No. 23-0115

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 2023

In Re Eugene Clegg, Debtor.

Vera Lynn Floyd, Chapter 7 Trustee,

Appellant.

v.

Eugene Clegg, Debtor,

Appellee.

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

BRIEF FOR APPELLEE

Team 16
Counsel for Appellee

Oral Argument Requested

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QUESTIONS PRESENTED

I. Whether equity gained in a debtor's property during compliance of a confirmed chapter 13 bankruptcy inures to the benefit of the debtor after they have converted the case to chapter 7 in good faith.

II. Whether a chapter 7 trustee may sell the ability to avoid and recover customary business transfers, as property of the bankruptcy estate.

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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

The debtor in this case is Eugene Clegg ("Eugene"), a veteran and owner of a historic movie theater, The Final Cut ("Final Cut"). R. 4. In 2011/2012, Debtor's mother, Emily Clegg ("Pink") transferred 100% interest to Eugene. R. 5. In 2021, due to financial and medical pressure created by the Covid-19 pandemic, Eugene filed for chapter 13 bankruptcy in an attempt to save his home. R. 4. After 8 months of timely payments under the confirmed chapter 13 bankruptcy plan Eugene was forced to close Final Cut after contracting long-COVID, which prevented him from working. R. 8. Without income, Debtor could not proceed with the confirmed chapter 13 plan and converted the case to chapter 7 in good faith. R. 8.

The debts Eugene sought protection from began in 2016 when Final Cut took a loan of $850,000 from Eclipse Credit Union ("Eclipse") to renovate the theater. R. 5. Because Eugene was able to complete the renovations by himself and with the help of local veterans Eugene was able to finish the job for less than the total loan amount. R. 5. As a sign of appreciation, Eugene chose to donate the remaining loan amount, approximately $75,000, to the Veterans of Foreign Wars ("VFW"). In early 2017, Final Cut completed renovations and maintained profitable for 3 years. R. 6. In March of 2020, the State of Moot declared a public health emergency for the COVID-19 pandemic, which prevented Final Cut from operating for almost a year. R. 6. Eugene's sole source of income came from the profits of Final Cut and without the business being able to operate Eugene borrowed $50,000 from his mother ("Emily Clegg"). R. 5-6. Final Cut was eventually able to reopen in 2021, however, attendance and revenue never returned to pre-pandemic levels. R. 6. Eugene thus was unable to maintain a consistent source of income

from Final Cut resulting in missed mortgage payments on his home serviced by Another Brick in the Wall Financial Corporation ("Another Brick"), and incurred additional credit card debt. R. 6.

Eugene then filed for chapter 13 bankruptcy on December 8, 2021. R. 6. As part of the required disclosures and the proposed plan it was shown at the time of filing that there was no available non-exempt equity in Eugene's home. R. 6. It was also disclosed that within one year of filing for chapter 13, Eugene had made $20,000 in payments to Emily Clegg for the money he had borrowed. R. 7. All parties to the bankruptcy filing believed Final Cut would be able to produce consistent profits and agreed that the debtor would fund the chapter 13 bankruptcy solely through future earnings of Final Cut. R. 7.

Prior to confirmation of the chapter 13 plan, Eclipse was made aware of the $75,000 donation Eugene made to VFW with the loan proceeds and objected to the proposed plan. R. 7. The main focus of their objection related to the $20,000 in payments Eugene had made to his mother, Emily Clegg. R. 7. Eclipse claimed that the payments made to Emily were preferential transfers and under a chapter 7 plan would be recoverable by the trustee. R. 7. To resolve the dispute the parties agreed to increase the entire chapter 13 plan amount by $20,000. R. 7. However, Eclipse continued their objection claiming the plan was not being proposed in good faith. R. 8. Eclipse's objections were finally resolved by including a planned claim of $150,000 with $25,000 being non-dischargeable in the event of conversion. R. 8. On February 12, 2022, the bankruptcy court confirmed Eugene's plan ("Plan") which referenced the "settlement with the chapter 13 trustee and expressly provided that all property of the estate vested in the Debtor." R. 8.

Eugene maintained his commitment to the Plan making payments for 8 months before contracting long-COVID, which prevented him from working and eventually led to the

permanent closing of Final Cut in October of 2022. R. 8. After the Final Cut closed Eugene was left with no income and chose to convert the case to chapter 7. R. 8. As part of the conversion, Eugene received the amount held in reserve for Eclipse and was stated that $10,000 had been distributed to the servicer of Eugene's home mortgage. R. 8-9.

Upon conversion, Vera Lynn Floyd ("Trustee Floyd") was appointed as the chapter 7 trustee. R. 9. Documents stated a value of $350,000 for Eugene's home and disclosed the payments made to Emily Clegg within one year of the chapter 13 petition date. R. 9. The records also show that Eclipse was still owed $200,000 in deficiency following the foreclosure and sale of the Final Cut property. R. 9. Trustee Floyd's first assessment of the estate found there was no available equity in Eugene's assets, but after commissioning a new appraisal of the debtor's home found the non-exempt equity had increased by $100,000 since the initial petition date. R. 9. Because of the increase in equity, solely observed and mentioned by Eugene, Trustee Floyd pounced at the opportunity and offered to purchase the home and the claim for a preferential transfer to Pink for $470,000. R. 9.

Trustee Floyd was satisfied with the offer and proceeded with a motion to allow for the sale. R. 9. Eugene raised the purely legal issue in objecting to the sale arguing that the post-petition, pre-conversion equity should inure to the benefit of the debtor, and because there was no equity at the time of the chapter 13 petition the home could not be sold. R. 10. Eugene further argued that the trustee's power to avoid preferential transfers could not be sold. R. 10. The bankruptcy court ruled in favor of Eugene on both objections and denied the sale motion. R. 10. Trustee Floyd timely appealed the court's ruling, and the disputes were certified for direct appeal for the Thirteenth Circuit. R. 10.

On May 10, 2023, the United States Court of Appeals for the Thirteenth Circuit held that any post-petition, pre-conversion increase in equity in a debtor's property inures to the benefit of the debtor, not the chapter 7 estate, upon a good-faith conversion from chapter 13 to chapter 7. R. 10, 17. The Court noted that, in accordance with the legislative history attributed with the bankruptcy code, chapter 13 proceedings are "intended to incentive a debtor to repay his debts with assurances that a chapter 7 trustee will not be able to seize any post-petition, pre-conversion equity for the benefit of the estate upon conversion." R. 16-17. Further, the Court distinctly appreciated and highlighted Eugene's "good-faith" conversion, and "consistent with the purpose of chapter 13, the Debtor should be rewarded, not punished, for seeking to repay his creditors." R. 17.

Moreover, Eugene, by disposing of the transferred funds to Emily Clegg, no longer had any interest in those funds. R. 20. The majority emphasized that the trustee's avoidance powers are not property of the estate, and even if the trustee retained an interest in the funds, "Eclipse cannot ever use them." R. 19. The Court further noted that Trustee Floyd cannot sell any avoidance powers even acting as a fiduciary in order to avoid "compromis[ing] the integrity of the bankruptcy system." R. 23-24. Judge Barrett dissented, arguing against the decisions presented on the two corresponding issues. R. 24.

This Court granted a writ of certiorari limited to the two issues presented before the court. R. 2.

Summary of the Argument

The decision of the Thirteenth Circuit should be reversed as a matter of law for the following three reasons. First, post-petition, pre-conversion equity appreciation obtained during the fulfillment of agreed upon payments in a chapter 13 bankruptcy remains with the debtor. Second, chapter 7 trustees cannot avoid and recover post-petition equity appreciation transfers that were made in the course of ordinary business practices. Lastly, as matter of public policy, affirming the Thirteenth Circuit's decision is consistent with the original purpose of the implementation of the bankruptcy code.

ARGUMENT

THE DECISION OF THE THIRTEENTH CIRCUIT SHOULD BE AFFIRMED AS A MATTER OF LAW

This Court should affirm the Thirteenth Circuit's ruling as a matter of law. This matter comes on appeal before the Court following the Thirteenth Circuit's ruling in favor of Eugene and the denying Trustee Floyd's sale motion. Thus, under a de novo standard of review, the reviewing court "decides an issue as if the court were the original trial court in the matter." R. 10. *(see, e.g., Razavi v. Comm'r of Internal Revenue*, 74 F.3d 125, 127 (6th Cir. 1996). The matter before the Court today turns on statutory interpretation that Appeals Circuit's have been arrived to differing conclusions. The Tenth Circuit held that post-petition appreciation in a non-exempt assets belongs to a debtor upon conversion from chapter 13 to chapter 7. *Rodriguez v. Barrera (In re Barrera)*, 22 F.4th 1217 (10th Cir. 2022). Moreover, a trustee's ability to avoid and recover transfers has been limited by several decisions issued by the Second Circuit Court of Appeals and the District Court. *In re Bernard L. Madoff Inv. Secs. LLC*, 440 B.R. 282 (Bankr. S.D.N.Y. 2010). As shown below, this interpretation should be the prevailing ruling in adjudicating this matter.

I. A Debtor Retains Post-Petition, Pre-Conversion Equity Gained During A Chapter 13 Bankruptcy

When the financial obligations of a debtor become insoluble the Bankruptcy Code provides relief allowing individuals to make a "fresh start" on their path to financial success. *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 367 (2007). The two relevant option in our case are Chapter 7 and Chapter 13, both of which offer different incentives and penalties. In Chapter 7, a debtor is entitled to a "clean break" of their financial obligations, however, the debtor must also promptly liquidate their assets. *Harris v. Viegelahn.*, 575 U.S. 510, 513 (2015). On the other

hand, Chapter 13 allows a debtor to retain their assets if completed under a court-approved plan. *Id.* at 514. The unfortunate reality for many Chapter 13 debtors is that they are unable to meet the financial obligations required under their plan. *Id.* The debtor is then faced with the option having their case dismissed, or in the alternative, converting their case to another chapter as allowed by 11 U.S.C.S § 1307(a).

The issue presented in our case occurs when a debtor attempts to make a "fresh start" under an approved Chapter 13 plan, making necessary payments to secured creditors, but in the event of conversion to Chapter 7 is forced to forfeit the equity they had established under the Chapter 13 plan. This is the unfortunate situation for our debtor, Eugene, who complied with his approved Chapter 13 plan for 8 months making mortgage payments on a property that had no non-exempt equity which a Chapter 7 trustee could liquidate. Nonetheless, upon conversion to Chapter 7 it was established that the home Eugene sought to preserve had substantially increased in equity over the course of the Chapter 13 plan, which the converted Chapter 7 trustee would like to liquidate.

A. Absent Bad-Faith Conversions, 11 U.S.C.S. § 348 Allows A Debtor To Retain Appreciation And Pay-Down Equity Gained During The Period Of A Chapter 13 Plan

Equity in a debtor's property that is created during a chapter 13 plan, either by appreciation of the property or pay-down of secured interests, inures to the benefit of the debtor even when case is converted to chapter 7. When an unfortunate debtor, like Eugene, converts a confirmed chapter 13 plan to chapter 7, 11 U.S.C.S § 348(f)(1)(A) ensures, "a debtor's postpetition earnings and acquisitions do not become part of the new Chapter 7 estate." *Viegelahn* at 517 (2015). As provided for in 11 U.S.C.S § 348(a), a conversion "does not commence a new bankruptcy case," and does so, "without effecting a change in the date of the

filing of the petition." *Id.* at 515. Additionally, 11 U.S.C.S § 541(a)(1) ensures, "a Chapter 7 estate does not include the wages a debtor earns or the assets he acquires after the bankruptcy filing. *Id.* at 514. Thus, a converted chapter 7 estate consists of, "the property as it existed on the petition date, with all its attributes, including the amount of equity that existed on that date." *Rodriguez v. Barrera*, BAP No. CO-20-003, 4 (B.A.P. 10th Cir. 2020). Moreover, 11 U.S.C.S § 348(f)(2) allows a converted chapter 7 estate to include the debtor's post-petition, pre-conversion property when converted in bad-faith, indicating, "when the conversion to Chapter 7 is made in good faith, no penalty is exacted." *Viegelahn* at 519.

Recent circuit decisions have placed diverging interpretations on the effect of 11 U.S.C.S § 348 on post-petition equity after a conversion to another chapter. For a proper analysis of the statutory interpretation, it is necessary that the statute be, "read as a whole, since the meaning of statutory language, plain or not, depends on context. *King v. St. Vincent's Hosp.*, 502 U.S. 215, 221 (1991).

Beginning with § 348(a), the bankruptcy code explains that when a case is converted from one chapter to another it, "does not effect a change in the date of the filing of the petition, the commencement of the case, or the order of relief." 11 U.S.C.S § 348(a). The result of this for a debtor who converts, like Eugene, is the bankruptcy code will refer to their original chapter 13 filing date as opposed to the conversion date.

To determine what, if any, of Eugene's home would be accessible to a chapter 7 estate, it must first be explained what the pre-conversion chapter 13 estate consisted of. The bankruptcy code describes the property of the estate in § 541(a)(1) as, "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C.S §

541(a)(1). This read in the context of § 348(a) holds that the commencement of the case refers to the original chapter 13 filing. At the time of Eugene's original chapter 13 filing his home had a valuation of $350,000, however, Another Brick held a mortgage of $320,000 on the property and the remaining $30,000 of equity was exempted as part of a properly applied homestead exemption. R. 6. Simply stated, Eugene's home did not have any non-exempt equity that a trustee could liquidate to the benefit of the estate.

To maintain Eugene's exemption status, § 522 states that for exemption purposes the value of property is determined, "as of the date of the filing of the petition." 11 U.S.C.S § 522(a)(2). This determination is known as the "snapshot rule" and holds that once a valuation of a property has been made for exemption purposes, "the asset will retain whatever status (i.e., exempt or part of the estate) it had when the debtor filed for bankruptcy and cannot be altered by circumstances that change later." *Rockwell v. Hull (In re Rockwell)*, 968 F.3d 12, 18 (1st Cir. 2020). A later circumstance, such as Eugene's conversion to chapter 7, will not change the status of Eugene's property from being exempt under chapter 13 to part of the chapter 7 estate. What the trustee is attempting to argue for is that Eugene's property should only rely on the petition date valuation of his home for purposes of his exemption rights, but that the trustee is entitled to use a post-conversion valuation to allow for the liquidation of the property. This difference, in when a property is valued, not only conveniently ignores sections of the bankruptcy code, but also punishes a debtor for attempting a chapter 13 plan in good faith. Had Eugene initially filed for chapter 7 as opposed to chapter 13, the valuation of his home would have remained at $350,000, of which, there was no non-exempt equity to allow a chapter 7 trustee to liquidate.

Finally, § 348(f)(2) stating, "if the debtor converts a case under chapter 13 of this title to a case under another chapter under this title in bad faith, the property of the estate in the converted case shall consist of the property of the estate as of the date of conversion." gives the greatest context that post-petition equity gained during compliance with a chapter 13 plan would inure to the benefit of the debtor by 11 U.S.C.S § 348(f)(2). The plain reading of this language indicates that bad faith converters will be punished by losing all property and equity that was post-petition. When read in context of § 348(f)(1)(a) and the snapshot rule of § 522(a)(2), it would only be consistent that the chapter 7 property of the estate for a good faith converter consists only of property, "with all its attributes, including the amount of equity that existed on that date," that is still owned by the debtor upon conversion. *Barrera* at 4.

In sum, the bankruptcy code for converted case consistently refers to the petition filing or commencement date for purposes of establishing the property of the estate. For converted cases, § 348(a) establishes that the original filing date of the converted case is what is being referenced for purposes of the petition filing or commencement date. The snapshot rule of § 522(a)(2) freezes any valuations of the debtor's property at the time of the original bankruptcy filing. When Eugene had filed his petition for bankruptcy and properly applied a homestead exemption, the snapshot rule would have "froze" the valuation of his home at $350,000, of which, remained no non-exempt equity. Thus, post-conversion estates do not include equity acquired through paying off secured interests or by appreciation acquired during compliance of a confirmed chapter 13 plan. *In re Nichols*, 319 B.R. 854, 857 (Bankr. S.D. Ohio 2004). For the foregoing reasons, post-petition, pre-conversion equity from a chapter 13 case converted in good faith should inure to the benefit of the debtor.

B. Ambiguity In The Term 'Property' Requires A Review Of Legislative History

Despite the clear statutory language of § 348 indicating that post-petition equity would inure to the benefit of the debtor, circuit decisions on the issue have struggled to come to an agreement on a dependable interpretation. Best explained by the 10th Circuit, "Ambiguity exists when reasonably well-informed individuals reach competing conclusions." *Barrera* at 10. The court further explained that § 348 has reached competing conclusions by well-informed individuals because, "bankruptcy judges do not agree whether postpetition appreciation in value of property belongs to a chapter 7 estate upon conversion." *Id.* The very fact that circuits have been split on the issue indicates that there is ambiguity in the language of the statute. *Id.* When statutory text is ambiguous, "a court can then resort to legislative history as an aid to interpretation." *United States v. Simmonds.*, 111 F.3d 737, 742 (1997).

Consider the following hypothetical from the legislative history of § 348(f) that explains the disincentives produced when post-petition equity inures to the benefit of the estate rather than the debtor:

> 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.

H.R. Rep. No. 103-835, at 57 (1994). This scenario described in the legislative history focuses on the exact issue as in our case. As part of Eugene's confirmed chapter 13 plan, he had paid $10,000 into the chapter 13 estate that was being reserved for Another Brick. R. 8-9. If § 348(f) were to be interpreted to inure to the benefit of the estate, Eugene is then faced with the issue

that his compliance with his chapter 13 plan has created equity in his previously exempt home that a chapter 7 trustee would later be entitled to liquidate post-conversion. Under these facts, Eugene would have been in a better position had he initially filed for chapter 7 instead.

The legislative history continues to support the theory that post-petition equity would inure to the benefit of the debtor by stating that § 348(f)(2), "gives the court discretion, in a case in which the debtor has abused the right to convert and converted in bad faith, to order that all property held at the time of conversion shall constitute property of the estate in the converted case." *H.R. Rep. No. 103-835*, at 57. This acknowledgement by Congress demonstrates the idea that the bankruptcy code is intended to be read as a whole, and that § 348(f)(1)(a) cannot be read without the context of § 348(f)(2). The legislative history here clearly recognizes that only after a finding of a bad-faith conversion may the court allow a trustee to recover post-petition equity by using the conversion date for the creation the estate. In the case of Eugene, who converted in good-faith as stipulated by Eclipse, this penalty cannot be exacted and a trustee can only rely on equity owned by the debtor at the time of filing the petition.

By reviewing the legislative history for the § 348(f) amendment, it is clear that "Congress was concerned that debtors would be counseled to file chapter 7 cases rather than chapter 13 cases," because of the risk that a debtor could lose equity gained from paying secured claims. *In re Pearson*, 214 B.R. 156, 164 (Bankr. N.D. Ohio 1997). The hypothetical provided in the history illustrates the risk of losing post-petition equity a chapter 13 debtor would take without the proposed § 348 amendment. The legislative history for inclusion of the amendment favors a debtor, like Eugene, who dutifully complied with his chapter 13 plan before converting his case

in good-faith. For the foregoing reasons, the legislative history of § 348(f) should be viewed to allow a chapter 13 debtor, who converts in good-faith, to retain the equity gained during compliance of the chapter 13 plan.

C. As A Matter Of Public Policy, Debtors Should Not Be Discouraged From Filing Chapter 13 If Any Equity Created In Compliance Of A Chapter 13 Plan Would Be Surrendered In The Event Of Conversion

Both chapter 7 and 13 of the bankruptcy code offer a debtor an opportunity to recover from unfortunate financial circumstances where the individual debtor is no longer able to maintain their obligations to creditors. However, chapter 13 allows a debtor the unique opportunity to retain their assets while making payments under a court-approved plan.

An important factor in deciding which option best suits a debtor's situation if that, "for many debtors, a residence is the only investment asset in their portfolios," and, "the prospect of losing that investment is what drives many debtors to seek bankruptcy protection." *Barrera* at 18. If the equity gained during the compliance of a confirmed chapter 13 plan were to later become available to a chapter 7 trustee, then the bankruptcy code would be a serious disincentive to attempt a chapter 13 plan. *Id.*

Chapter 13 bankruptcy offers a great opportunity for debtors, like Eugene, to keep their home and is the main driving force behind their decision to seek protection. When these unfortunate debtors attempt to meet the obligations of a chapter 13 there is no reason to punish them by later taking their home for trying and sadly are unable to accomplish that goal and seek further protection. For the foregoing reasons and with this public policy goal in mind, the equity a chapter 13 debtor obtains while complying with a court-approved chapter 13 plan should not later be given to a chapter 7 trustee upon conversion in good-faith.

II. Chapter 7 Trustees Cannot Avoid And Recover Post-Petition Equity Appreciation Transfers

A debtor who, in good faith, like in the case at bar, converts to chapter 7 is entitled to obtain the proceeds in such a manner that all trustees will be entitled to due compensation. Since its inception, chapter 13 bankruptcy was intended to allow redress for debtors, with regular income, to retain his property only upon court approval of a repayment plan apportioned upon the debtor's "future earnings or other future income." *Viegelahn* at 514. (§ 1322(a)(1)). Conversely, in order to pay his creditors, typically from "future earnings or other future income." (11 U.S.C.S. §§ 704(a)(1), 726, 727) *Law v. Siegal*, 571 U.S. 415, 415 (2014). R. 11.

Accordingly, in this case, in response to the unforeseen global pandemic stifling businesses across the world, Eugene timely filed and the bankruptcy court confirmed a chapter 13 plan to repay creditors upon petitioning for bankruptcy, pursuant to the duties set forth in 11 U.S.C. §§ 1321, 1326. (R. 11.) Further, after successfully making payments, pursuant to the plan provisions, for 8 months, Eugene converted in good faith to the chapter 7 trustee. Pursuant to § 547, a chapter 7 trustee will not be able to avoid any preferential transfers made in the ordinary course of business. 11 U.S.C.S. § 547(c)(2). Moreover, the burden of establishing the avoidance power of a transfer rests with the trustee, as well as, the debtor possessing the burden of proving the lack thereof. 11 U.S.C. § 547(g). As shown below, the chapter 7 trustee will not be able to show that they are entitled to those preferential transfers because the transfer made to Emily Clegg should not be deemed as property of the estate for avoidance power purposes.

A. Preference Actions Made In The Ordinary Course Of Financial Affairs Between Debtor And Transferee Are Not Property Of The Estate That Can Be Sold By The Trustee

Central to deciphering a trustee's ability to avoid and recover transfers requires defining what the property entails, and preferential actions are not to be deemed property of the estate that can be sold by the trustee.

The bankruptcy code describes the property of the estate in § 541(a)(1) as, "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C.S § 541(a)(1). Further, causes of action are considered property of the estate. *United States v. Nordic Vill., Inc.*, 503 U.S. 30, 37 (1992) *(see In re Simply Essential, LLC*, 640 B.R. 922, 930(Bankr. N.D. Iowa 2022)). However, where events that give rise to a cause of action occur subsequently of the chapter 7 petition, "that cause of action is not property of the bankruptcy estate." *Haley v. Dow Lewis Motors*, 72 Cal. App. 4th 497, 500 (1999). § 926(a) plainly states that "if the debtor refuses to pursue a cause of action" then, only upon request of a creditor, "the court may appoint a trustee to pursue such cause of action. 11 U.S.C.S. § 926(a). However, § 926 should not apply to the case at bar and should bear little weight in this analysis because, here, Eugene has not expressly refused to pursue an applicable cause of action, nor is there any evidence that ~~creditor/~~eclipse requested the court to appoint a trustee, as well as the fact that Trustee Floyd had already been appointed and thus possesses no new interest to pursue any hypothetical claim. § 543(a) prevents an unauthorized custodian from taking action in the administration of property of the debtor or property of the estate. *Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery (In re Cybergenics Corp.)*, 226 F.3d 237, 246 (3rd Cir. 2000). Moreover, we agree with the majority's position chapter 5 causes of action do not fall within the scope of § 541(a)(1). The avoidance power provided in 11 U.S.C. § 544(b) is unique from others because a trustee can use this power only if there is an un541secured creditor of the debtor that actually has the "requisite nonbankruptcy cause of action." *Id. at* 239. A nonbankruptcy cause of action, for example, might entail a debtor bringing a fraudulent transfer cause of action to recover assets transferred before a bankruptcy filing. In that scenario, the fraudulent transfer claim would be the

nonbankruptcy cause of action because the fraudulent conduct would have been actionable, aside from any bankruptcy proceedings.

The Supreme Court has been dispositive of this principle as displayed in *Law v. Siegel*, 571 U.S. 415 (2014). In *Siegal*, the debtor claimed the central lien at issue was fraudulent in order to establish a lack of non-exempt equity in the residence for distribution to creditors, and the trustee contended that surcharging the debtor's homestead exemption was appropriate to reimburse the trustee for extensive as well as costly litigation in establishing that the claim lien against the debtor's homestead was fraudulent. *Siegel*, 571 U.S. 415. The Court unanimously held that the bankruptcy court exceeded its limits in surcharging the homestead exemption to pay the trustee's attorney fees. *Id.* This Court emphasized that the "fraudulent conduct in a bankruptcy case may also subject a debtor to criminal prosecution under 18 U.S.C. § 152." *Siegel*, at 427.

Indeed, Eugene's conduct clearly distinguishes itself from *Siegel*, as emblematic of good faith efforts to remedy an unforeseen financial predicament. Here, Eugene, and nearly everyone else in the world at the time, could not have possibly anticipated the consequences of the duration of an unprecedented global pandemic, therefore he should not be punished for the unfortunate circumstances. Due to the nature of Eugene and Emily Clegg's transactions, exemplary of their close relationship as mother and son, this Court should affirm the Thirteenth Circuit's ruling and prevent Trustee Floyd from avoiding the transfer.

B. Trustee's May Not Avoid A Transfer Made In The Ordinary Course Of Financial Affairs Between Debtor And The Transferee

In accordance with § 547(c)(2) of the Bankruptcy Code, Trustee Floyd should be prevented from exercising the statutory power to avoid a transfer made in accordance with previous well-established financial practices. A chapter 7 trustee's unique avoidance power may

not be used to avoid a transfer made in the ordinary course of business or financial affairs between the debtor and transferee. 11 U.S.C. § 547(c)(2). While § 547(c)(2) requires a subjective analysis of the party's ordinary course of financial affairs amongst the parties, the relationship between Eugene and his mother is abundantly clear to order prevention of avoidance of their transaction. Here, our first point of analysis derives in early 2012 when Emily Clegg transferred 100% ownership, contingent-free, of Final Cut to Eugene. Thereafter, Eugene initiates his debt with Eclipse to renovate Final Cut. Once renovations were completed, Eugene recovered from the lack of business and maintained profitability for three years. Then in March of 2020, an unprecedented global pandemic paralyzed commerce across the globe. Final Cut was, unfortunately, amongst the global businesses that suffered and struggled to sustain the revenue stream to pre-pandemic levels. Cognizant of the unforeseen revenue disruption from Final Cut, and aware of the uncertainty of when return to pre-pandemic levels, on September 8, 2020, Eugene borrowed, on an unsecured basis, $50,000 from his mother, Emily Clegg, in order to financially survive. Given the close relationship evident between Eugene and Emily Clegg, as well as Eugene's self-imposed obligation to fulfill his agreement, Eugene commenced a partial payment to pay back the September loan transferred from Emily Clegg. Eventually, however, Final Cut, was forced to permanently shut their operation down. Soon thereafter, Eugene, in good faith, converted to chapter 7 bankruptcy.

Under chapter 7 bankruptcy, a trustee appointed to administer the bankruptcy estate, including the authority to avoid certain transfers of property made by the debtor, shall have the ability to avoid certain preferential transfers. 11 U.S.C. § 547. A trustee solely possesses the power to use this authority to recover property or funds for the benefit of creditors, however they are not mandated to do so. 11 U.S.C. §§ 549, 704. (*See Hartford Underwriters Ins. Co. v. Union*

Planters Bank, N.A., 530 U.S. 1, 6-7 (2000). The bankruptcy code regulates chapter 7 liquidation proceedings, dictating the order in which claims are to be paid as well as defining the duties of a chapter 7 trustee. 11 U.S.C.S. §§ 704, 726 *(see Contrs., Laborers, Teamsters & Eng'rs Health & Welfare Plan v. Killips (In re M & S Grading, Inc*.), 526 F.3d 363, 367 (8th Cir. 2008). § 550 allows the trustee to recover the transferred property or its value from the recipient of the preferential transfer "for the benefit of the estate." 11 U.S.C. § 550 (*See Wellman v. Wellman (In re Wellman)*, 933 F.2d 215, 218 (4th Cir. 1991)(holding that avoidance powers provide for recovery only if the recovery is for the benefit of the estate). However, it is not typical for a chapter 7 trustee to sell the ability to avoid transfers. Chapter 7 trustee's serves the role of a legal representative and fiduciary appointed by the court to act in the best interest of the creditors and the bankruptcy estate, and thus "the trustee may not be the representative of any particular creditor but must represent all creditors without partiality." *Dye v. Brown (In re AFI Holding, Inc.)*, 355 B.R. 139, 142 (9th Cir. BAP 2006). A trustee's role, as statutorily ratified, is to marshal and liquidate assets for the benefit of creditors, not to sell their avoidance power for compensation. *Hartford Underwriters*, 530 U.S. at 7. Although these powers are vested to the trustee, those avoiding powers are not deemed "property" of the estate, but rather, statutorily created powers to recover property. *Cybergenics Corp.* at 246. (*quoting Collier On Bankruptcy P 541.12 n.1 (Lawrence P. King, ed.*, 1999)). Further, the Thirteen Circuit held that "the ability of a chapter 7 trustee to avoid and recover preferential transfers is not estate property that can be sold but, rather, a statutory power that cannot." R. 4. Adopting Trustee Floyd's position would raise ethical and legal concerns. Avoidance powers, vested to the trustee, are meant to be exercised for the benefit of the entire body of creditors, and any attempt to monetize or privatize those powers could be contrary to the trustee's fiduciary duty. *In re Metropolitan Electric Manufacturing Co.*,

295 B.R. 7, 11-12 (Bankr. E.D.N.Y. 2003) (*see Ngan Gung Restaurant v. Foong (In re Ngang Gung Restaurant)*, 254 B.R. 566, 570 (Bankr. S.D.N.Y. 2000)(citing *Commodity Futures Trading Commission v. Weintraub*, 471 U.S. 343, 355 (1985)). Further, § 725 of the bankruptcy code requires the court to determine the appropriate disposition of property in which the estate and an entity other than the estate have an interest. 11 U.S.C.S. § 725.

In this case, Eugene attained an $850,000 debt from a loan sought from Eclipse in 2016 in order to initiate renovations to Final Cut. In October 2020, Final Cut permanently closed, causing Eclipse to commence foreclosure proceedings against Final Cut. Later, when Eugene could no longer fulfill his chapter 13 payments, due to the unanticipated pandemic stifling businesses across the globe, Final Cut sold. Eugene was indebted to Eclipse for approximately $200,000 due to the deficiency with respect to his guarantee of the Loan after foreclosure, which Eclipse completed post-conversion. R. 9. Once admitting Eugene's evident good faith cooperation, Eclipse agreed to settle its claim in exchange for $150,000, of which $25,00 was deemed non-dischargeable even in the event of conversion. R. 8.

Essential to this analysis is the fact that Eclipse has already essentially recovered $700,000 from their $850,000 investment. Additionally noteworthy is the circumstance that gave rise to Eugene's insolvency. At every step throughout the bankruptcy proceedings, Eugene has remained steadfastly cooperative in order to restore all parties to the best of his ability. Having already been accepted that the estate was "bereft of assets," Eugune maintains the position that any available equity that can be attained should be evenly distributed. Moreover, Eclipse has already been compensated a fair deal given their investment, and their proposition is nothing short of egregious greed. Any distribution of assets should be evenly distributed.

The 3rd Circuit is dipositive of the distribution of assets issue in the case *Official Comm. Of Unsecured Creditors of Cybergenics Corp., v. Chinery ("In re Cybergenics Corp.")*, 226 F.3d 237 (3d Cir. 2003). There, Cybergenics was burdened with over $60 million of debt, secured by Cybergenic's assets. *In re Cybergenics Corp.* at 239. Facing financial distress, Cybergenics filed for chapter 11 bankruptcy, operating as a debtor in possession. *Id.* Similarly to the case at bar, the court assessed Cybergenics' avoidance power. *Id.* at 243. The court noted that "the fact that section 544(b) authorizes a debtor in possession [...] to avoid a fraudulent transfer, does not mean that the fraudulent transfer is an asset of the debtor in possession." *Id.* Moreover, this power should not be confused with the separate authority of a trustee or debtor in possession to "pursue the [...] debtor's causes of action that become property of the estate upon the filing of the bankruptcy petition. *Id.* (*see Sender v. Simon*, 84 F.3d 1299, 1304 (10th Cir. 1996). The court also deemed that the transaction central to the avoidance power should not be deemed as "an assignment of avoidance powers (or even an authorization of the right to exercise the avoidance powers)." *Cybergenics Corp.* at 245. Instead, the court rejected the view that this transaction qualified as a "sale of Cybergenics' 'assets,'" especially because of the exclusion of listing these as assets in the bankruptcy plan. *Id.*

Indeed, Eugene went further than *Cybergenics* because of the abundant displays of good faith and absent any fraudulent activity. Also, the fact that Eclipse has already obtained more than 88% of their original investment, coupled with the fact that Eugene's mother would be unable to obtain relief for her well-intention financial assistance would strike contrary to the scope of the bankruptcy code because of the it would deny a just repayment of good faith to a consistent financial partner. Therefore, this Court should rule in Eugene's favor and affirm the Thirteenth Circuit's decision.

C. As A Matter Of Policy, Denying Appellant's Claim Would Be Consistent With The Principles Rooted In The Foundation Of The Bankruptcy Code

Affirming the Thirteenth Circuit's holding effectively complies with the original purpose of the implementation of the bankruptcy code. Historically, Congress understood that many debtors fail to successfully complete a chapter 13 plan. Thus, Congress accorded debtors a "'nonwaivable right' to convert a chapter 13 case to one under chapter 7 'at any time.'" *Viegelahn* at 514.

In the case at bar, while it is undisputed that Pink had no obligations set forth at the inception of the Petition, for the purposes of § 547, requiring a non-party transferee to divulge equity dutifully owed to her would be contrary to the purpose of bankruptcy proceedings as a whole. The central consideration for implementation of the Bankruptcy Code is to grant a "fresh start" to the "honest but unfortunate debtor." *Grogan v. Garner*, 498 U.S. 279, 286 (1991). Even if this Court found that Pink should be deemed, for purposes of § 547 application, an insider, the avoidance power would not apply in this case. The avoidance powers, set forth in sections 544-553 allow a trustee's to avoid and recover certain transfers made by a debtor. *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1663 (2019). However, this power may used in order to "share the available assets as fairly as possible" between the similarly situated party's. *Grede v. FCStone, LLC*, 746 F.3d 244, 246 (7th Cir. 2017).

Even if this Court found that a trustee may avoid an ordinary course of business transfer, Appellant still will not be entitled to the relief it seeks. Any proceeds of the available equity deriving from the post-petition property appreciation should be distributed equally amongst the viable creditors. Any creditor that recieved a greater payment than others of his class is required to disgorge so that all may share equally. *Union Bank v. Wolas*, 502 U.S. 151, 160-61 (1991) (*see* R. 18.) Given that the estate of the debtor has already been deemed "bereft of assets,"

coupled with Eugene's repeated display of good faith, any equity found must be equally distributed among all viable claimants. Divergence from this principle would run afoul to the very nature of bankruptcy law to grant a "fresh start" to the "honest but unfortunate debtor." *Marrama* at 367. Therefore, Eugene ought not to be punished for his attempts to remedy his unfortunate financial circumstance.

CONCLUSION

WHEREFORE, Respondent Eugene Clegg asks this Court to affirm the decision of the Thirteenth Circuit.

Respectfully submitted,

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Team 16
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