**No. 23-0115**

IN THE

# Supreme Court of the United States

IN RE EUGENE CLEGG, *Debtor*,

VERA LYNN FLOYD, CHAPTER 7 TRUSTEE, *Petitioner*,

*v.*

EUGENE CLEGG, *Respondent*.

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

**BRIEF FOR RESPONDENT**

Team 20
*Counsel for Respondent*

## QUESTIONS PRESENTED

I. Whether any post-petition, pre-conversion increase in equity in a debtor's property benefits the debtor under 11 U.S.C. §§ 348 and 541, when a debtor's assets are frozen in time as of the commencement of his case, and when Congress intended good faith conversions to be penalty-free.

II. Whether a Chapter 7 trustee is prohibited from selling, assigning, or otherwise transferring to a creditor the power to avoid and recover transfers under 11 U.S.C. §§ 547 and 550, when such authority is exclusively vested in a fiduciary of the estate, and when a debtor lacks interest in avoidance actions at the commencement of their case.

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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 impact of COVID-19 on the Debtor's small business

The debtor in this bankruptcy case, a highly decorated Cpl. Eugene Clegg (the "Debtor"), is the owner and operator of The Final Cut, LLC ("Final Cut"), a single-screen movie theater in the City of Moot. R. at 4. In 2016, Final Cut borrowed $850,000 (the "Loan") from Eclipse Credit Union ("Eclipse"), to renovate the theater. R. at 5. Eclipse was granted first priority, perfected liens on Final Cut's real and personal property, with the Debtor executing an unconditional, unsecured personal guaranty. R. at 5. In early 2017, the rehabilitation was completed, and Final Cut was reopened to the public. R. at 5.

In March 2020, the COVID-19 pandemic caused Final Cut to cease operation for nearly a year, forcing the Debtor to borrow $50,000 on an unsecured basis from his mother, Pink. R. at 6. The theater reopened in February 2021, however, attendance failed to rebound, resulting in further credit card debt and delayed home mortgage payments by the Debtor to Another Brick in the Wall Financial Corporation (the "Servicer"). R. at 6. The Debtor failed to make mortgage payments for several months, and the Servicer commenced foreclosure proceedings. R. at 6.

### The Debtor filed Chapter 13 bankruptcy to save his home and business

The Debtor sought relief under Chapter 13 of the Bankruptcy Code[1] (the "Code") on December 8, 2021 (the "Petition Date"). R. at 6. At that time, the Debtor's home was appraised at $350,000. R. at 6. The Debtor had a non-contingent, liquidated, and undisputed secured debt to the Servicer of $320,000. R. at 6. The Debtor properly claimed a state law homestead exemption in the amount of $30,000, the maximum amount in the State of Moot. R. at 6–7. The Debtor appropriately disclosed on his Statement of Financial Affairs that he had made preference

[1] Specific sections of the Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.*, are identified herein as "section ___."

payments to Pink, who was an insider of Final Cut, within one year prior to the Petition Date in the aggregate amount of $20,000. R. at 7. The Debtor's Chapter 13 plan proposed to make payments over three years, with the Debtor curing the petition arrears and making ongoing monthly payments on the mortgage loan to the Servicer via the Chapter 13 trustee. R. at 7. The plan stated that, given the value of the Debtor's home, secured indebtedness and the homestead exemption, the Debtor maintained no equity in his home as of the Petition Date. R. at 7. The proposed plan was to be funded solely through future earnings from Final Cut. R. at 7.

The Chapter 13 trustee objected to the Debtor's plan as failing to satisfy section 1325(a)(4), which requires each creditor to receive under the plan no less than it would otherwise receive in a hypothetical liquidation under Chapter 7. R. at 7. To resolve the objection, the Debtor graciously amended the plan to increase the aggregate payments to creditors by $20,000 over the applicable commitment period—the amount that creditors would receive if the preference payment to Pink was repaid to the creditors. R. at 7–8. The bankruptcy court confirmed the Debtor's plan, which incorporated the stipulation, and expressly provided that all property of the estate vested in the Debtor. R. at 8.

**The Debtor made a good faith conversion to Chapter 7**

The Debtor made timely and consistent payments under the plan for eight months before contracting long-COVID in September 2022, rendering him unable to work and make an income. R. at 8. Despite the Debtor's best efforts, in October 2022, the theater permanently closed, and Eclipse commenced foreclosure proceedings. R. at 8. The Debtor was no longer able to make payments and chose to convert his Chapter 13 case to a Chapter 7. R. at 8. No party contended this conversion lacked good faith. R. at 8. The Chapter 13 trustee distributed $10,000 to the Servicer and returned the funds held in reserve for Eclipse back to the Debtor. R. at 8–9.

The Chapter 7 trustee (the "Trustee") was appointed, who stated the Debtor owed Eclipse roughly $200,000 due to the deficiency with respect to his guarantee of the Loan after foreclosure. R. at 9. The Debtor indicated that he intended to reaffirm the mortgage debt he owed to the Servicer and remain in his home. R. at 9. The Trustee initially concluded the estate was bereft of assets but, after the Debtor made a passing comment about the value of their property potentially increasing, the Trustee commissioned an appraisal of the Debtor's home, confirming that the non-exempt equity in the home had increased by $100,000 since the Petition Date. R. at 9. The Trustee began marketing the home for sale in line with their duty to "collect and reduce to money the property of the estate for which the trustee serves." *See* 11 U.S.C. § 704(a)(1). R. at 9. Eclipse offered to purchase the home and alleged preference claim against Pink for a total of $470,000. R. at 9. The Trustee determined that the offer maximized the value of the assets for the benefit of creditors and filed a motion (the "Sale Motion") to sell the home and alleged preference claim to Eclipse under section 363(b). R. at 9.

**The lower courts ruled in favor of the Debtor**

The Debtor objected to the Sale Motion on two grounds. First, the Debtor argued that any post-petition, pre-conversion increase in the equity of his home should inure to his benefit. R. at 10. Accordingly, because there was no equity available for the estate as of the Petition Date, the Trustee could not sell the home. R. at 10. Second, the Debtor contended the avoidance and clawback powers of the trustee under sections 547 and 550 cannot be sold. R. at 10. The bankruptcy court ruled in favor of the Debtor on both objections and denied the Sale Motion. R. at 10. The United States Court of Appeals for the Thirteenth Circuit affirmed. R. at 4.

## STANDARD OF REVIEW

The standard of review for issues of law, as in this case, is *de novo*. *See Fed. Hous. Fin. Agency for Fed. Nat'l Mortg. Ass'n v. Nomura Holding Am., Inc.*, 873 F.3d 85, 138 n.54 (2d Cir. 2017). "Under a *de novo* standard of review, the reviewing court decides an issue as if the court were the original court in the matter." *Razavi v. Comm'r of Internal Revenue*, 74 F.3d 125, 127 ($6^{th}$ Cir. 1996).

## SUMMARY OF THE ARGUMENT

This Court should affirm the Thirteenth Circuit's ruling in favor of the Debtor for two reasons. First, the express and implied language of the Code dictates that the assets, exemptions, and liabilities of the Debtor's estate are determined at the point the bankruptcy petition is filed. As a result, any post-petition, pre-conversion property increase in the value of the Debtor's home belongs to the Debtor. Second, avoidance actions are not property of, nor derived from the bankruptcy estate, but instead are statutory powers exclusive to the Trustee which cannot be used as a bartering chip that can be purchased by the estate's creditors.

The purpose of the Code is to grant a fresh start to honest debtors while allowing an equitable distribution to all creditors through a collective proceeding. To punish debtors who seek to convert their case by allowing post-petition, pre-conversion property value increases to be retroactively included in the estate would disincentivize debtors from converting, or even filing, their bankruptcy case. Allowing the increased property value to be paid to creditors, rather than inure to the debtor, would deprive future debtors' relief under long-understood bankruptcy practices. Upholding the clear demarcation of the petition date is paramount because it affirms the point at which the estate is fixed, which ensures equity protection for good faith debtors amidst property value increases. Withholding the post-petition, pre-conversion property value increase

from the Debtor would undermine the goals of bankruptcy, guaranteed protections of assets by Congress, and the clear language of the Code.

Furthermore, the scope of the Chapter 7 debtor's estate is limited to the property held by the debtor at the time they file the petition for bankruptcy. A trustee cannot attempt to bring avoidance actions into the estate because the power to avoid and recover transfers are not "interest[s] in property" under section 541(a)(7). Avoidance actions are *powers* statutorily vested in trustees by law at the time a bankruptcy estate is created and do not qualify as *interests in property*. Avoidance actions arise upon filing a bankruptcy petition and are not acquired after commencement as required by section 541(a)(7). A trustee is a neutral party with the sole power to utilize the avoidance actions, rendering them non-transferable to any creditor. This practice has been well understood since the development of the modern Code. The authority of trustees would be irreparably compromised if their avoidance and clawback powers were sold to creditors and used as bargaining chips to increase their individual powers against a debtor.

The clear language of the Code, the long-held goals of bankruptcy, and the dependence on the reliable and understood powers of bankruptcy trustees support this interpretation as it balances the Code's purpose of allowing a fresh start for debtors and the policy demands of ensuring the exclusive application of avoidance powers by trustees. Therefore, this Court should resolutely affirm the decision of the Thirteenth Circuit.

## ARGUMENT

Property of the estate in a converted case consists of the property the Debtor held as of the date of his petition. 11 U.S.C. § 348. The petition date locks in the value of the Debtor's assets and liabilities, ensuring that any changes to the financial circumstances of the Debtor do not disrupt the fair and equitable distribution of assets to creditors. *In re Lantz*, 446 B.R. 850, 858 (Bankr. N.D. Ill. 2011). The petition date decisively states what the positions of all parties are: the debtor,

creditors, and trustee. *In re Awayda*, 574 B.R. 692, 695 (Bankr. C.D. Ill. 2017). This understanding is expressed in the Code's plain language and ensures that any post-petition, pre-conversion property increase in the value of the Debtor's home is retained by the Debtor.

Bankruptcy laws are meant to streamline the settlement of the estate in a fair and equitable manner. The petition date marks a pivotal moment in a debtor's case, typically excluding newly acquired property interests from the estate and limiting the authority of both the Trustee and creditors. The Trustee's attempt to argue against this is to disregard a clear, functional rule of thumb and thrust bankruptcy proceedings into uncertainty. Additionally, allowing increases in property value to be brought into the estate at the time of conversion would discourage Chapter 13 filings, as debtors might lose equity in assets gained during Chapter 13. Firmly adhering to the petition date to determine estate assets protects debtors from being punished for initially seeking relief under Chapter 13.

Further, the language of section 541 of the Code is clear in saying that avoidance actions are not property of the estate. 11 U.S.C. § 541. Avoidance actions are detailed under numerous sections of the Code, but are not mentioned anywhere in section 541, "Property of the estate." The scope of the bankruptcy estate is confined to property held by the debtor at the time of petition. *Mission Prod. Holdings v. Tempnology, LLC*, 139 S. Ct. 1652, 1663 (2019). Debtors do not possess such an interest because the authority to avoid and recover transfers is vested exclusively in the trustee. *Hanson v. Hanson (In re Hansen)*, 332 B.R. 8, 13 (B.A.P. 10th Cir. 2005). Moreover, avoidance powers come into existence the very moment a bankruptcy case commences, not before nor afterward.

It is in the policy interests of all parties that these powers are not for sale. The prohibition on selling avoidance powers exists because the power to avoid a preference should be used to

ensure equitable distribution among all creditors. Selling the power to only one creditor essentially diminishes each creditor's pro rata share, because one creditor will have authority far outweighing that of fellow creditors. Allowing this power to be sold would also result in diminishing the authority of the trustee itself, as they will cease to be the sole, impartial authority that conducts fair proceedings under bankruptcy.

The Trustee seeks to argue that these long-held readings of the Code and its policies are debatable and flexible. They are mistaken. The assurance to all parties that bankruptcy is a procedure that operates under equitable rules of fairness relies on the understanding of the assets of the estate and the powers of the trustee. To allow these authorities to be undermined would result in irreparable harm to the understanding and operation of bankruptcy, and the promise sought under it by all parties.

## I. Any Increase in Equity in a Debtor's Property, After the Petition Date, Rightfully Belongs to the Debtor When His Case is Converted from Chapter 13 to Chapter 7.

### A. The "snapshot rule" establishes fair and consistent entitlements for debtors, creditors, and trustees by freezing assets as of the petition date, thereby protecting all parties from the uncertainties of changes in property value adhering to 11 U.S.C. § 348 and § 541

In statutory construction, it is a fundamental rule that courts must interpret each word, clause, and provision of a statute in a way that ensures no part becomes insignificant, inoperative, or superfluous. *Duncan v. Walker*, 533 U.S. 167, 174 (2001). Section 348(f)(A) maintains that "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 (emphasis added). Additionally, "bankruptcy is governed by the state laws in effect at the time of the petition filing, fixing the status and rights of all parties involved at that point." *White v. Stump*, 266 U.S. 310, 313 (1924). This premise has led to the

development of the "snapshot rule," which effectively freezes a debtor's financial status at the time of the bankruptcy filing, creating a fixed reference point for the adjudication of the bankruptcy case. *In re Rockwell*, 968 F.3d 12, 18 (1st Cir. 2020).

Furthermore, section 348(f)(2) declares that "if the debtor converts a case under chapter 13 . . . in bad faith, the property of the estate in the converted case shall consist of the property of the estate *as of the date of conversion*." 11 U.S.C. § 348 (emphasis added). Section 348(f)(2) applies a distinct treatment for bad faith and good faith debtors. *See Harris v. Viegelahn*, 575 U.S. 510, 518 (2015). It imposes penalties on the former while safeguarding the latter, ensuring the protection of a debtor's post-petition earnings. *Id.* at 518. This statutory language inherently showcases the Code's intent of aiding "honest but unfortunate debtors" to achieve a "fresh start," ensuring equitable and just application in bankruptcy proceedings. *Harris*, 575 U.S. at 518

Upon filing a bankruptcy petition, the bankruptcy estate is formed, which encompasses all the debtor's prepetition property and interests, irrespective of their location or the holder. *City of Chicago v. Fulton*, 592 U.S. 154, 156 (2021) (citing 11 U.S.C. § 541(a)). Under section 502(b), the rights of holders of claims and interests are fixed as of the petition date. *Lantz*, 446 B.R. at 858. The rights of prepetition creditors to recover debts from a debtor's assets are established and unaltered by post-filing events, which are determined by the conditions set on the date of petition. *Id.* By locking in the value of assets and liabilities at the time of petition, the snapshot rule ensures that subsequent changes in the financial landscape do not disrupt the equitable distribution of assets or the fulfillment of obligations as initially determined by the bankruptcy court. *In re Stewart*, 452 B.R. 726, 738–39 (Bankr. C.D. Ill. 2011). The Debtor's post-petition, pre-conversion equity increase should therefore benefit him, not the estate, as there was no equity at the Petition Date. *See* R. at 10.

Section 1327(a) establishes that the provisions of a confirmed plan bind the debtor and each creditor. This binding applies regardless of whether the creditor's claim is provided for by the plan, or whether the creditor has objected to, accepted, or remained neutral towards the plan. *Matter of Burns*, 90 B.R. 301, 304 (Bankr. S.D. Ohio 1988). Further, the court's endorsement of a Chapter 13 plan under section 1325(a)(4), which ensures that creditors receive no less than what they would in a Chapter 7 liquidation, inherently sets the property's value as stated at the time of confirmation in accordance with section 348(f). *In re Page*, 250 B.R. 465, 466 (Bankr. D.N.H. 2000).

The bankruptcy court's confirmation of the Debtor's plan, per section 1327(a), solidifies a binding agreement that anchors the Debtor's right to property at the values set during confirmation. This action enforces stability and certainty in the bankruptcy process, constraining creditors to the established valuations. In accordance with section 1327(b) and (c), barring specific exceptions, the act of confirmation bestows upon the debtor all property of the bankruptcy estate, which liberates such property from any claims or interests of creditors contemplated with the plan. *Bullard v. Blue Hills Bank*, 575 U.S. 496, 502–503 (2015). Such an adjudication reinforces the integrity of the Debtor's court-approved repayment strategy, ensuring adherence to the established statutes. In this case, creditors are legally confined to the property valuations set during the plan's confirmation and cannot legitimately demand any amount exceeding those pre-established valuations. *See In re Page*, 250 B.R. 465, 466 (Bankr. D.N.H. 2000).

The confirmation of the Debtor's Chapter 13 plan carries significant weight in the context of property valuation and creditor claims: an unopposed confirmation signifies an acceptance of these values, especially when such a plan aligns with the treatment of unsecured creditors as they would be treated in a Chapter 7 case. *In re Slack*, 290 B.R. 282, 287 (Bankr, D.N.J. 2003), *aff'd,*

112 F. App'x 868 (3d Cir. 2004); *See also In re Kuhlman*, 254 B.R 755, 758 (Bankr. N.D. Cal. 2000) (emphasizing the importance of either a formal valuation or a confirmed plan). The Debtor's home, appraised at $350,000, faced initial objections from the Creditor. *See* R. at 6-7. However, these were resolved, leading to the court's confirmation of the plan and preventing the inclusion of property appreciation in the bankruptcy estate. *See* R. at 8. Additionally, treating confirmations of bankruptcy plans as implicit valuations not only promotes judicial efficiency but also provides stability. *Warren v. Peterson*, 298 B.R. 322, 326 (N.D. Ill. 2003). This, therefore, precludes the need for complex revaluations in the event of a conversion from Chapter 13 to Chapter 7, thus streamlining the bankruptcy process and reducing the associated costs and time.

In the Debtor's case, the bankruptcy court's confirmation of the plan without objections cemented the property values as established at the time of confirmation. This confirmation acts as a definitive directive, barring creditors from asserting claims over any value appreciation that occurred post-confirmation. This effectively ensures that the Debtor's rights to his property, as initially assessed and agreed upon during the Chapter 13 proceedings, are protected and respected in the subsequent Chapter 7 proceedings, in line with the intended function of the Code—to provide equitable treatment and financial stability for all parties involved.

Yet, the Ninth District has argued that any appreciation in asset value that occurs after the petition is filed is straightforwardly considered part of the bankruptcy estate. *In re Reed*, 940 F.2d 1317, 1323–32 (9th Cir. 1991). However, a reorganization plan under Chapter 13 is unique because it is aimed at repayment and financial rehabilitation as opposed to the liquidation focus of Chapter 7 as seen in *Reed.* The intent behind Chapter 13 is to encourage and reward the debtor's efforts to manage and repay their debts. *Harris*, 575 U.S. at 518. This allows debtors to retain the benefits of their efforts, such as increased equity in assets. Conversely, Chapter 7's primary

objective is the immediate liquidation of assets to satisfy creditors. *Harris*, 575 U.S. at 518. The appreciation of assets in a case that has always been under Chapter 7 should logically benefit the creditors, as the debtor did not engage in the same effort to manage and repay their debts. In contrast, the Debtor in this case diligently attempted debt repayment for eight months but, due to the unforeseen impact of COVID, faced circumstances beyond his control, and halted his efforts. *See* R. at 8. Moreover, this differentiation upholds the principle of equitable treatment among debtors and creditors. It recognizes the efforts and commitments of debtors who initially opt for Chapter 13 and potentially provides them with a more favorable outcome upon conversion to Chapter 7, as a form of acknowledgment for their attempt at debt resolution.

Bankruptcy laws are structured to ensure the swift and efficient resolution of a bankruptcy estate. *Katchen v. Landy*, 382 U.S. 323, 328 (1966). This approach is intended to address the debtor's financial situation within a defined period, protecting the interests of both debtors and creditors. This is reinforced by a clear and definite standard for financial evaluations, established on the date of the bankruptcy petition. *Lantz*, 446 B.R. at 858; *See also Awayda*, 574 B.R. 695 (holding that the date of a bankruptcy filing decisively determines the positions and entitlements of all parties involved—the debtor, creditors, and trustee—from that moment onwards.) In this context, Chapter 13 bankruptcy stands out for its ability to incorporate property or interest acquired after commencement into the estate. *Id.* This inclusion is in stark contrast to Chapter 7 bankruptcy, where property interests are excluded at the outset remain outside the estate, regardless of any subsequent changes in their nature. *See* 11 U.S.C. § 522. While Chapter 13 permits debtors to retain post-filing property as part of the estate under section 1306(a)(1), by adhering to a repayment plan Chapter 7 provides an end to the debtor's obligations. *In re Hawk*, 871 F.3d 287, 296 (5th Cir. 2017). Additionally, when looking at section 348(a) together with section 522, the filing date of

the Chapter 13 petition is the controlling factor. *In re Lindberg*, 735 F.2d 1087, 1089 (8th Cir. 1984).

In sum, the confirmation of a Chapter 13 plan solidifies the obligations of creditors and debtors in bankruptcy proceedings. Similarly, the confirmation of the plan establishes the values of the assets and liabilities as agreed upon by all parties. The increase in equity value is, therefore, excluded from the bankruptcy estate upon conversion to Chapter 7, as it was not within the estate when the plan was confirmed. The "snapshot" of the estate at the time the plan is confirmed is a clear demarcation of what is and is not part of the bankruptcy estate, and what can or cannot be collected and distributed by the trustee to the creditors. This interpretation serves the intended function of the Code—to provide equitable treatment and financial stability for all parties involved.

### B. A debtor's post-petition assets following a good faith transition from Chapter 13 to Chapter 7 are protected from unjust penalization for repayment efforts.

Equity increases in assets during Chapter 13, even those existing at the time of bankruptcy filing, are retained by the debtor and do not transfer to the Chapter 7 estate. Section 348 requires the equity to be acquired during Chapter 13, regardless of when the underlying asset was obtained. *In re Hodges*, 518 B.R. 445, 451 (E.D. Tenn. 2014). *Hodges* notes that section 348(f) aims to incentivize debtors to choose Chapter 13 bankruptcy by ensuring that property and equity accumulated during the Chapter 13 phase are not transferred to the Chapter 7 estate in the event of a conversion. *Id.* at 448. The Debtor's consistent payments for eight months undeniably demonstrate a commitment to debt resolution and financial rehabilitation under Chapter 13. *See* R. at 8. This should be encouraging for debtors to opt for Chapter 13, as it affirms that their efforts towards debt repayment will not be rendered futile upon conversion. *See In re Nichols*, 319 B.R. 854, 856–57 (Bankr. S.D. Ohio 2004) (holding that debtors should retain any equity accrued in assets during Chapter 13 due to plan payments, even upon converting to Chapter 7, to encourage

debtors to opt for Chapter 13 filings and ensure their efforts in repaying debts are not nullified in the conversion process).

Moreover, section 348(f)(1)(A) was written to protect debtors who initially sought relief under Chapter 13, ensuring that they are not penalized by creditor claims on post-petition property in the event of a Chapter 7 conversion. *In re Brown*, 953 F. 3d 617, 620 (9th Cir, 2020). Given the Debtor's proven track record of meeting his Chapter 13 plan obligations, equity increases in his assets during this period must be viewed as a direct result of his proactive financial management. Therefore, it is both just and congruent with the objectives of the Code to allow the Debtor to retain this increased equity post-conversion to Chapter 7.

Additionally, the Debtor's right to retain increased equity in his property is deeply rooted in the legislative intent of section 348(f). Section 348(f)(1)(B) explicitly states that collateral valuations established in Chapter 13 are carried over upon conversion to Chapter 7 with adjustments made for payments already rendered. *In re Pearson*, 214 B.R. 156, 164 (Bankr. N.D. Ohio 1997). This is to prevent disincentivizing Chapter 13 filings due to the fear of losing equity in collateral upon conversion to Chapter 7. *Id.* Property valuations and secured claims established in a Chapter 13 case are preserved upon conversion to Chapter 7. *In re Page*, 250, B.R 465, 466 (Bankr. D.N.H. 2000). Consequently, the Debtor's confirmed and uncontested valuations in the Chapter 13 plan continue to be binding in a converted Chapter 7 case. This infuses consistency and fairness into the conversion process. The Court in *In re Leon & Eliondер Harmon* clarifies that increases in equity, whether from post-petition wage payments to a secured lender or through asset appreciation, accrue to the debtor's benefit. No. 18-10579, 2022 WL 20451952, at *10 (Bankr. E.D. La. June 9, 2022). Moreover, property in the debtor's control at the time of conversion,

including post-petition assets, becomes their vested interest, remaining outside the scope of the new Chapter 7 estate, provided the conversion is in good faith. *In re Michael*, 699 F.3d 305, 313–14 (3d Cir. 2012).

Though the Ninth Circuit argues that post-petition appreciation of assets forms part of the bankruptcy estate, they seem to overlook the nuanced differences between Chapter 13 and Chapter 7 bankruptcy proceedings. *See Matter of Castleman*, 75 F.4th 1052 (9th Cir. 2023). Section 348(f) suggests that assets accrued during Chapter 13, including any increase in equity, should not transfer to the Chapter 7 estate upon conversion, which aligns with the rehabilitative purpose of Chapter 13. *See Hodges*, 518 B.R. at 451; *Pearson*, 214 B.R. at 164.

Furthermore, section 348(f)(1)(B) establishes that collateral valuations and secured claims established in Chapter 13 are retained upon conversion to Chapter 7. This provides consistency in the treatment of debtors who convert from Chapter 13 to Chapter 7, aligning their treatment with what they would have experienced had they filed a Chapter 7 case originally. The *Castleman* ruling also conflicts with the snapshot rule that sets the bankruptcy estate at the time of the original filing, which ensures the stability and predictability of bankruptcy proceedings. *See Rockwell*, 968 F.3d at 18. Thus, the appreciation of prepetition assets post-filing should benefit the Debtor, particularly because he actively engaged in his Chapter 13 repayment plan and would have continued to do so had the COVID shutdown not occurred. *See* R. at 8. The position that *Castleman* takes does not sufficiently account for the specific provisions of section 348(f) nor the overarching goals of Chapter 13 bankruptcy. Applying *Castleman*'s reasoning to the instant case undermines the Debtor's repayment efforts and the rehabilitative purpose of the Code.

The language of the Code is clear: the post-petition, pre-conversion equity increase inures to the benefit of the debtor. However, the Trustee argues that there is ambiguity as to whether the

equity increases inure to the Debtor or the estate. *See* R. at 9. When faced with ambiguity in the relevant statutes when read together, it is prudent to consult section 348(f)'s detailed legislative history, following the wisdom and insight that is often gained from exploring additional information rather than neglecting it. *Pub. Intervenor v. Mortier*, 501 U.S. 597, 610 n.4 (1991). Considering all property at the time of conversion from Chapter 13 to Chapter 7 as part of the Chapter 7 estate could discourage Chapter 13 filings, as debtors might lose equity increase in assets like their home gained during Chapter 13; the amendment counteracts this by allowing courts discretion to include such property in the estate only in cases of bad faith conversion. H.R. Rep. No. 103-835, at 57 (1994), *as reprinted in* 1994 U.S.C.C.A.N. 3340, 3366. Congress assures that a debtor who tries but fails to repay debts in Chapter 13 will not be disadvantaged for attempting a repayment plan, provided the conversion is made in good faith, by enabling the debtor to keep post-petition assets that would not have been required in an initial Chapter 7 filing. *In re Barrera*, No. BAP CO-20-003, 2020 WL 5869458, at *7 (10th Cir. BAP (Colo.) Oct. 2, 2020), *aff'd*, 22 F.4th 1217 (10th Cir. 2022).

Treating all property at the time of conversion from Chapter 13 to Chapter 7 as part of the Chapter 7 estate not only unfairly penalizes the debtor but also disrupts the balance of interests between the debtor and creditors, leading to a potential windfall for the latter. As the congressional report stated in H.R. Rep. 103-835, debtors engaging in repayment plans are not unduly penalized if they eventually convert to Chapter 7. This measure prevents the undue disadvantage to a debtor who, despite good faith efforts, fails to complete the Chapter 13 plan. *Barrera*, No. BAP CO-20-003, 2020 WL 5869458, at *7.

Moreover, the approach suggested in *Castleman* tilts the scale unfairly in favor of creditors. It enables creditors to benefit from increases in asset value resulting from the debtor's management

and payments during the Chapter 13 period. This is inherently inconsistent with Chapter 13's aim and could potentially discourage debtors from choosing to file under Chapter 13, fearing their efforts might ultimately benefit their creditors more than themselves in the event of a conversion to Chapter 7.

In sum, the interpretation that penalizes the debtor by including post-petition asset appreciation in a converted Chapter 7 estate, without considering the nature of the conversion, is not only unfair to the debtor but also creates an inequitable advantage for creditors. This interpretation strays from the protective spirit of the Code and undermines the balance between debtor and creditor rights, essential to the equitable functioning of the bankruptcy system. Therefore, there must be an assertion of the protective measures inherent in section 348(f) to uphold a balanced and fair approach that respects the Debtor's efforts and the original intent of bankruptcy proceedings.

## II. Avoidance Actions are Not Property of the Bankruptcy Estate and Cannot Be Sold by a Chapter 7 Trustee.

### A. The plain text of 11 U.S.C. § 541 unambiguously excludes avoidance powers from being considered part of the estate.

This Court has consistently asserted that when the language of a statute has a clear and straightforward interpretation, courts should adhere to it without further scrutiny and apply the regulation as written. *Textron Inc. v. Comm'r of Internal Revenue*, 336 F.3d 26, 31 (1st Cir. 2003) (collecting cases). Here, the language of section 541 is plain: avoidance actions are not property of the estate. Nonetheless, the Trustee in this case attempts to add words into the statute that are simply not there. *See Stanton Rd. Assocs. v. Lohrey Enters.*, 984 F.2d 1015, 1020 (9th Cir. 1993) (noting courts lack the power to "read into [a] statute words not explicitly inserted by Congress").

The filing of any bankruptcy petition automatically creates the bankruptcy "estate." 11 U.S.C. § 541(a). This estate encompasses all of the debtor's property and 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); *Ellis v. Westinghouse Elec. Co., LLC*, 11 F.4th 221, 227 (3d Cir. 2021). Admittedly, this Court has recognized that Congress intended section 541(a)(1) to be construed broadly. *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204–05 (1983) (citing H.R. Rep. No. 95–595, p. 367 (1977); S. Rep. No. 95–989, p. 82 (1978). However, as it relates to avoidance powers, there is no ambiguity in what section 541(a)(1)-(7) considers "property of the estate" that would necessitate a broad interpretation; the section is simply silent on Chapter 5 rights and powers. *See United States v. Thompson/Center Arms Co.*, 504 U.S. 505, 524 (1992) (White, J., dissenting) (noting that silence in a statute does not create ambiguity); *United States v. Valle*, 538 F.3d 341, 345 (5th Cir. 2008) ("A statute is ambiguous if it is susceptible to more than one reasonable interpretation or more than one accepted meaning.") (internal quotations omitted). In the absence of any such ambiguity, meaning should be derived from the text of the statute, not committee reports or legislative history. *See generally* Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 369 (2012) (discussing the unreliability of committee reports as an aid in statutory construction).

In the seven numbered paragraphs of section 541(a), Congress distinctly classified six types of property belonging to the estate. *Jess v. Carey (In re Jess)*, 215 B.R. 618, 619 (B.A.P. 9th Cir. 1997). Accordingly, the Thirteenth Circuit in this case correctly relied on section 541(a)(1)–(7)'s textual clarity and found the statute unambiguous. R. at 19. The Court adopted the plain meaning rule, R. at 21, which reasons that "unless there is some ambiguity in the language of a statute, a court's analysis must end with the statute's plain language." *Hillman v. I.R.S.*, 263 F.3d 338, 342 (4th Cir. 2001) (citing *Caminetti v. United States*, 242 U.S. 470, 485 (1917)).

The deliberate exclusion of avoidance powers within the text of section 541 is a powerful indication that Congress never intended them to be part of the bankruptcy estate. This conclusion is bolstered by the interpretive doctrine of *expressio unius exclusio alterius*, which underscores that when specific elements are expressly enumerated, the exclusion of others is implied. *Chevron U.S.A. v. Echazabal*, 536 U.S. 73, 81 (2002). *Expressio unius* is suitable when an omitted term creates a clear contrast with those expressly mentioned, thereby reinforcing a positive inference in favor of exclusion. *Chevron U.S.A. v. Echazabal*, 536 U.S. 73, 81 (2002). This doctrine has already been judiciously applied in the interpretation of various Code sections. *See, e.g.*, *Madoff v. Amaral (In re Amaral)*, 550 B.R. 1 (Bankr. D. Mass. 2016) (interpreting section 363(h)); *Burnett v. Stewart Title, Inc.*, 431 B.R. 894 (S.D. Tex. 2010) (interpreting section 525).

Examining section 541(a)(3), which designates that any property recovered by a trustee under sections 329(b), 363(n), 543, 550, 553, or 723 becomes property of the estate, it is evident that this provision does not encompass the right to avoid and recover preferential transfers. Avoidance actions are specifically detailed under sections 547, 548, and 549, but are noticeably absent from section 541—a section aptly titled "Property of the estate." *See Merit Mgmt. Grp., LP v. FTI Consulting, Inc.*, 583 U.S. 366, 380 (2018) (observing that a statute's section headings provide indications of Congress's intent).

Although various Code provisions incorporate other sections by cross-reference,[2] section 541(a) lacks any such cross-reference to sections 547 to 549. This omission strongly suggests that Congress did not intend avoidance powers to be part of the estate. Since section 541(a)(3) explicitly includes actions available to the trustee to bring into the estate, it is reasonable to conclude that the exclusion of avoidance powers was intentional and deliberate. *See D.H.S. v. MacLean*,

[2] *E.g.*, 11 U.S.C. §§ 303(b)(2), 502(d), 521(d), 749, 901(a).

574 U.S. 383, 391 (2015) ("Congress generally acts intentionally when it uses particular language in one section of a statute but omits it in another.").

### B. A debtor does not possess an interest in a Chapter 5 avoidance action at the time his bankruptcy estate commences, so the ability to avoid and recover transfers cannot be part of the estate under 11 U.S.C. § 541(a)(1).

The scope of the bankruptcy estate is confined to the property held by the debtor at the time of petition. *See* 11 U.S.C. § 541(a)(1) (defining the estate to encompass all legal or equitable interests the debtor possesses "as of the commencement of the case."). *See also Mission Prod. Holdings v. Tempnology, LLC*, 139 S. Ct. 1652, 1663 (2019) ("The estate cannot possess anything more than the debtor itself did outside bankruptcy."). Under section 541(a), prepetition causes of action are included as part of the estate. *Henry v. Abbott Labs.*, 651 F. App'x 494, 503 (6th Cir. 2016). As the court in *Pitman Farms v. ARKK Food Co., LLC (In re Simply Essentials, LLC)* acknowledged, avoidance actions are, also, causes of action. 78 F.4th 1006, 1008 (8th Cir. 2023). However, there is a split in authority as to whether avoidance powers are assets of the estate that can be sold. *Compare Cadle Co. v. Mims (In re Moore)*, 608 F.3d 253 (5th Cir. 2010) *and In re Prof'l Inv. Props.*, 955 F.2d 623, 626 (9th Cir. 1992) *with Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery (In re Cybergenics Corp.)*, 226 F.3d 237, 242 (3d Cir. 2000).

If avoidance actions are indeed considered causes of action, they are not the kinds that can be sold to creditors, nor can they be brought into the estate as property. To bring a cause of action within the estate under section 541(a)(1), the debtor must have some kind of state-based interest in the action prepetition. *See Sender v. Simon*, 84 F.3d 1299, 1305 (10th Cir. 1996) ("State law provides the guidelines for determining whether a cause of action belongs to the debtor and therefore becomes property of the estate."); *Artesanias Hacienda Real S.A. de C.V. v. N. Mill Capital, LLC (In re Wilton Armetale, Inc.)*, 968 F.3d 273, 280 (3d Cir. 2020) (observing that causes of action becomes property of the estate if the debtor could have asserted it on his own behalf

under state law); *In re Underhill*, 579 F. App'x 480, 482 (6th Cir. 2014) ("State substantive law determines the nature and extent of causes of action.") (internal quotations omitted).

Debtors do not possess interests in Chapter 5 avoidance actions because the authority to avoid and recover transfers is vested in the trustee for the benefit of creditors, not the debtor. *Hansen v. Hansen (In re Hansen)*, 332 B.R. 8, 13 (B.A.P. 10th Cir. 2005). *See also Gaudet v. Babin (In re Zedda)*, 103 F.3d 1195, 1201 (5th Cir. 1997) (observing the Code vests the trustee with avoidance powers); *Miller v. Kirkland & Ellis LLP (In re IH 1, Inc.)*, Nos. 09-10982 (LSS), 12-50713 (LSS), 2016 Bankr. LEXIS 4604, at *31 (Bankr. D. Del. Sep. 28, 2016) ("Avoidance actions are not owned by the debtor prepetition but are within the unique purview of the trustee.") (internal quotations omitted). Even a debtor-in-possession could only hold such power *in trust* for the benefit of creditors, not himself. *In re J.E. Jennings, Inc.*, 46 B.R. 167, 169 (Bankr. E.D. Pa. 1985). Any assertion that the Debtor can hold such power for himself is meritless.

Conversely, certain causes of action undeniably belong to the debtor at the start of the case. *See, e.g.*, *In re Pennysaver USA Publ'g, LLC*, 587 B.R. 43 (Bankr. D. Del. 2018) (action to collect a prepetition account); *In re Cooper*, 47 B.R. 842 (Bankr. W.D. Mo. 1985) (action by a debtor seeking an injunction); *Eastport Assocs. v. City of L.A. (In re Eastport Assocs.)*, 935 F.2d 1071 (9th Cir. 1991) (action by debtor alleging zoning legislation impacted property of the estate). Avoidance powers differ from these cases though because they are not derived from some inherent state authority to pursue in state court; rather, they are exclusively granted to trustees by the legislative actions of Congress. *See* 11 U.S.C. §§ 547, 548.

Moreover, section 544(b)(1), for example, does not empower a trustee to bring an avoidance action in state court. *Zazzali v. United States (In re DBSI, Inc.)*, 869 F.3d 1004, 1015 (9th Cir. 2017). Instead, the statute only permits the trustee to pursue a federal cause of action in

the bankruptcy court. *Id.* at 1015. Without sections 544, 547, or 548, the Trustee in this case would lack any claim altogether, given that avoidance powers are a derivative of a federal cause of action. Hence, it is irrelevant to whether the State of Moot provides the Debtor the cause of action prepetition because the matter at hand arises entirely under federal law. *Cf. Straub v. 160 Royal Palm, LLC (In re 160 Royal Palm, LLC)*, No. 22-13592, 2023 U.S. App. LEXIS 21059, at *5 (11th Cir. Aug. 14, 2023) (concluding that Florida's Offer of Judgment Statute, which awards attorney's fees in civil actions, does not apply to bankruptcy proceedings because bankruptcy proceedings governed by federal law).

In this case, the Trustee contends that avoidance powers should be considered part of the estate, relying on dicta found in *Whiting Pools*, in which Justice Blackmun reasoned that section 541(a)(1) "is intended to include in the estate any property made available to the estate by other provisions of the Bankruptcy Code." 462 U.S. at 205. Following this rationale, the Court in *Whiting Pools* directed the I.R.S. to return seized property under section 542(a), asserting that the property rightfully belonged to the estate. *Id.* at 209. The seized items included tangible personal property like mechanical equipment, vehicles, inventory, and office supplies—all of which were seized to satisfy a tax lien. *Id.* at 199–200. But therein lies the distinction between *Whiting Pools* and this case: the respondent in *Whiting Pools* had a prepetition legal interest in the seized property, while here, the Debtor lacks a prepetition legal interest in an avoidance action because, before petitioning for bankruptcy, he cannot independently use an avoidance power in either federal or state court.

The Trustee is not alone in her misplaced reliance on *Whiting Pools*. *See, e.g.*, *In re Simply Essentials, LLC*, 78 F.4th at 1008–09 (referencing *Whiting Pools*, the court found "the same logic to apply to avoidance actions" and ruled that avoidance actions are part of the estate); *In re Murray*

*Metallurgical Coal Holdings, LLC*, 623 B.R. 444, 509 (Bankr. S.D. Ohio 2021) (citing *Whiting Pools*, 462 U.S. at 204–05). However, these cases inappropriately expand Justice Blackmun's reasoning, as *Whiting Pools* merely involved the return of personal property once owned by the estate, which could have been returned through a seizure release without involving the bankruptcy court. Again, the Debtor in this case has no prepetition legal interest in avoidance actions as opposed to the interest he would have in office supplies, for example.

In sum, Chapter 5 avoidance actions do not belong to the estate before the petition is filed, nor do they belong to the Debtor. Section 541(a)(1) stipulates that the debtor's legal or equitable interests "as of" the petition filing date becomes part of the estate. However, avoidance actions only come into play when a debtor initiates his case, not before. *Myers v. Raynor (In re Raynor)*, 406 B.R. 375, 381 (B.A.P. 8th Cir. 2009). Consequently, it is incorrect to assert that the Debtor has an interest at the commencement of his case.

**1. Section 541(a)(7) does not apply to avoidance actions.**

The Trustee, alongside several recent cases,[3] incorrectly relies on section 541(a)(7) to incorporate avoidance actions into the estate. Section 541(a)(7) stipulates that property of the estate encompasses "[a]ny interest in property that the estate *acquires after* the commencement of the case. 11 U.S.C. § 541(a)(7) (emphasis added). The crux of the matter lies in the fact that avoidance powers come into existence the very moment a bankruptcy case commences, not afterward. As the Court in *Seaver v. Mortg. Elec. Registration Sys. (In re Schwartz)* observed, section 547 "create[s]" a cause of action, 383 B.R. 119, 126 (B.A.P. 8th Cir. 2008). Thus, if something is tied to the very

[3] *See, e.g.*, *In re Murray Metallurgical Coal Holdings, LLC*, 623 B.R. at 512; *In re Simply Essentials, LLC*, 640 B.R. 922, 926–27 (Bankr. N.D. Iowa 2022); *King v. Exp. Dev. Can. (In re Zetta Jet USA, Inc.)*, 644 B.R. 12, 35 (Bankr. C.D. Cal. 2022).

moment of an action, like the commencement of the estate, it cannot logically occur later. Chapter 5 causes of action simply do not fall within the scope of section 541(a)(7).

a. *Avoidance actions are rights given to the trustee by operation of law and do not qualify as an "interest in property."*

A Chapter 5 avoidance action is not an "interest in property" under section 541(a)(7). To illustrate a more fitting example of what qualifies as an "interest," consider the scenario where a trustee enters into a contract after the creation of the estate. In such instances, the estate's interest would appropriately be recognized as property of the estate under section 541(a)(7). *Accord In re Ford*, 61 B.R. 913 (Bankr. W.D. Wis. 1986) (determining proceeds from a post-commencement contract were deemed property of the estate); *Cantu v. Schmidt (In re Cantu)*, 784 F.3d 253 (5th Cir. 2015) (concluding that a Chapter 11 debtor's malpractice claim, arising after commencement but before conversion to Chapter 7, is property of the estate).

Avoidance powers, as their name implies, is a *power* given to the trustee. *See* 11 U.S.C. § 544(a) ("the trustee shall have . . . rights and powers . . . ."). Conversely, section 541(a)(7) specifically refers to "interest[s] in property." Notably, this Court has endeavored to distinguish between "powers" and "interests." *Cf. Hunt v. Rousmanier's Adm'rs*, 21 U.S. (8 Wheat.) 174, 204 (1823) (discussing the effect of the phrase "power coupled with an interest"). The stark contrast in language between sections 544 and 541 emphasizes that, according to the plain language rule, Congress did not intend for a trustee's rights and powers to be construed as property interests eligible for inclusion in the estate and subsequent sale. This stands in contrast to a Chapter 11 debtor's malpractice claim, for instance, which is recognized as property of the estate and subject to inclusion and sale. *See In re Cantu*, 784 F.3d 253.

b. *Section 541(a)(7) lacks clarity on how a debtor "acquires" avoidance actions as "interests" in property, thereby challenging their inclusion in the estate.*

Without a specific mechanism to explain how an estate acquires certain property, section 541(a)(7) cannot be used to bring that property into the estate. *In re Klein-Swanson*, 488 B.R. 628, 637 (B.A.P. 8th Cir. 2013) (finding that a Chapter 7 debtor's post-petition bonus did not qualify as property of the estate under section 541(a)(7) because the trustee could not demonstrate "how the estate acquired an interest in such funds"); *In re Vote*, 276 F.3d 1024, 1027 (8th Cir. 2002) (declining to include a farmer's post-petition compensation because the "trustee has not shown how the bankruptcy estate acquired an interest in the payments"). Along this rationale, this Court in *Segal v. Rochelle* reasoned that property acquired by a debtor after the commencement of the case should be deemed part of the estate only if it was "sufficiently rooted in the pre-bankruptcy past." *Segal v. Rochelle*, 382 U.S. 375, 380 (1966). In the present case, the only element rooted in the Debtor's pre-bankruptcy past is the preferential payment made to Pink. R. at 7. Unlike tort or contract claims, preference claims are not debtor-derived. *Knoll, Inc. v. John Zelinsky & Key Bank, N.A.*, No. 05-cv-1499 (GLS/DRH), 2008 U.S. Dist. LEXIS 133897, at *14 (N.D.N.Y. Apr. 7, 2008).

Avoidance powers simply exist as a matter of law. The Code fails to expound on how the estate would acquire avoidance powers "after the commencement of the case." *See* 11 U.S.C. § 541(a)(7). Sections 544, 547, 548, and 549, all of which relate to the power of the trustee, only specify that the trustee possesses avoidance powers and remains silent on their "acquisition" Furthermore, several circuits have consistently ruled that post-petition causes of action, that arise after the case has commenced, do not become part of the bankruptcy estate. *See, e.g.*, *Henry*, 651 F. App'x at 503–04; *Cook v. Baca*, 512 F. App'x 810, 819 (10th Cir. 2013); *In re Witko*, 374 F.3d 1040, 1042 (11th Cir. 2004). These cases reinforce the fact that avoidance actions

are not sufficiently rooted in a debtor's past to be considered part of the estate, particularly when examined in the absence of a clear delineation of how such powers are acquired post-commencement.

**2. Historical practice prohibited the sale or assignment of avoidance actions.**

Since the early 1900s, courts have consistently held that a trustee is prohibited from selling, transferring, or assigning the right to pursue a suit to avoid a preference or fraudulent transfer. *See Belding-Hall Mfg. Co. v. Mercer & Ferdon Lumber Co.*, 175 F. 335, 340 (6th Cir. 1909); *Grass v. Osborn*, 39 F.2d 461, 461 (9th Cir. 1930); *Parker v. Hand*, 299 Ill. 420, 423–24 (1921); *Webster v. Barnes Banking Co.*, 113 F.2d 1003, 1005 (10th Cir. 1940). Even if a contract were to attempt to assign avoidance power to someone other than the trustee, the court would likely deem it ineffective. *See Tex. Consumer Fin. Corp. v. First Nat'l City Bank*, 365 F. Supp. 427, 430 (S.D.N.Y. 1973) (invalidating an assignment where the plaintiff assigned to a creditor "all causes of action which [the plaintiff] may have for preferences or fraudulent transfers or conveyances"). As the court reasoned in *In re Sapolin Paints*, this prohibition exists because the power to avoid a preference should be wielded in the interest of ensuring an equitable distribution among creditors. 11 B.R. 930, 937 (Bankr. E.D.N.Y. 1981). Selling an avoidance power essentially diminishes each creditor's pro rata share. *See* 11 U.S.C. § 726(b); *Begier v. IRS*, 496 U.S. 53, 58 (1990) ("[C]reditors of equal priority should receive pro rata shares of the debtor's property."). Therefore, it remains firmly entrenched, as it has been for over a century, "well-established law that individual creditors cannot bring suits to avoid preferences on their own behalf." *McCarthy v. Navistar Fin. Corp. (In re Vogel Van & Storage)*, 210 B.R. 27, 32 (N.D.N.Y. 1997).

Under the Bankruptcy Act of 1898, Pub. L. No. 55-541, §60(b), 30 Stat. 544 (1898), Congress provided that preferences "shall be voidable by the trustee." When interpreting this language, "shall" is usually given the common meaning of "must" and is interpreted as implying

a command or mandate and is thereby not a permissive word. *United States v. Johnson*, 941 F.2d 1102, 1111 (10th Cir. 1991). Accordingly, it was well established that before the Code, only the trustee could exercise avoidance powers, excluding them from being sold, transferred, or assigned. This pre-Code practice serves as an important tool of construction in interpreting the modern Code. *See Kelly v. Robinson*, 479 U.S. 36, 44, 46, 50 (1986) (reasoning that pre-Code practice informs the court's understanding of the Code's language when a practice is "widely accepted" and "established."). *See also Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 10 (2000).

### C. <u>**The bankruptcy trustee holds exclusive authority over avoidance actions, rendering them non-transferrable to any creditor.**</u>

Chapter 5 of the Code unequivocally bestows upon the bankruptcy trustee the exclusive authority to avoid and recover prebankruptcy transfers. *See* 11 U.S.C. § 544(a); *Merit Mgmt. Grp., LP v. FTI Consulting, Inc.*, 583 U.S. 366, 370 (2018). This power, which is distinct from estate property and the focus of this appeal, cannot be transferred or assigned to a creditor or any third party. *See* 11 U.S.C. §§ 544(a), 11 U.S.C. § 547(b), 11 U.S.C. § 548(a)(1)(a), 11 U.S.C. § 549(a) (delineating avoidance powers *exclusively* to the trustee). The Trustee's misguided belief that a power, established by law, can be bartered to a creditor or non-fiduciary for the alleged "benefit of the estate" wrongly interprets avoidance actions as if they were assets of the estate. Moreover, a creditor cannot pursue a cause of action themselves because they are reserved for the trustee alone. *See* 6 *Collier on Bankruptcy* ¶ 704.07 (16th ed.) ("It is not for creditors or stockholders themselves to pursue courses of action on behalf of the estate; that is the duty of the trustee.").

Avoidance powers are merely causes of action granted to the trustee at the time of commencement—which were never available to the debtor prior to petition. Adhering to foundational principles of bankruptcy law, when a debtor lacks interest in an asset at the time of

the petition, that property does not become part of the estate. *See Chartschlaa v. Nationwide Mut. Ins. Co.*, 538 F.3d 116, 122 (2d Cir. 2008) (recognizing assets within the estate as those existing at the commencement of the case) (citing 11 U.S.C. § 541(a)).

Additionally, the language in Chapter 5 that relates to avoidance actions speaks specifically of the "trustee." *E.g.*, § 544(a) ("the trustee shall have" the "rights and powers"); § 544(b) ("the trustee may avoid any transfer"); § 547(b) ("the trustee may" avoid preferences); § 548(a)(1) ("the trustee may avoid" fraudulent transfers). In *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 3 (2000), this Court examined the language of section 506(c), which provides, in part, that "[t]he trustee may recover" expenses of preserving property in a secured claim. The court recognized the unique role of the trustee as the sole party named in the statute and reasoned that when Congress uses the word "trustee" it means the trustee and no one else. *Id.* at 3. The language of sections 544, 547, and 548 all support the same exclusivity that the court in *Hartford Underwriters* observed in section 506(c). Thus, it is clear that avoidance powers may only be exercised by the bankruptcy trustee and cannot be sold or assigned to anyone else. *See In re Bargdill*, 238 B.R. 711, 714 (Bankr. N.D. Ohio 1999); *Chapman Lumber Co. v. Chapman*, 343 B.R. 217, 220 (Bankr. N.D. Iowa 2006).

**1. The trustee is a neutral fiduciary who cannot favor one creditor over another.**

The bankruptcy trustee is entrusted with a critical role—fulfilling fiduciary duties to both the estate and its creditors, with the explicit charge of maximizing distributions. *Wisdom v. Gugino*, 649 F. App'x 583, 584 (9th Cir. 2016). Given this important role, the trustee must prioritize the best interests of *all* creditors associated with the estate. In stark contrast, a creditor does not bear any fiduciary duty towards the estate or fellow creditors. *See Germain v. Conn. Nat'l Bank*, 988

F.2d 1323, 1330 n.8 (2d Cir. 1993) ("The creditor acts in his own interest and in general owes no duty to any other party.").

Selling a preference action exclusively to one of the Debtor's creditors results in exclusive benefits for that particular creditor. This practice contradicts the trustee's responsibilities to the remainder of the estate's creditors and violates a fundamental principle of the Code: equality of distribution among creditors. *Begier*, 496 U.S. at 58. A trustee, as fiduciary of the estate, must treat all parties fairly. *Sherr v. Winkler*, 552 F.2d 1367, 1374 (10th Cir. 1977). Selling an avoidance action would be detrimental to the estate as a whole. It shrinks the pool from which other creditors could draw since the creditor acquiring the avoidance action retains any proceeds for personal gain. In essence, the trustee's duty is to the collective interest of all creditors. The trustee's failure to do so undermines the estate's other creditors.

**2. Prohibiting the sale of a Chapter 5 avoidance action does not result in absurdity.**

The Code, when plain and unambiguous, demands rigorous adherence to its provisions. *United States v. Ron Pair Enters.*, 489 U.S. 235, 241 (1989). While strict adherence may lead to harsh results, equitable considerations may not trump the clear language in the statute. *In re Hayes*, 327 B.R. 453, 460 (Bankr. C.D. Cal. 2005). *See also Gardenhire v. I.R.S. (In re Gardenhire)*, 209 F.3d 1145, 1148 (9th Cir. 2000) ("Close adherence to the text of the relevant statutory provisions and rules is especially appropriate in a highly statutory area such as bankruptcy.").

The court in *In re Simply Essentials, LLC* observed that "[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). However, this is an over-

exaggeration; the inability to sell or transfer a Chapter 5 cause of action does not create any absurdity for four reasons.

First, an inability to prosecute avoidance actions does not equate to abandonment or a supposed breach of fiduciary duty. If an avoidance action is essential to the estate's interest, the trustee can obtain financing to prosecute a cause of action. Second, the trustee can also find an attorney who is willing to work on a contingency fee basis to pursue an avoidance claim, reducing the upfront cost to the estate. *See Smart World Techs., LLC v. Juno Online Servs. (In re Smart World Techs., LLC)*, 423 F.3d 166, 180 (2d Cir. 2005) (commending the debtor for securing an attorney on a contingency basis). Third, a trustee is under no mandatory duty to pursue an avoidance action where the cost of litigation exceeds the potential recovery. *See In re Haugen Constr. Serv., Inc.*, 104 B.R. 233, 240 (Bankr. D.N.D. 1989) (noting sections 544, 547, 548, and 549 provide discretion to the trustee in pursuing an avoidance action, without mandating such action); *McCord v. Agard (In re Bean)*, 251 B.R. 196, 204 (E.D.N.Y. 2000); (suggesting that a trustee should undertake a cost-benefit analysis when determining whether the prosecution of a cause of action would result in a meaningful recovery for the estate's creditors).

Finally, the inability to sell avoidance claims would not reach absurdity because the bankruptcy court, although a court of equity, does not have unlimited powers to prevent harsh outcomes. *See Law*, 571 U.S. at 421 ("We have long held that whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.") (internal quotations omitted); *Sunbeam Prods. v. Chi. Am. Mfg., LLC*, 686 F.3d 372, 375 (7th Cir. 2012) ("What the Bankruptcy Code provides, a judge cannot override by declaring that enforcement would be 'inequitable.'"). The bankruptcy court cannot assign a Chapter 5 avoidance

action simply because the trustee lacks the means for which to prosecute it. This violates the powers that Congress intended for the trustee to possess exclusively.

While the Code exclusively grants these powers to the trustee, limited circumstances have seen courts permit creditors derivative standing to pursue a debtor's cause of action. *See Commodore Int'l v. Gould (in Re Commodore Int'l Ltd.)*, 262 F.3d 96, 100 (2d Cir. 2001) (outlining rules where a creditor's committee may attain standing to pursue a debtor's claim). *See also Official Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery*, 330 F.3d 548, 560 (3d Cir. 2003) (developing a different set of rules for derivative standing); 5 *Collier on Bankruptcy* ¶ 544.07 (16th ed.) (listing entities other than the trustee that can assert section 544 powers). Yet, such instances should be assessed on their specific facts. *See, e.g.*, *Avalanche Mar., Ltd. v. Parekh (In re Parmetex, Inc.)*, 199 F.3d 1029, 1031 (9th Cir. 1999) (permitting a Creditor to pursue an avoidance action under Chapter 7 because "the trustee stipulated that the Creditors could sue on his behalf"); *Glinka v. Fed. Plastics Mfg. (In re Housecraft Indus. USA, Inc.)*, 310 F.3d 64, 71 (2d Cir. 2002) (granting standing to a secured creditor was merely "assisting [the trustee] with the litigation").

A broad rule granting derivative standing to every creditor in a bankruptcy proceeding, where a trustee does not pursue an avoidance action, would undermine the trustee's integral role in bankruptcy. In both *Parekh* and *Glinka*, the courts recognized the trustee's role and only permitted standing because the trustee approved it by written instrument. This Court should resist letting creditors assume the trustee's role, as their interests and duties fundamentally differ.

## CONCLUSION

For these reasons, this Court should affirm the decision of the United States Court of Appeals for the Thirteenth Circuit.

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