruptcy estate.

Causes of action held by a debtor's estate are property of the estate because causes of action are generally property of the party who can bring the claim. *See, e.g.*, *United States v. Nordic Vill., Inc.*, 503 U.S. 30, 37 (1992) (asserting a chapter 5 cause of action, section 550, constitutes property of the estate); *Parker v. Goodman (In re Parker)*, 499 F.3d 616, 624 (6th Cir. 2007) ("As 'all legal or equitable interests,' causes of action . . . constitute property of the estate under section 541(a)(1)."). Preference transfers are a statutory cause of action because fraudulent transfers are deemed as such, both of which are chapter 5 causes of action under the Bankruptcy Code's plain language. *See Granfinanciera, S.A. v. Nordberg*, 492 U.S. § 33, 53-54 (1989).

In fact, section 926 of the Bankruptcy Code describes avoidance powers as causes of action because it states that if a debtor in municipal bankruptcy "refuses to pursue a *cause of action* under section 544, 545, *547*, 548, [or] 549(a) . . ." then a court "may appoint a trustee to pursue such cause of action" upon a creditor's request. 11 U.S.C. § 926(a) (emphasis added). Under "a fundamental canon of statutory of construction," the language in the Bankruptcy Code "must be read in their context and with a view to their place in the overall statutory scheme." *National Assn. of Home Builders v. Defenders of Wildlife*, 551 U.S. 644, 666 (2007). Because section 926 explicitly lists section 547 as a cause of action, it is a cause of action under the Bankruptcy Code's plain meaning. Thus, a preference action created under section 547(b) is a "legal or equitable interest" under section 541(a) because it is a cause of action and causes of action are property of the estate under a broad reading of the Bankruptcy Code's plain language.

A preference cause of action is property of the estate under section 541(a), though it may be argued that chapter 5 causes of actions, such as preference actions, are not within the scope of section 541(a)(1) because they did not exist prior to the bankruptcy petition but are created on the petition date. It is true that section 541(a)(1) only includes "legal or equitable interests of the debtor . . . as of the commencement of the case" as property of the estate. 11 U.S.C. § 541(a)(1). But even if "of the commencement of the case" in section 541(a)(1) is interpreted to mean only the debtor's pre-petition property, the post-petition preference action would still be property of the estate under section 541(a)(7). *See* 11 U.S.C. § 541(a).

Section 541(a)(7)'s plain language provides that "Any interest in property that the estate acquires after the commencement of the case" is estate property. 11 U.S.C. § 541(a)(7). The bankruptcy estate acquires the preference cause of action either upon the commencement of the case under section 541(a)(1) or after the commencement of the case under section 541(a)(7). *See* 11 U.S.C. § 541(a). Thus, a preference action is property of the estate either way.

The word "trustee" in the Bankruptcy Code means the trustee and no one else, at least in the context of section 506(c). *See Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6-7 (2000). However, the *Hartford Underwriters* court intentionally did not determine if another party can "act in the trustee's stead" because the court wanted to give lower courts the flexibility in allowing others, besides the trustee, to exercise avoidance actions. *Id.* at 13 n.5 (drawing their "attention to the practice of some courts of allowing creditors . . . a derivative right to bring avoidance actions when the trustee refuses to do so"). Thus, it is a stretch to say that the Bankruptcy Code's plain language states that only a trustee can bring a chapter 5 cause of action.

Furthermore, preference causes of action are property of the estate rather than mere statutory powers vested in a trustee because section 541(a) is "a definition of what is included in the estate, rather than as a limitation." *Whitting Pools*, 462 U.S. at 203-05. Property of a bankruptcy estate includes "any property made available to the estate by other provisions of the Bankruptcy Code," like "property in which the debtor did not have a possessory interest at the time the bankruptcy proceedings commenced." *Id*. Because the ability to avoid and recover transfers through a preference cause of action is made available to the bankruptcy estate under sections 547(b) and 550, it is included as property of the estate. *See Id.*

Chapter 7 trustees have a statutory duty to "collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest." 11 U.S.C. § 704(a)(1). To uphold this duty, chapter 7 trustees may sell property of the estate with court approval. 11 U.S.C. § 363(b)(1). Thus, because a preference cause of action constitutes property of the estate, a chapter 7 trustee may sell it in order to reduce it to money if they are given the court's approval to do so.

Though the plain language of the Bankruptcy Code allows for a trustee to sell avoidance claims as property of the estate, it could be argued that other canons of statutory construction weigh towards finding avoidance actions cannot be sold as property of the estate. Such arguments are addressed in case law expounded on below. But such arguments do not outweigh the Bankruptcy Code's plain meaning, taken together with public policy considerations, as the latest and most thoroughly reasoned case law expounded below has held.

For the reasons above, preference actions are property of the estate that a chapter 7 trustee can sell with court approval under the plain language of the Bankruptcy Code.

B. Case law interpreting the Bankruptcy Code weighs towards finding that preference actions are property of the estate that a chapter 7 trustee may sell.

The latest and most thoroughly reasoned case law holds that preference actions are property of the estate that a chapter 7 trustee may sell, though there is a circuit split on the issue. The Eighth Circuit Court of Appeals held that chapter 5 avoidance actions are property of the estate that a chapter 7 trustee can sell. *Pitman Farms v. ARKK Food Co. (In re Simply Essentials, LLC)*, 78 F.4th 1006, 1011 (8th Cir. 2023).

In *Pitman Farms*, a chapter 7 trustee had avoidance claims they believed to be creditable against an owner, but the trustee lacked funds to prosecute the avoidance claims. *Id.* at 1007. Because the estate lacked funds to prosecute the avoidance claims, the trustee proposed selling them to a creditor. *Id.* at 1007-08. As the target of the claims, the owner objected to the trustee selling the avoidance claims by arguing the chapter 5 causes of action were not property of the estate and thus could not be sold by the trustee. *Id.* at 1008.

The *Pitman Farms* court relied on Supreme Court precedent to hold that estate property includes property the estate no longer has a possessory interest in because it had been repossessed prepetition. *Id.* at 1009 (citing *United States v. Whiting Pools*, 462 U.S. 198, 209 (1983)). Admittedly, *Whiting Pools* did not directly deal with avoidance actions but rather it decided the turnover provision of section 542(a) constitutes property of the estate under section 541(a)'s broad definition of "property of the estate." *Whiting Pools*, 462 U.S. at 208-09.

However, the *Pitman Farms* court reasoned the same logic applies to avoidance actions "because debtors have the right to file for bankruptcy and . . . the Trustee may file avoidance actions to recover property." 78 F.4th at 1009. Bolstering this reasoning, Supreme Court precedent states, "property of the estate includes inchoate or contingent interests held by the debtor prior to the filing of bankruptcy." *Id.* (citing *Segal v. Rochelle*, 382 U.S. 375, 379 (1966). Thus, *Pitman Farms* held that avoidance actions are property of the estate under section 541(a) because an avoidance action is properly classified as an "inchoate or contingent interest[]" held by the debtor's estate. *Id.* at 1009. *Pitman Farms* also addressed a surplusage argument made against including chapter 5 causes of action as property of the estate under section 541(a). *See Id.* at 1009-10.

The canon against surplusage instructs courts "to interpret the words of a statute in context" so no part of a statutory provision "will be inoperative or superfluous, void or insignificant." *Hibbs* *v. Winn*, 542 U.S. 88, 101 (2004) (citing 2A N. Singer, Statutes and Statutory Construction § 46.06, pp. 181-186 (rev. 6th ed. 2000)). Section 541(a)(3) cross-references section 550, the text of which states that it is the "interest in property that the trustee recovers" that becomes property of the estate. 11 U.S.C. § 541(a)(3). Thus, one could argue section 541(a)(3) would be superfluous if section 541(a)(1) or 541(a)(7) includes a trustee's avoidance powers as property of the estate because the estate has not yet filed, won, and recovered a judgment from a preference action.

However, "[t]he 'canon against surplusage is not an absolute rule.'" *Pitman Farms*, 78 F.4th at 1009 (citing *Marx v. Gen. Revenue Corp.*, 568 U.S. 371, 385 (2013)). After all, it is not unusual for Congress to be redundant, "so long as there is no 'positive repugnancy' between two laws, a court must give effect to both." *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253 (1992) (citation omitted). Redundancies are more likely when the statutes have been "edited over time to add specificity[,]" like the Bankruptcy Code has been. *Pitman Farms*, 78 F.4th at 1010. The possibility that interpreting avoidance actions as property of the estate under section 541(a) might render section 541(a)(3) superfluous is overcome by the plain language of section 541(a) in its entirety. *Id.* After all, section 541(a)'s definition of what is included as "property of the estate" is broad. *Patterson*, 504 U.S. at 757.

The Eighth Circuit is not alone in holding that chapter 5 causes of action are property of the estate under section 541(a). *See, e.g., Silverman v. Birdsell*, 796 F. App'x 935, 937 (9th Cir. 2020) (holding a "bankruptcy trustee may sell an estate's avoidance claims"); *Cadle Co. v. Mims (In re Moore)*, 608 F.3d 253, 262 (5th Cir. 2010) (holding fraudulent-transfer claims are property of the estate under section 541(a)); *Mellon Bank N.A. v. Dick Corp. (In re Qualitech Steel Corp.)*, 351 F.3d 290 (7th Cir. 2003) (avoidance actions can be sold as property of the estate as long as the sale is "for the benefit of the estate); *Morely v. Ontos, Inc. (In re Ontos, Inc.)*, 478 F.3d 427, 431 (1st Cir. 2007). However, not all circuits necessarily agree.

In contrast to the Eighth Circuit's *Pitman Farms* decision, the Third Circuit Court of Appeals ruled that avoidance actions are not a debtor's "assets." *Official Comm. Of Unsecured Creditors of Cybergenics Corp. v. Chinery (In re Cybergenics Corp.)*, 226 F.3d 237, 245 (3d Cir. 2000). However, the *Cybergenics* court never touched on whether an avoidance action is "property" of the estate because it only touched on whether avoidance actions are "assets" of the debtor. *Id.* A debtor's "assets" and what is included as "property of the [bankruptcy] estate" do not fall under the same exact definition, as set forth in section 1123(b)(3)(B). *Id.*

Additionally, the Third Circuit has since stated that "*Cybergenics* does *not* hold that trustees cannot transfer causes of action," which undermines citing *Cybergenics* to argue that a preference action cannot be sold by a trustee as property of the estate with court approval. *In re Wilton Armetale, Inc.*, 968 F.3d 273, 285 (3d Cir. 2020) (emphasis added). Plus, *Cybergenics* intentionally did not analyze whether the avoidance action at issue was property of the estate. 226 F.3d at 247 n.16. Like *Cybergenics*, other courts support the notion that avoidance actions might not be property of the estate or that a trustee may not sell avoidance actions. *See, e.g.*, *In re Clements Mfg. Liquidation Co.*, LLC, 558 B.R. 187 (Bankr. E.D. Mich. 2016). But *Cybergenics* is "[t]he case most contrary" to the *Pitman Farms* decision. *Pitman Farms*, 78 F.4th at 1010. Case law across the federal circuits obtains reasoning that supports the *Pitman Farms* decision.

For example, a chapter 7 trustee in the Ninth Circuit Court of Appeals' jurisdiction lacked funds to pursue avoidance claims that they believed had significant value and the court held that "[i]t is a well settled principle that avoidance powers may be assigned to someone other than the debtor or trustee." *Duckor Spradling & Metzger v. Baum Trust (In re P.R.T.C., Inc.)*, 177 F.3d 774, 781 (9th Cir. 1992) (interpreting the law governing a reorganization plan under section 1123(b)(3)(B)). It is well settled that a trustee can sell an avoidance action with “approval of the bankruptcy court” because the buyer of the avoidance action will pursue an interest common to all creditors. *Briggs v. Kent (In re Pro. Inv. Properties of Am., Inc.)*, 955 F.2d 623, 626 (9th Cir. 1992).

Effectually, a creditor who buys and pursues an avoidance action could “be identified as a representative appointed to enforce the debt in line” with a reorganization or payment plan. *Id.* As such, allowing a chapter 7 trustee to sell avoidance claims, like preference actions, benefits the estate and all of the estate’s creditors when a trustee determines that they do not have the funds to pursue the action themself. Such was the case in *Pitman Farms*. 78 F.4th at 1007-08.

Similar to how the trustee in *Pitman Farms* did not have sufficient funds to pursue avoidance actions they believed to be creditable, the chapter 7 trustee had insufficient funds to pursue a preference action against Pink. Though the facts are unclear as to whether the chapter 7 trustee believed the preference action against Pink would be creditable, the chapter 13 trustee believed a preference action against Pink would have been creditable if the case were a chapter 7 case when the chapter 13 trustee was administering the estate before the case converted to a chapter 7 case. Thus, it is reasonable to conclude that Floyd, the chapter 7 trustee, believed the preference action against Pink was creditable.

Like how the bankruptcy court approved the sale of the avoidance action in *Pitman Farms* because it found that the avoidance action was property of the estate, the bankruptcy court here should have approved of the sale of the preference action as property of the estate. Thus, under *Pitman Farms*, the latest and most thoroughly reasoned case law that aligns with Supreme Court precedent, the chapter 7 trustee in our case should be allowed to sell the preference action against Pink because it is property of the estate, and the sale would maximize the value of the estate.

For the reasons above, compelling case law supports interpreting the Bankruptcy Code to allow a chapter 7 trustee to sell preference actions as property of the estate, and so does public policy considerations and policy goals the Bankruptcy Code was enacted to achieve.

C. Allowing a chapter 7 trustee to sell preference actions aligns with Congress's policy goals set forth in the Bankruptcy Code because it facilitates maximizing the estate's value and increases equitable payments to all creditors.

Public policy objectives set forth by Congress are better achieved when chapter 7 trustees are allowed to sell chapter 5 causes of action for the benefit of the estate. Bankruptcy courts are courts of equity that are given leeway to flexibly apply equitable remedies in bankruptcy proceedings. *Young v. United States*, 535 U.S. 43, 50 (2002); *see also United States v. Energy Resources Co.*, 495 U.S. 545, 549 (1990) ("bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships"). As such, courts should interpret the Bankruptcy Code to fairly fulfill the policy goals of the Bankruptcy Code's sections. Preference actions under section 547 serves two primary goals:

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

Union Bank v. Wolas, 502 U.S. 151, 160-61 (1990) (citation omitted). Additionally, chapter 7 trustees have a statutory duty to "collect and reduce to money the property of the estate . . . and close such estate as expeditiously as is compatible with the best interests of parties in interest." 11 U.S.C. § 704(a)(1).

To fulfill this goal, chapter 7 trustees can sell property of an estate with court approval. 11 U.S.C. § 363(b)(1). As explained above, section 541(a) defines property of the estate as "all legal or equitable interests of the debtor in property as of the commencement of the case" and all "interest[s] in property that the estate acquires after the commencement of the case." 11 U.S.C. § 541(a)(1), (7). When determining what is included as property of the estate, one must remember the definition of "property of the estate" in section 541(a) is "broad." *Patterson*, 504 U.S. at 757.

Thus, chapter 7 trustees may need to sell preference actions in order to execute their statutory duties because the realities of practicing bankruptcy law may leave them no better option. One of the realities of being a chapter 7 trustee is that there may not be a feasible mechanism to obtain a recovery for creditors when there are insufficient funds in an estate to litigate a claim, even if the trustee believes the claim to be creditable. In fact, "[t]o allow parties otherwise facing meritorious Chapter 5 avoidance claims to escape those claims because the Trustee cannot afford to pursue them and they cannot be sold or transferred would be an absurd result." *In re Simply Essentials, LLC*, 640 B.R. 922, 930 (Bankr. N.D. Iowa 2022).

Allowing a chapter 7 trustee to sell a preference action that could not otherwise be pursued despite the potential recovery the preference action could claw back into the estate empowers a trustee to fulfill their statutory duty under section 704(a). A trustee's duty under section 704(a) requires a trustee to "maximize the value of the estate" or maximize the "distribution to the [estate's] creditors." *See Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 352 (1985); *IRS v. Luongo (In re Luongo)*, 259 F.3d 323, 340 n.16 (5th Cir. 2001). Trustees also have a duty to minimize the administrative expenses associated with causes of action the estate may have to enable them to maximize the value of the estate and thus the amount distributed to creditors. *See In re Taxman Clothing Co.*, 49 F.3d 310, 315 (7th Cir. 1995).

Additionally, not allowing a trustee to sell avoidance actions "would encourage the [debtor] to make preferential transfers to favored [creditors] (who would not need to repay the [estate])." *Mellon Bank, N.A. v. Dick Corp. (In re Qualitech)*, 351 F.3d 290, 293 (7th Cir. 2003). Encouraging such behavior from debtors would allow debtors to cheat the bankruptcy proceedings for their own benefit at the cost of the debtor's other creditors who are supposed to share the value of the estate equally. Thus, not allowing a trustee to sell avoidance actions may render the purpose of section 547(b) useless if the preference action cannot be brought only because a trustee cannot fund litigating the claim.

One could argue that allowing a creditor to purchase an avoidance action inherently means that the purchaser of the claim will have a larger payout than other creditors. However, such an argument is close-minded because the purchaser of an avoidance claim not only increases the value of the estate but also costs the purchaser money that they are not necessarily guaranteed to recover from the claim because, no matter how creditable the claim may be, they may not win a judgment. Plus, when a trustee sells an avoidance claim, the recovery of the claim to the purchaser can have strings attached that allow the rest of the estate's creditors to share in the recovery. *See, e.g., Pitman Farms*, 78 F.4th at 1008 (purchaser of the avoidance action agreed to assume "all risks, costs, and fees of the" litigation, reduce "its own claims against the estate[,]" and provide "the estate with 15% of the proceeds of any additional recovery," after deducting its costs and fees).

Here, it is undisputed that Eclipse offered a fair and reasonable purchase price for the preference cause of action against Pink. Eclipse's purchase of the preference action eliminates the need for the trustee to incur administrative expenses to litigate the preference claim that the estate cannot afford. Ultimately, allowing the trustee to sell the preference action means they are better suited to fulfill their statutory duties to maximize the value of the estate and the distribution to creditors, which are the goals Congress has set up the Bankruptcy Code to achieve.

For the reasons above, public policy objectives set forth by Congress are better achieved when chapter 7 trustees are allowed to sell chapter 5 causes of action, such as preference actions, for the benefit of the estate.

CONCLUSION

For the foregoing reasons, we respectfully request this Court to hold that post-petition, pre-conversion increases in a debtor's home equity inures to the bankruptcy estate and that a chapter 7 trustee can sell a preference action as property of the estate upon court approval.