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 PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE THIRTEENTH CIRCUIT

BRIEF FOR THE PETITIONER

Counsel for Petitioner

QUESTIONS PRESENTED

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

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

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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 Petitioner, Chapter 7 Trustee Vera Lynn Floyd (the "Trustee"), attempted to perform her statutory duties under the Bankruptcy Code (the "Code")[1] by liquidating property of the estate to maximize creditor distribution. R. at 9-10. The Trustee's diligent efforts, however, were quickly and improperly stymied by the Respondent, Corporal Eugene Clegg (the "Debtor") to the detriment of the estate. R. at 4.

The bankruptcy court prevented the Trustee from selling the Debtor's assets despite the Trustee's good faith and compliance with Chapter 7. R. at 4. After the Debtor chose to convert his case to one under Chapter 7, the Trustee began marketing the Debtor's property and filed a motion to sell (the "Sale Motion"), seeking the bankruptcy court's permission to liquidate property of the estate "consistent with the Trustee's duty" under the Code. R. at 9. Upon objection from the Debtor, the bankruptcy court denied the Sale Motion and prohibited the sale from moving forward, preventing the Trustee from performing her statutory obligations. R. at 10.

Factual Background

Shortly after his retirement in 2011, the Debtor received 100% interest in a movie theatre, Final Cut LLC ("Final Cut"), from his mother Emily Clegg. R. at 5. The Debtor caused Final Cut to borrow $850,000 (the "Priority Loan") from Eclipse Credit Union ("Eclipse"). R. at 5. In addition to the Debtor granting first priority liens on Final Cut's real and personal property, the Debtor also executed an unconditional personal guaranty on the Priority Loan, indicating the Debtor's legal intent to repay Eclipse in full. *Id.* The Debtor used the Priority Loan to renovate Final Cut's theatre and build the business' brand. *Id.* But the Debtor also used Eclipse's loan to

[1] The Bankruptcy Code is set forth in 11 U.S.C. §§ 101 *et seq.* Specific sections of the Bankruptcy Code are identified herein as "section__" or "§__."

fulfill a personal, non-business-related desire to donate the remaining $75,000 without notice or consent from Eclipse. *Id.*

Six months into the COVID-19 pandemic, the Debtor took out an additional loan of $50,000 from his mother. R. at 5. Even with this loan, the Debtor fell behind on his credit card and home mortgage obligations owed to Another Brick in the Wall Financial Corporation (the "Servicer"). *Id.* Despite the Debtor's failure to pay the Servicer, the Debtor chose to pay his mother $20,000, or forty percent of his mother's loan, before any other creditor received payment. R. at 6-7.

The Chapter 13 Case

The Debtor filed for Chapter 13 bankruptcy on December 8, 2021 (the "Petition Date"). R. at 6. Attempting to save his $350,000 home, the Debtor claimed the maximum State of Moot homestead exemption of $30,000 after identifying a $320,000 non-contingent, liquidated, and undisputed secured debt owed to the Servicer. R. at 6-7. Given the Servicer's secured claim and the Debtor's homestead exemption, the Debtor maintained no equity in his home as of the Petition Date. R. at 7. On Schedules E/F and H, the Debtor included his unsecured, guaranteed debt to Eclipse. R. at 6. In his Statement of Financial Affairs, the Debtor included the $20,000 preference payment to his mother. R. at 7.

The Debtor, Chapter 13 trustee, and other parties in interest initially believed that Final Cut would be profitable enough to fund the Debtor's plan. *Id.* During the § 341 meeting, however, tension between the Debtor and Eclipse reached a climax. R. at 7. First, Eclipse learned of the Debtor's $75,000 personal donation and promptly commenced an adversary proceeding seeking to declare its Priority Loan non-dischargeable. R. at 7-8. Shortly thereafter, both Eclipse and the trustee objected to the Debtor's Chapter 13 plan. R. at 7. Eclipse argued that the Debtor proposed

the plan in bad faith, while the trustee argued that the Debtor's preference payment to his mother would pay some creditors less than they would receive in a hypothetical Chapter 7 case. R. at 7-8.

The Debtor tried to ameliorate the tension with makeshift amendments that increased plan payments by $20,000, and recognized an estimated claim of $150,000 owed to Eclipse with $25,000 non-dischargeable even in the event of a conversion. R. at 7-8. The bankruptcy court confirmed the Chapter 13 plan with these amendments on February 12, 2022. R. at 8.

The Debtor's Decision to Convert the Case from Chapter 13 to Chapter 7

Unfortunately, the Debtor quickly became delinquent on his plan payments and Eclipse commenced foreclosure proceedings against Final Cut. R. at 8. This left the Debtor with two options: (1) dismiss the bankruptcy case, or (2) convert the bankruptcy case to one under Chapter 7. R. at 9. The Debtor made the decision to convert the case to Chapter 7, and the Petitioner was appointed as the Chapter 7 Trustee. *Id.*

The Trustee swiftly and diligently began to strategize how to liquidate the Debtor's estate which was "bereft of assets." R. at 9. Recognizing the nationwide increase in property value, the Trustee commissioned an appraisal of the Debtor's property which discovered that the Debtor's home value increased by $100,000. *Id.* The Trustee marketed the newly valued property and entertained offers for other estate assets. *Id.*

Eclipse offered the Trustee $470,000 for the Debtor's home and preference action against the Debtor's mother. R. at 9. This transaction would pay creditors *one hundred cents on the dollar*. The Trustee promptly filed the Sale Motion with the bankruptcy court to capitalize on Eclipse's unparalleled offer. *Id.*

Procedural Posture

The Debtor, however, objected to the Sale Motion, arguing that: (1) any post-petition, pre-conversion increase in the equity of the Debtor's home should inure to the Debtor's benefit, and (2) the Trustee cannot sell the preference action against the Debtor's mother. R. at 10. On the first issue, the Debtor argued that since the house had no equity available for the estate as of the Petition Date, the Trustee could not sell the home. *Id.* On the second issue, the Debtor asserted that the Trustee's "statutory ability" to avoid and recover a preference cannot be sold. *Id.*

The Bankruptcy Court for the District of Moot agreed with the Debtor on both objections and denied the Sale Motion. R. at 4. The Trustee timely appealed to the Thirteenth Circuit which affirmed the bankruptcy court's decision over the dissent of Judge Barrett. R. at 24, 35. This Court granted certiorari on both issues. R. at 2.

STANDARD OF REVIEW

Since the issues before this Court are based on statutory interpretation of the Code, the standard of review is *de novo*. *Texas v. Soileau (In re Soileau)*, 488 F.3d 302, 305 (5th Cir. 2007). For *de novo* review, this Court affords no deference to the lower court decision and must treat this issue "anew." *Salve Regina College v. Russel*, 499 U.S. 225, 238 (1991).

SUMMARY OF THE ARGUMENT

This Court should reverse the decision of the Thirteenth Circuit because (1) post-petition, pre-conversion appreciation of a home's value inures to the estate, and (2) preference actions are property of the estate that may be sold to maximize the estate's value.

The Extensive Scope of Property of the Estate

Congress intended for the Code to provide an expansive definition of "property of the estate," which includes all conceivable interests that a debtor holds at the initiation of a bankruptcy

proceeding. This broad scope of property of the estate transcends both issues presented before this Court, and bankruptcy jurisprudence has consistently upheld Congress' broad meaning.

Congress drafted property of the estate broadly to create a comprehensive pool of assets to satisfy creditors' claims. Since the Code's issuance, numerous courts have placed several tangible and intangible assets in the purview of property of the estate because property of the estate is not static: as bankruptcy jurisprudence continues to progress, novel assets, interests, and legal arguments continue to further Congress' intention to provide a non-exhaustive, comprehensive definition of property of the estate.

The expansive nature of property of the estate is an indispensable tool in bankruptcy. Both post-petition, pre-conversion appreciation in a debtor's home and preference actions should fall within the expansive definition of property of the estate. Thus, the Chapter 7 Trustee should be permitted to sell both the Debtor's home and the relevant preference action to benefit the creditors of the estate. Accordingly, this Court should reverse the Thirteenth Circuit's decision and respect the years of bankruptcy jurisprudence that reinforces a broad definition of property of the estate.

Post-petition, Pre-conversion Appreciation in the Debtor's Home Inures to the Benefit of the Estate

Upon conversion from Chapter 13 to Chapter 7, a debtor's home remains property of the estate, and any post-petition, pre-conversion appreciation is considered part of the bankruptcy estate under §§ 541(a) and 348(f)(1)(A). Additionally, § 541(b) details property Congress expressly wished to *exclude* from the broad definition of property of the estate—post-petition, pre-conversion home appreciation is notably not included in § 541(b). Congress' silence in § 541(b) is instructive, thus any change in market value that results in appreciation of a debtor's home should benefit the estate and is not a newly acquired asset belonging to the debtor.

After the Debtor made the choice to convert, the provisions of Chapter 7 controlled his case. This chapter dictates that all the Debtor's non-exempt assets will be liquidated in exchange for a discharge of the Debtor's personal liabilities. Congress intended for the Debtor to relinquish all non-exempt assets, including any post-petition, pre-conversion equity in his home, to pay creditors. Both the Eighth Circuit Bankruptcy Appellate Panel and the Ninth Circuit Court of Appeals take this position, and this Court should follow suit.

A Trustee Is Empowered to Sell a Preference Action To Maximize Estate Value

The Code likewise emphasized the broad power granted to a Chapter 7 trustee to expeditiously close and maximize the value of the estate. Numerous courts have aligned themselves with Congress' broad grant of power to a Chapter 7 trustee, which includes allowing a trustee to sell preference actions. This Court should affirm the holdings of an overwhelming majority of lower courts that hold that a trustee may sell a preference action to maximize estate value.

Preference actions fall within the broad definition of property of the estate which a trustee may sell to fulfill their duties under 11 U.S.C. § 704. Lower courts have employed numerous Code provisions to bolster Congress' intent to capture preference actions as property of the estate, including: § 541(a)(1), (3), (4), (6), and (7). These lower courts reason that the trustee's ability to sell a preference action promotes the dual purpose of Chapter 7: to provide relief to debtors and to maximize creditor distribution. Additionally, lower courts reference this Court's precedent and the Code's legislative history to conclude that evolving bankruptcy jurisprudence aligns itself with Congress' intent to include preference actions as property of the estate.

The sale of a preference action may benefit the estate more than prosecution of the action itself would. Thus, a trustee may sell such a preference action upon the bankruptcy court's final approval to ensure the sale is fair and reasonable.

The Thirteenth Circuit did not rule on whether the Trustee's sale of the preference action to Eclipse was fair and reasonable—rather, the bankruptcy court ruled that the Trustee had no power to sell the preference. Notably, Eclipse offered one hundred cents on the dollar for the preference action. The Trustee's sale of the preference action to Eclipse would be more prompt than the prosecution of it would be, thus expediting the close of the bankruptcy case. Additionally, the Trustee's sale would maximize the estate's value because fewer administrative expenses would be required to sell a preference in comparison to prosecuting the preference.

Thus, this Court should adopt the reasoning employed by a majority of the lower courts, which holds that preference actions are property of the estate that may be sold to maximize creditor distribution.

ARGUMENT

I. STATUTORY ANALYSIS OF THE CODE REQUIRES THAT POST-PETITION, PRE-CONVERSION APPRECIATION IN THE DEBTOR'S HOME INURES TO THE BENEFIT OF THE CHAPTER 7 BANKRUPTCY ESTATE.

This Court's jurisprudence has been steadfast in its instruction to lower courts to "prefer the plain meaning since that approach respects the words of Congress . . . [and] avoid the pitfalls that plague too quick a turn to the more controversial realm of legislative history," *Lamie v. United States Tr.*, 540 U.S. 526, 536 (2004); *see also Ratzlaf v. United States*, 510 U.S. 135, 147-48 (1994) ("[W]e do not resort to legislative history to cloud a statutory text that is clear."). The "sole function of the courts," *Lamie*, 540 U.S. at 534, is to enforce statutes according to their terms "where the disposition required by the text is not absurd." *Id.*

The disposition required by the Code provisions that govern conversions and property of the estate is not absurd. The plain language of §§ 348 and 541, particularly when read in conjunction with one another, is clear. In *Lamie*, this Court refused to read additional context into the relevant Code provision because the disposition required was not absurd. *Lamie*, 540 U.S. at 528 ("With a plain, non-absurd meaning in view, this Court will not read 'attorney' in § 330(a)(1)(A) . . . in effect enlarging the statute's scope.").

Here, an analysis of the plain language of the relevant Code provisions dictates that any post-petition, pre-conversion appreciation in the value of the Debtor's home inures to the benefit of the Chapter 7 estate. Due to the lack of any absurdity in the disposition required by the relevant provisions, only an analysis of the statutory language is required. After all, this Court's "unwillingness to soften the import of Congress' chosen words . . . is longstanding. It results from 'deference to the supremacy of the Legislature, as well as recognition that Congressmen typically vote on the language of a bill.'" *Lamie*, 540 U.S. at 538 (quoting *United States v. Locke*, 471 U.S. 84, 95 (1985)).

A. Sections 541 and 348 Provide that The Debtor's Home is Property of the Estate in a Chapter 7 Case that has Been Converted from Chapter 13.

As Judge Barrett stated in her dissenting opinion, "proper analysis of this issue begins and ends with the statutory text." R. at 24. Upon conversion of a case from Chapter 13 to Chapter 7, § 348 is instructive in determining property of the Chapter 7 estate. 11 U.S.C. § 348. Specifically, § 348(f)(1)(A) states that "property of the estate in the converted case shall consist of property of the estate, as of the date of the filing of the petition, that remains in possession of or is under the control of the debtor on the date of conversion." 11 U.S.C. § 348(f)(1)(A). While the plain language of § 348(f)(1)(A) alone is arguably enough to conclude that any post-petition, pre-conversion appreciation in the property value of a debtor's home inures to the benefit of the

bankruptcy estate, the argument is only bolstered by an overwhelming body of case law that broadly interprets § 541. *See infra* Section II.A.

Although Congress did not define "property of the estate" in § 348, it amended § 348(f) in 1994 to build on the existing slate of § 541. 11 U.S.C. § 541; *see Dewsnup v. Timm*, 502 U.S. 410, 419 (1992) ("[W]hen Congress amends the bankruptcy laws, it does not write 'on a clean slate.'"). Section 541 functions to both outline the parameters of what is included in property of the estate, § 541(a), as well as expressly identify assets Congress intended to be excluded from property of the estate. § 541(b).

Courts have consistently interpreted § 541(a) "to include all of the debtor's assets, both legal and equitable, . . . limited only by subsections (b) and (c)." *Potter v. Drewes (In re Potter)*, 228 B.R. 422, 423-24 (B.A.P. 8th Cir. 1999) (citing *United States v. Whiting Pools, Inc*., 462 U.S. 198, 204-05 (1983)). This broad interpretation reflects the purpose of the statute, which is to "aggregate to the greatest extent possible, albeit with some exception, every stitch of property belonging to a debtor so that it can be used to pay claims." *In re Adams*, 641 B.R. 147, 151 (Bankr. W.D. Mich. 2022).

When considering the effect of §§ 541 and 348 on a case converted from Chapter 13 to Chapter 7, the court in *In re Lang* stated that, "[T]he Chapter 7 trustee may treat an asset as property of the estate if it satisfies two conditions. First, it must have been property of the estate as of the date of filing. Second, it must remain in the debtor's possession or control on the date of conversion." 437 B.R. 70, 72 (Bankr. W.D.N.Y. 2010).

Further, it bears worth noting that a debtor's decision to claim a state law homestead exemption does not remove, or exempt, the property itself from the bankruptcy estate. *See Schwab v. Reilly*, 560 U.S. 770, 782 (2010) (defining exempt property "as the debtor's interest—up to a

specified dollar amount—in the assets described . . . *not* as the assets themselves."). Thus, when the Debtor claimed the applicable state law homestead exemption in his Chapter 13 case, his home was not removed or exempted from the bankruptcy estate. After all, a debtor's right to use his or her homestead exemption "comes into play . . . only if and when the trustee attempts to sell the property." *In re Hyman*, 967 F.2d 1316, 1321 (9th Cir. 1992).

Here, the Debtor's home was unequivocally property of the estate as of the date of filing. § 541(a). There is no dispute that the home was property of the estate when the Debtor filed his Chapter 13 petition on December 8, 2021. During the pendency of the Debtor's Chapter 13 case, he remained in possession of his home and was still in control when he voluntarily converted his case to Chapter 7 in late 2022.

i. There is No Distinction Between Post-Petition Appreciation in the Debtor's Home and the Value of the Home Itself.

Section 541 makes express note, in § 541(a)(6)-(7), of assets that comprise property of the estate. The former states that any "proceeds, product, offspring, rents, or profits of or from property of the estate, except such are as earnings from services performed by an individual debtor after the commencement of the case." 11 U.S.C. § 541(a)(6). The latter includes "any interest in property that the estate acquires after the commencement of the case." 11 U.S.C. § 541(a)(7). At least one bankruptcy court has held that the post-petition appreciation in a debtor's home was not separate, after-acquired property and, therefore, found cases applying 541(a)(6) applicable. *In re Goins*, 539 B.R. 510, 516 (Bankr. E.D. Va. 2015); *In re Castleman*, 631 B.R. 914, 920 (Bankr. W.D. Wash. 2021), *aff'd*, No. 2:21-CV-00829-JHC, 2022 WL 2392058 (W.D. Wash. July 1, 2022), *aff'd*, *Castleman v. Burman (In re Castleman)*, 75 F.4th 1052 (9th Cir. 2023).

Finding that post-petition appreciation in the value of property inures to the benefit of the Chapter 7 trustee upon conversion, the court in *In re Potter* grounded its reasoning in the text of §

541: "Nothing in Section 541 suggests that the estate's interest is anything less than the entire asset, including any changes in its value which might occur after the date of filing." *Potter*, 228 B.R. at 423-24. Further, the Eighth Circuit concluded that any appreciation in the value of the property does not fall within the purview of any of the exceptions listed in § 541. *Id.* at 424.

In 2022, another bankruptcy court considered the impact of post-petition appreciation and stated:

> [T]he right to benefit from the appreciation of one's property is among the most valuable 'sticks' in the 'bundle of sticks.' The value of the real estate is a consequence of market forces, the condition of the property, and its location – it is not itself an interest in the property. Instead, . . . the interests in the property determine how we allocate that value. . . . Under § 541(a)(1) and subject to § 541(a)(6), the [t]rustee holds the appreciation 'stick.'

In re Adams, 641 B.R. 147, 152 (Bankr. W.D. Mich. 2022). Thus, any post-petition appreciation in the Debtor's property is simply a characteristic, or facet, of already existing property of the estate and, therefore, able to be sold for the benefit of the creditors. Although Congress specifically excludes any after-acquired property from the bankruptcy estate, there is no authority in the Code to support that a change in market value—whether it is appreciation or depreciation—is a newly acquired asset belonging to the Debtor.

ii. Had Congress Intended to Exclude Appreciation (or Depreciation) From the Bankruptcy Estate, It Could Have Done So. Its Silence Is Instructive.

In § 541(b)(1)-(10), Congress describes ten different assets—in significant detail—that are to be excluded from the bankruptcy estate. 11 U.S.C. § 541(b). Some examples include, "[A]ny power that the debtor may exercise solely for the benefit of an entity other than the debtor," 11 U.S.C. § 541(b)(1), "[F]unds placed in an education individual retirement account not later than 365 days before the date of the filing of the petition," 11 U.S.C. § 541(b)(5), and "any interest in cash or cash equivalents that constitute proceeds of a sale by the debtor of a money order." 11

U.S.C. § 541(b)(8). Not one of the ten exclusions stated in the Code references post-petition, pre-conversion appreciation (or depreciation) of a debtor's homestead as a separate asset, let alone one that should be excluded from the bankruptcy estate.

Reading additional exemptions into the Code that are not expressly enumerated by Congress is a slippery slope to judicial activism. Further, the Debtor's attempt here to exclude the appreciation on his home from his Chapter 7 bankruptcy estate fails to consider the implications of an unfavorable market on a debtor's home in a converted case. The Ninth Circuit found this logic persuasive and stated:

> Were we to accept the [debtor's] argument that they're entitled to post-filing appreciation, we would also have to hold that a debtor is subject to post-filing *de*preciation, which would give *debtors in falling property markets* less than the [homestead exemption amount] guaranteed them by state law. Nothing in the bankruptcy law compels, or even suggests, such a drastic interference with the operation of the state homestead exemption statute. In fact, our case law strongly suggests the opposite result.

Hyman, 967 F.2d at 1321 (second emphasis added).

Fluctuation is inherent in the real estate market and is something Congress could have accounted for in drafting the exclusions enumerated within § 541(b). However, its decision not to do so should be instructive for the aforementioned reasons. If Congress intends to exclude equity resulting from post-petition appreciation on the Debtor's home, it may of course do so through the legislative process. But, it is not within this Court's province to do so.

B. CASES CONVERTED TO CHAPTER 7 ARE GOVERNED BY CHAPTER 7 PROVISIONS AS OF THE DATE OF CONVERSION.

In *Harris v. Viegelhahn*, this Court was unequivocal in its conclusion that "when a debtor exercises his statutory right to convert, the case is placed under Chapter 7's governance, and no Chapter 13 provision holds sway." 575 U.S. 510, 520 (2015). Thus, the Thirteenth Circuit's attempt to use Chapter 13 provisions in what is now a Chapter 7 case is respectfully unpersuasive.

See 11 U.S.C. § 103(j) ("Chapter 13 of this title applies only in a case under such chapter."); 11 U.S.C. § 103(b) ("Subchapters I and II of Chapter 7 of this title apply only in a case under such chapter."); *see also In re Montilla*, No. 22BK02585, 2022 WL 12165276, at *2 (Bankr. N.D. Ill. Oct. 12, 2022) (stating that upon conversion, "[T]he debtor then proceeds with a chapter 7 estate administered by a chapter 7 trustee, as if a chapter 13 case had never been filed.").

Here, the Debtor chose to convert his case from Chapter 13 to Chapter 7, albeit due to a series of unfortunate events. It is important to note that this was not the only option available to the Debtor. He could have also opted to dismiss his Chapter 13 case when he was no longer able to make payments under his Chapter 13 plan. *See* 11 U.S.C. § 1307(b) ("On request of the debtor at any time . . . the court shall dismiss a case under this chapter."). Of course, doing so would lift the automatic stay and permit his creditors to seek to collect any debts still owed. To avoid this,[2] the Debtor opted to convert his case to Chapter 7, and because of that decision he must contend with the provisions that govern Chapter 7 as they come.

A Chapter 7 debtor seeks a discharge of any personal liability he or she has on most debts, and a financial fresh start. *See* 11 U.S.C. §§ 524, 727. However, in Chapter 7, the discharge comes at a steep cost—liquidation of a debtor's non-exempt assets. *See* 11 U.S.C. § 726. This is the new bargain the Debtor struck in exchange for the extension of the automatic stay, and the hope of obtaining a discharge. In *Adams*, the bankruptcy court acknowledged the import of this new covenant upon conversion:

> [T]his is the deal that chapter 7 debtors strike with their creditors (and the risk they accept) in exchange for getting relief from their debts, as the [d]ebtors did last year when they voluntarily converted their case to chapter 7, rather than dismissing it. Indeed, they already have the benefit of the discharge and have lived in the [home] after the conversion date.

[2] There are no facts to indicate that this was in fact the reason for the Debtor's decision to convert. However, this is the most likely reason a debtor would choose to convert a case from Chapter 13 to Chapter 7.

Adams, 641 B.R. at 154-55.

There is no debate that outside of bankruptcy, the Debtor "as the owner of the fee simple interest in the property, would be entitled to any appreciation in its value." *Id.* at 152. After all, "[T]he right to benefit from the appreciation of one's property is among the most valuable 'sticks' in the 'bundle of sticks.'" *Id.* However, the Debtor's decision to convert his case to Chapter 7, rather than dismiss it, placed him squarely inside the confines of Chapter 7 of the Code, forcing him to play by the new rules.

If the Debtor had instead dismissed his Chapter 13 case, he could have sold his home and used of the proceeds of the sale, including any appreciation value, to pay the debt still owed to his creditors (and has the option to negotiate with the Servicer outside of bankruptcy[3]). Notably, $25,000 of the debt owed to Eclipse is non-dischargeable pursuant to the settlement, R. at 8, so the Debtor is responsible for this amount regardless of whether he obtains a discharge in his Chapter 7 case.

However, opting for the Chapter 7 route left all non-exempt assets to the Chapter 7 Trustee to sell for the benefit of the Debtor's creditors, including the Debtor's home. *See Adams*, 641 B.R. at 153 ("In the current market environment, where property values are generally increasing, debtors are at risk of having to surrender their homes to chapter 7 bankruptcy trustees who, charged with the statutory duty to reduce the property of the estate to money, may seek to sell a debtor's home.").

Here, the Debtor seeks to reap the protections of Chapter 7 without incurring all the risk inherent to the Chapter. Ensuring that the Debtor's home—which was property of the estate as of

[3] There is, of course, no guarantee that the Servicer would negotiate with the Debtor outside of bankruptcy, but the Debtor paid down $10,000 in the first eight months of his Chapter 13 plan, and the additional $100,000 in value may have produced a small equity cushion for the Servicer. These facts could support a productive negotiation between the Debtor and the Servicer upon dismissal of his Chapter 13 case.

the date of conversion—remains property of the Chapter 7 estate, inclusive of any market changes affecting the valuation of the home, maintains the "deal that Chapter 7 debtors strike with their creditors." *Adams*, 641 B.R. at 154.

C. THIS COURT SHOULD ADOPT THE SOUND REASONING OF THE EIGHTH CIRCUIT BANKRUPTCY APPELLATE PANEL IN *GOETZ* AND THE NINTH CIRCUIT IN *CASTLEMAN*.

Both the Bankruptcy Appellate Panel for the Eighth Circuit and the Ninth Circuit Court of Appeals have dealt with very similar facts. *See Goetz v. Weber (In re Goetz)*, 651 B.R. 292, 295 (B.A.P. 8th Cir. 2023); *Castleman v. Burman (In re Castleman)*, 75 F.4th 1052, 1054 (9th Cir. 2023). In both cases, these courts held that post-petition, pre-conversion appreciation inured to the benefit of the bankruptcy estate. This Court should find the reasoning of the Eighth Circuit Bankruptcy Appellate Panel and the Ninth Circuit Court of Appeals persuasive for two reasons.

First, the *Goetz* and *Castleman* courts identify and apply the relevant Code provisions to the facts, with a focus on the plain language of the statutes. Second, the reasoning of both opinions comports with a number of underlying bankruptcy principles—principles that would be upended if this Court were to affirm the decision of the Thirteenth Circuit.

In *Goetz*, the debtor filed for Chapter 13 in 2020 and properly claimed her homestead exemption pursuant to state law, like the Debtor in the case at bar. *Goetz*, 651 B.R. at 295. The relevant parties agreed that upon the filing of the debtor's Chapter 13 petition, there was no equity in the home. *Id.* The home subsequently vested with the debtor upon confirmation of her Chapter 13 plan. *Id.* Almost two years later, the debtor in *Goetz* moved to convert her case from Chapter 13 to Chapter 7. *Id.* At the time of conversion, the debtor's residence had increased in value by $75,000, which would "result in more than $62,000 in proceeds after satisfying the mortgage lien and paying the . . . homestead exemption and costs of sale." *Id.* The bankruptcy court held that the increase in equity was property of the Chapter 7 bankruptcy estate. The debtor appealed, seeking

a reversal of the bankruptcy court's opinion. On appeal, the Bankruptcy Appellate Panel affirmed the decision of the bankruptcy court. *Id.* at 302.

Castleman tells a similar story to *Goetz* and the case at bar. Debtors filed for Chapter 13 bankruptcy in 2019 and claimed their homestead exemption, after which there would be no equity in the home. *Castleman*, 75 F.4th at 1054. After about twenty months, the debtors were unable to make payments on their confirmed Chapter 13 plan and opted to convert their case to Chapter 7. Between the petition date and the conversion date, the value of debtors' home had appreciated by approximately $200,000. *Id.* When the Chapter 7 trustee sought to sell the debtors' home, the debtors objected, arguing that the appreciation should inure to their benefit. The bankruptcy court disagreed, finding that the appreciation inured to the benefit of the Chapter 7 estate. *Castleman*, 631 B.R. at 920. Unsurprisingly, debtors appealed and on appeal, the Ninth Circuit affirmed the bankruptcy court's decision. *Castleman*, 75 F.4th at 1058.

Both courts engage in statutory analysis of §§ 541 and 348 as a threshold matter, acknowledging that the crux of the issue is whether the debtor's home—and thus any appreciation in value—is property of the Chapter 7 estate. *Castleman*, 75 F.4th at 1056; *Goetz*, 651 B.R. at 296. Both courts acknowledge the broad scope of § 541(a), with a focus on the specific inclusions of "proceeds, product, offspring, rents, or profits of or from property of the estate" and "any interest in property that the estate acquired after the commencement of the case," in § 541(a)(6)-(7). *Castleman*, 75 F.4th at 1056-57; *Goetz*, 651 B.R. at 296.

The *Castleman* and *Goetz* courts also address the role of § 348 in determining property of the estate in a converted case. The courts acknowledge that § 348 does not specify whether post-petition, pre-conversion appreciation is property of the estate or property of the debtor. However, when read in conjunction with § 541, which defines the "property of the estate" referenced in §

348(f)(1)(A), they concluded that "nothing in Section 541 suggests that the estate's interest is anything less than the entire asset, including any changes in its value which might occur after the date of filing." *Goetz*, 651 B.R. at 298 (quoting *Potter*, 228 B.R. at 424); *Castleman*, 75 F.4th at 1058.

Both courts importantly find that, due to statutory analysis of the relevant Code provisions and a lack of any specific instruction regarding appreciation by Congress, "[A]ppreciation is not a distinct asset but rather a characteristic or attribute of property subsumed within a particular asset." *Goetz*, 651 B.R. at 297. Further, they both dismiss any need to delve into legislative history,[4] detecting no ambiguity in the statutory provisions that control property of the estate in a bankruptcy case converted from Chapter 13 to Chapter 7. *Goetz*, 651 B.R. at 298-99; *Castleman*, 75 F.4th at 1057 ("[B]ecause we conclude the language of § 348(f), when read in conjunction with the remainder of the Bankruptcy Code, is not ambiguous, we do not look to legislative history for guidance.").

In holding that post-petition, pre-conversion appreciation in the debtor's home inured to the benefit of the Chapter 7 estate, the reasoning employed by the *Castleman* and *Goetz* courts comports with a myriad of other basic bankruptcy principles.

One of the principles underlying the issue in *Goetz* and the case at bar is the concept of the state law homestead exemption. The Missouri state law homestead exemption the debtor claimed in *Goetz* permits the debtors to exempt "a house, appurtenances, and land not exceeding the value of fifteen thousand dollars." *See* Mo. Rev. Stat. § 513.475(1). As the court explained, this homestead exemption permitted the debtor to "remove from the estate only a portion of the value

[4] The *Goetz* court suggests that the underlying legislative history would not even amount to a different result. *Goetz*, 651 B.R. at 299 ("Section 348(f) does not specify that debtors are entitled to retain equity resulting from payment during the Chapter 13 case – the scenario referenced in the House Report.").

of the homestead—equity in the maximum sum of $15,000. It is not an in-kind exemption . . . [allowing a debtor] to remove the dwelling house and appurtenances, and the land in its entirety." *Goetz*, 651 B.R. at 301. The Missouri homestead exemption in *Goetz* authorized an exemption up to $15,000, indicating that the remaining value of the home—regardless of the numeric amount—is non-exempt. Thus, a finding that any post-petition, pre-conversion appreciation on a debtor's home inures to the benefit of the estate comports with the underlying concept of a homestead exemption. If Congress or state legislatures intended to provide for an expansion of the homestead exemption in cases of post-petition appreciation, they could have done so. Without more, the federal and state law homestead exemptions are instructive.

The *Castleman* court grounds its reasoning in the overarching policy differences between Chapter 13 and Chapter 7, citing to this Court's summary of the differences between the two in *Harris*:

> Chapter 7 allows a debtor to make a clean break from his financial past, but at a steep price: prompt liquidation of the debtor's assets. . . . [A] chapter 7 debtor must forfeit virtually all his prepetition property. . . . Chapter 13 works differently. . . . Debtors are allowed to retain their assets, commonly their home or car. And creditors, . . . usually collect more under a Chapter 13 plan than they would have received under a Chapter 7 liquidation.

Harris, 575 U.S. at 513-14. The holding in *Castleman* harmonizes these important policy differences between the two chapters. A debtor in Chapter 13 is generally permitted to retain their assets in exchange for repayment of debts over a three-to-five-year period. A debtor who converts their case to Chapter 7, however, pays a "steeper price," now unburdened by the necessity to turn over almost all their disposable income to creditors. This "steeper price" is the prompt liquidation of non-exempt assets. Thus, a finding that any post-petition, pre-conversion appreciation in a debtor's home inures to the benefit of the Chapter 7 estate to benefit creditors comports with these crucial policy differences underlying these two chapters.

For all the foregoing reasons, this Court should reverse the Thirteenth Circuit, and find that the post-petition, pre-conversion appreciation on the Debtor's home inures to the benefit of the Chapter 7 bankruptcy estate and the Debtor's creditors.

II. THE CODE PROVISIONS ALLOW THE TRUSTEE TO SELL A PREFERENCE ACTION TO MAXIMIZE THE BANKRUPTCY ESTATE'S VALUE.

To preserve a Chapter 7 trustee's fiduciary duty to maximize estate value, this Court should allow trustees to sell preference actions. *See Butner v. United States*, 440 U.S. 48, 55 (1979). The second issue asks whether this Court should limit a trustee's ability to maximize the value of the estate when acting in good faith. The threshold determination of whether a trustee acted in good faith or in the best interest of the estate rests with the bankruptcy court, *see In re Dalen*, 259 B.R. 586, 609-10 (Bankr. W.D. Mich. 2001), and § 363 gives the bankruptcy court discretion in deciding whether a sale will benefit the estate. *See* 11 U.S.C. § 363(b), (c), (e). This Court should neither inhibit a trustee's ability to maximize estate value nor disregard the importance of a bankruptcy judges' discretion. *See id.* Preference actions are property of the estate that a trustee may sell to fulfill their duties under § 704. 11 U.S.C. § 704. In some contexts, the sale of a preference action may benefit the estate more than the prosecution of it will because the sale gives a trustee the opportunity to minimize administrative expenses. Affirming the Thirteenth Circuit would inadvertently stymie a trustee's efforts to maximize estate value.

Accordingly, this Court should allow a trustee to sell a preference action to benefit the estate and its creditors.

A. The Chapter 7 Trustee Wields Broad Discretion When Commissioning Property of the Estate.

Selling a preference action furthers the dual-purpose of Chapter 7: to provide relief to an aggrieved debtor and to maximize creditor distribution. *See Bartenwerfer v. Buckley*, 598 U.S. 69,

73-74 (2023); *Taggart v. Lorenzen*, 139 S. Ct. 1795, 1800 (2019). Chapter 7 grants a debtor an opportunity to obtain a "fresh start" via a discharge injunction. *Bartenwerfer*, 598 U.S. at 73-74. A debtor may receive this discharge in exchange for allowing a Chapter 7 trustee to liquidate their non-exempt assets. 11 U.S.C. § 727(a)(1); *Czyzewski v. Jevic Holding Corp.*, 580 U.S. 451, 455-56 (2017). In satisfying their end of the quid pro quo arrangement, a Chapter 7 trustee's paramount duty is to maximize the value of the estate and the amount paid to creditors. 11 U.S.C. § 704(a)(1) ("The trustee shall . . . collect and reduce to money the property of the estate . . . and close such estate as expeditiously as is compatible with the best interests of parties in interest."); *see also* William L. Norton III & Hon. William L. Norton, Jr., *Norton Bankr. L. & Prac. Dict. of Bankr. Terms* §§ C50, C330 (3d ed. 2023) (describing creditors as typical parties in interest in Chapter 7 cases).

A preference payment is a pre-petition transfer by a debtor to a creditor that increases the creditor's recovery compared to similarly situated creditors. 11 U.S.C. § 547; Norton & Norton, *supra*, § P70. A pre-petition transfer is presumed a preference when a debtor transfers an interest in property: (1) for the benefit of a creditor; (2) who holds an antecedent debt; (3) while the debtor was insolvent; (4) within ninety days before filing the case, or one year for a transfer to an insider (like the Debtor's mother here); that would (5) enable the creditor to receive more than they would have if (A) the case were under Chapter 7, (B) the transfer had not been made, and (C) the creditor received the payment of such debt to the extent provided by the provisions of this title. 11 U.S.C. § 547(b); Norton & Norton, *supra*, § P70. Only if these elements are satisfied may a trustee avoid the pre-petition transfer as a preference, § 547(b), and the parties here do not dispute that the $20,000 pre-petition transfer to the Debtor's mother was a preferential payment. R. at 10 n. 11

("The Debtor raised a purely legal issue as to whether the preference action is property of the estate that can be sold by the Trustee.").

Property of the estate is comprised of a debtor's interest in property, including all legal and equitable interests. 11 U.S.C. § 541(a)(1); Norton & Norton, *supra*, § P160. Congress intended for "property of the estate" to broadly encompass all types of property, such as tangible, intangible, causes of action, and even novel interests of first impression. *See, e.g.*, 11 U.S.C. § 541; *Segal v. Rochelle*, 382 U.S. 375, 379 (1966); *In re Kane*, 628 F.3d 631, 637 (3d Cir. 2010); *Pension Transfer Corp. v. Beneficiaries under the Third Amendment to Fruehauf Trailer Corp. Retirement Plan No. 003* (*In re Fruehauf Trailer Corp.)*, 444 F.3d 203, 211 (3d Cir. 2006); Norton & Norton, *supra*, § P160.

Marshalling property of the estate is a duty that *may* be satisfied by a trustee. *See, e.g.*, 11 U.S.C. § 550(a) ("the trustee *may* recover, for the benefit of the estate, the property transferred") (emphasis added); § 541(a)(3) ("interest in property that the trustee recovers under section . . . 550"). However, this duty is not *exclusive* to the trustee. *See, e.g.*, 11 U.S.C. § 554(a) ("the trustee *may* abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate") (emphasis added); § 542(a) ("an *entity* . . . in possession, custody, or control, . . . of property that the trustee may use, sell, or lease . . . shall deliver to the trustee, and account for, such property") (emphasis added).

Conversely, § 704 enumerates the *exclusive* duties of the Chapter 7 trustee. § 704(a) ("The trustee *shall*") (emphasis added). This provision includes numerous mandates when investigating and liquidating a debtor's assets, such as "collect[ing] and reduc[ing] to money the property of the estate for which such trustee serves, and clos[ing] such estate as expeditiously as is compatible with the best interests of parties in interest." § 704(a)(1).

Congress intended to grant the Chapter 7 trustee wide latitude when performing their duties. *See, e.g.*, § 704(a)(1); *United States v. Sims (In re Feiler)*, 218 F.3d 948, 952 (9th Cir. 2000) (describing the trustee's duties in the context of avoidance powers); *Yadkin Valley Bank & Trust Co. v. McGee* (*In re Hutchinson)*, 5 F.3d 750, 753-54 (4th Cir. 1993) ("In order to close an estate expeditiously, a bankruptcy trustee must expeditiously perform each task necessary to close the estate, including the liquidation of the estate."); *Riverside-Linden Inv. Co. v. Crake (In re Riverside-Linden Inv. Co.)*, 925 F.2d 320, 322 (9th Cir. 1991) ("The bankruptcy court described the trustee's duty to expeditiously close the estate as his 'main' duty . . . . This is a general proposition that seems beyond reproach[.]"). And the language of § 704(a)(1) is both expressly and implicitly mandated by other Code provisions and the Federal Rules of Bankruptcy Procedure. *See, e.g.*, Fed. R. Bankr. P. 1001 (providing that the rules shall be construed to secure the just, speedy, and inexpensive determination of every case).

Given the broad and permissive language used by Congress, this Court should not restrict a trustee from maximizing the value of the estate through a blanket prohibition on selling preference actions like the one here.

B. SECTIONS 541 AND 363 PROVIDE THAT A PREFERENCE ACTION IS PROPERTY OF THE ESTATE THAT SHOULD BE SOLD TO MAXIMIZE THE VALUE OF THE ESTATE.

A Chapter 7 trustee may only sell "property of the estate" under 11 U.S.C. § 363, and since preference actions fall under the broad definition of property of the estate, § 541(a), a trustee may sell a preference action to benefit the estate. § 363.

The sale of property of the estate outside the ordinary course of a debtor's business is subject to court approval after notice and hearing. 11 U.S.C. § 363(b)(1); *In re Scimeca Found., Inc.*, 497 B.R. 753, 771 (Bankr. E.D. Pa. 2013); *Prime Lending II, LLC v. Buerge (In re Buerge)*, No. BAP KS-12-074, 2014 WL 1309694, at *9 (B.A.P. 10th Cir. Apr. 2, 2014). A bankruptcy

court will approve a motion to sell if a trustee demonstrates sound business judgment, meaning "the purchase price is fair and reasonable and the sale process has been conducted in good faith by the trustee and by the prospective purchaser." *Scimeca*, 497 B.R. at 771 (citing *In re Abbotts Dairies of Pennsylvania, Inc.*, 788 F.2d 143, 149-50 (3d Cir. 1986)). Here, likely because the sale would result in creditors receiving one hundred cents on the dollar and there are no facts to support bad faith, the Trustee's fairness, reasonability, and good faith while transacting with Eclipse is not at issue. R. at 10 n.11. If the facts were different here, and bad faith was suggested, the bankruptcy court may not have approved the sale—the Trustee's ability to sell a preference action is not unfettered. § 363 ("The trustee, after notice and a hearing, may . . . sell . . . property of the estate"); § 704(a)(1) ("The trustee shall . . . collect and reduce to money the property of the estate.").

i. The Lower Courts Do Not Require Much Guidance—An Overwhelming Majority of Courts Already Hold That Avoidance Actions are Property of the Estate.

Only the Thirteenth Circuit affirmatively holds that a preference action is not property of the estate, relying on the Third Circuit's *Cybergenics* ruling that declined to entertain a property of the estate analysis. *Floyd v. Clegg (In re Clegg)*, No. 22-0359, at 18 (13th Cir. Mar. 10, 2023); *Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery (In re Cybergenics Corp.)*, 226 F.3d 237, 246 (3d Cir. 2000).

An overwhelming majority of courts hold that a preference action is property of the estate that may be sold by a trustee, *see infra* Section II.B.ii, but some circuit courts also permit the sale of avoidance actions without determining whether they are property of the estate. *See, e.g.*, *Mellon Bank N.A. v. Dick Corp.*, 351 F.3d 290 (7th Cir. 2003); *Duckor Spradling & Metzger v. Baum Trust (In re P.R.T.C., Inc.)*, 177 F.3d 774 (9th Cir. 1999); *Professional Inv. Properties v. Kent (In re Professional Inv. Properties)*, 955 F.2d 623 (9th Cir. 1992).

Like the Third Circuit, the Seventh and Ninth Circuits failed to analyze whether a preference action is property of the estate, but *Cybergenics* reasoned that, "Issues relating to property of the estate are simply not relevant to the inquiry into whether the fraudulent transfer claims in the Committee's complaint were assets of Cybergenics as debtor or debtor in possession." *Cybergenics*, 226 F.3d at 246. Therein lies *Cybergenics*' greatest flaw.

The *Cybergenics* court's unwillingness to analyze the threshold question—whether a preference action is property of the estate—renders its decision unpersuasive, even according to the Third Circuit itself. *See Artesanias Hacienda Real S.A. de C.V. v. North Mill Capital, LLC (In re Wilton Armetale, Inc.)*, 968 F.3d 273, 285 (3d Cir. 2020) ("*Cybergenics* does not hold that trustees cannot transfer causes of action. It leaves that question open because the asset transfer at issue did not reach the creditors' claims.").

In a footnote, however, the *Cybergenics* court assumed, *arguendo*, that "an analysis of property of the estate was necessary" to determine whether the trustee there could sell a fraudulent transfer action. *Id.* at 246 n. 16. The court defined the issue as one focused on the "cause of action to avoid the transfer, not on any sort of 'equitable interest' that some courts have said may be retained by a debtor," which presented an issue "not before [the court] in th[at] case[.]" *Id.* The court also cited to the leading *Collier on Bankruptcy* treatise to support their claim that avoidance powers are not property of the estate. *Id.*; *see also* Lawrence P. King, *Collier on Bankruptcy* ¶ 541.14 n.1 (15th rev. ed. 1999).

Importantly, the theory employed by *Cybergenics* has since been outdated according to *Collier on Bankruptcy* itself, and no longer appears in ¶ 541.14 n. 1. *Compare* King, *supra*, ¶ 541.14 n.1 ("avoiding powers are not property of the estate, but, rather, statutorily created powers to recover property") *with* Richard Levin & Henry J. Sommer, *Collier on Bankruptcy* ¶ 541.12[4]

(16th ed. 2023) ("Because the statute only references proceeds . . . there was a conflict regarding whether a trustee's avoiding powers are property of the estate . . . . [*Cybergenics* held] to the contrary . . . [but the Third Circuit] subsequently opined that the *Cybergenics* left the question open."). *See Armetale*, 968 F.3d at 285.

Indeed, the most recent version of *Collier on Bankruptcy* now asserts, "More recent cases have held that avoiding power actions are property of the estate and can be sold." Levin & Sommer, *supra*, ¶ 541.12[4]. Since 2020, the Third Circuit has not endorsed its own *Cybergenics* ruling. *Armetale*, 968 F.3d at 285. Other circuits have expanded their reasoning to hold that avoidance actions are property of the estate under either § 541(a)(1), (3), (4), (6), or (7). Levin & Sommer, *supra*, ¶ 541.12[4].

ii. Several Analyses Support the Majority's Position That a Avoidance Actions Are Property of the Estate.

Section 541(a)(7) includes "[a]ny interest in property that the estate acquires after the commencement of the case." 11 U.S.C. § 541(a)(7). This Court in *Segal v. Rochelle* stated the term "property" should be "construed most generously and an interest is not outside its reach because it is novel or contingent or because enjoyment must be postponed." 382 U.S. 375, 379 (1966). While *Segal* predates the Code, courts have recognized that Congress adopted the *Segal* definition of property to broadly capture diverse legal and equitable interests. *Potter v. Drewes (In re Potter)*, 228 B.R. 422 (B.A.P. 8th Cir. 1999); *Barowsky v. Serelson (In re Barowsky)*, 946 F.2d 1516, 1518 (10th Cir. 1991); *Matter of Yonikus*, 996 F.2d 866, 869 (7th Cir. 1993) (citing *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204-05 (1983)).

This broad interpretation of "property," established by this Court and later adopted by Congress, has led numerous lower courts to correctly hold that avoidance actions are property of the estate under § 541(a)(7). *See, e.g.*, *Goldstein v. Stahl (In re Goldstein)*, 526 B.R. 13, 21 (9th

Cir. B.A.P. 2015); *Nelson v. Ramette (In re Nelson)*, 274 B.R. 789 (B.A.P. 8th Cir. 2002), *aff'd*, 322 F.3d 541 (8th Cir. 2003) (quoting *Whetzal v. Alderson*, 32 F.3d 1302, 1303 (8th Cir. 1994)); *King v. Exp. Dev. Can. (In re Zetta Jet USA, Inc.)*, 644 B.R. 12, 35 (Bankr. C.D. Cal. 2022); *In re Simply Essentials, LLC*, 640 B.R. 922, 927 (Bankr. N.D. Ia. 2022); *In re Murray Metallurgical Coal Holdings, LLC*, 623 B.R. 444, 512 (Bankr. S.D. Ohio 2021); *Maloof v. BT Commer. Corp.*, No. 1:07 CV 1902, 2008 WL 650325, at *4 (N.D. Ohio Mar. 5, 2008); *Smith v. Morris R. Greenhaw Oil & Gas, Inc. (In re Greenhaw Energy, Inc.)*, 359 B.R. 636, 642 (Bankr. S.D. Tex. 2007); *In re Robotic Vision Sys., Inc.*, 343 B.R. 393, 398 (Bankr. D.N.H. 2006); *Gonzales v. United States (In re Silver)*, 302 B.R. 720, 725 (Bankr. D.N.M. 2003); *Polvay v. B.O. Acquisitions (In re Betty Owens Sch.)*, No. 96 CIV. 3576 (PKL), 1997 WL 188127, at *2 (S.D.N.Y. Apr. 17, 1997).

Similarly, § 541(a)(1) includes "all legal or equitable interests of the debtor in property as of the commencement of the case," § 541(a)(1), which encompasses Chapter 5 causes of action like preference actions. *See, e.g.*, *Granfinanciera v. Nordberg*, 492 U.S. 33, 49 n. 7 (1989); *Parker v. Goodman (In re Parker)*, 499 F.3d 616, 624 (6th Cir. 2007); *In re Smith*, 640 F.2d 888, 892 (7th Cir. 1981). Additionally, this Court in *United States v. Whiting Pools* interpreted the language of "interests of the debtor" and "as of the commencement of the case" to include "any property made available to the estate by any other provision of the [] Code" including "property in which the debtor did not have a possessory interest" at the commencement of the bankruptcy proceeding. 462 U.S. at 203, 205 (holding that property seized by the IRS constituted property of the estate); 11 U.S.C. § 541(a)(1).

Using this reasoning, lower courts have held that avoidance actions are property of the estate. *See, e.g.*, *Cadle Co. v. Mims (In re Moore)*, 608 F.3d 253, 262 (5th Cir. 2010); *Morley v. Ontos, Inc. (In re Ontos, Inc.)*, 478 F.3d 427, 431 (1st Cir. 2007); *see also Murray*, 623 B.R. at

510. Alternatively, courts have used both § 541(a)(3) and (4) to reach the same conclusion. Under § 541(a)(3), property of the estate includes "[a]ny interest in property that the trustee recovers under section . . . 550," which reads, "[T]o the extent that a transfer is avoided under section . . . 547 . . . , the trustee may recover, for the benefit of the estate, the property transferred[.]" 11 U.S.C. §§ 541(a)(3), 550(a). In addition, § 541(a)(4) further includes "[a]ny interest in property preserved for the benefit of or ordered transferred to the estate under section . . . 551[,]" which reads, "Any transfer avoided under section . . . 547 . . . is preserved for the benefit of the estate but only with respect to property of the estate." 11 U.S.C. §§ 541(a)(4), 551. This Court in *United States v. Nordic Village* construed a "postpetition transfer under § 550" as a "claim . . . [which] is property of the estate." 503 U.S. 30, 37 (1992) (internal citations and quotations omitted).[5] Thus, *Nordic Village* describes "the right to recover a postpetition transfer," or the postpetition avoidance action itself, as property of the estate. *Id.* Sections 541(a)(3) and (4) also address "interests arising from avoided transfers" which demonstrate carefully described Congressional intent to include avoidance actions in the definition of property of the estate. Brendan Gage, *Is There a Statutory Basis For Selling Avoidance Actions?*, 22 J. Bankr. L. & Prac. Section II.A.3 (2013).

Lastly, § 541(a)(6) includes "[p]roceeds . . . of or from property of the estate" which includes avoidance actions according to the broad language defining "proceeds" in the legislative history. 11 U.S.C. § 541(a)(6); Gage, *supra*, Section II.A.3; S. Rep. No. 95-989, 95th Cong., 2d Sess. 83 (1978) ("Proceeds here is not used in a confining sense . . . but is intended to be a broad term to encompass all proceeds of property of the estate.").

[5] Notably, this Court's construction of post-petition transfers as claims under § 550 is still good law; only the discussion regarding sovereign immunity was superseded by the Bankruptcy Reform Act of 1994, codified in § 106(a)(1). *See, e.g.*, Pub. L. No. 103-394, 108 Stat. 4106; 11 U.S.C. § 106(a)(1); *Miller v. United States*, 71 F.4th 1247, 1253 (10th Cir. 2023).

Here, under any analysis above, this Court should find the Debtor's preference payment to be property of the estate which the Trustee has a statutory duty to sell for the benefit of the estate. The bankruptcy estate was created as soon as the petition was filed, which also created a right to any preference payments made to the Debtor's mother within one year of the filing. Additionally, even before the commencement of the case, the value of the transfer is subject to this preferential return as soon as the petition is filed. Thus, employing either § 541(a)(1) or (7) and this Court's rulings in *Segal*, *Granfinanciera*, *Whiting Pools* and their progeny, a preference action becomes property of the estate.

Even if this Court defined the preference action as a "claim" under § 550, this Court's *Nordic Village* ruling would trigger the dual § 541(a)(3) and (4) analysis. Alternatively, any proceeds derived from prosecuting the preference action under § 550, in combination with Congress' broad definition of proceeds, would cover preference actions as property of the estate under the § 541(a)(6) analysis. Accordingly, this Court's holdings in *Segal*, *Nordic Village*, and *Whiting Pools*, combined with recent trends in bankruptcy proceedings and an overwhelming majority of lower court holdings, provides this Court a persuasive foundation to assert that a preference action is property of the estate.

C. REFERENCE TO SECTIONS 363 AND 550 ESTABLISH THAT THE SALE OF A PREFERENCE ACTION MAY BENEFIT THE ESTATE MORE THAN THE TRUSTEE'S PROSECUTION OF A PREFERENCE ACTION.

A trustee may prosecute a preference action only when the prosecution's effect will benefit the estate. 11 U.S.C. § 550. Similarly, a trustee may sell property of the estate only when the sale would benefit the estate and the bankruptcy court approves it. § 363. While a trustee's sale of a preference action may concurrently benefit the purchaser, the purchaser's consideration for the sale will always benefit the estate when the administrative expense of prosecuting and reclaiming

the value exceeds the purchase price of the preference. And considering both the bankruptcy court's final approval of a sale and a trustee's duty to maximize estate value, a preference can seldom benefit only the purchaser and not the estate. Thus, if the Trustee's sale of the preference action would benefit the estate more than the Trustee prosecuting the preference action herself, the Trustee must be permitted to sell that preference action to maximize estate value. § 704(a).

The preliminary power to prosecute a preference action is certainly reserved to a trustee. 11 U.S.C. § 547(b). A creditor looking to prosecute a preference action must, therefore, establish standing. *See, e.g.*, *Hartford Underwriters Ins. Co. v. Union Planters Bank*, 530 U.S. 1, 9-11, 13 n.5 (2000). This Court has held that the Code authorizes other parties to bring such actions in certain circumstances. *See id.* This Court in *Hartford Underwriters* narrowly construed the statutory language of "the trustee may" in § 506(c) to mean exclusive to the trustee. *Id.* at 11-13. But both *Hartford Underwriters* and lower courts have recognized instances where a creditor or other party in interest may prosecute a preference or other avoidance action. *See id.* at 1, 9-11, 13 n.5; *see also In re Cybergenics*, 330 F.3d 548, 555-59 (3d Cir. 2003); *Commodore Int'l Ltd. v. Gould (In re Commodore Int'l Ltd.)*, 262 F.3d 96, 99 (2d Cir. 2001); *Hyundai Translead, Inc. v. Jackson Truck & Trailer Repair, Inc. (In re Trailer Source, Inc.)*, 555 F3d 231, 244-45 (6th Cir. 2009). *But see United Phosphorus, Ltd. v. Fox (In re Fox)*, 305 B.R. 912, 914-15 (B.A.P. 10th Cir. 2004) (concluding *Hartford Underwriters* decision mandates that the concept of derivative standing should be rejected).[6]

Lower court decisions that permit creditors to prosecute an avoidance action rest on *Hartford Underwriters*' detailed exceptions wherein a creditor may assume the role of a trustee:

[6] According to *Collier on Bankruptcy*, *Fox* has been characterized as a "tiny minority" opinion. Levin & Sommer, *supra*, ¶ 547.11[6] n. 53 (citing *In re Roman Catholic Church of the Archdiocese of Santa Fe*, 621 B.R. 502, 506-07 (Bankr. D.N.M. 2020); *Issa v. Royal Metal Indus. (In re X-Treme Bullets, Inc.)*, 642 B.R. 312, 329 (D. Nev. 2022)).

(1) demonstration of pre-Code practice, *Hartford Underwriters*, 530 U.S. at 9-10; (2) derivative standing, *id.* at 13 n.5; and (3) consent of the trustee and bankruptcy court. *Id.*; 11 U.S.C. §§ 547, 550 (detailing that "the trustee may" take the respective action). These exceptions are read together with a Chapter 7 trustee's duty to maximize estate value—a duty so important that some courts even describe other clauses of § 704(a) as "merely directory as to what the trustee shall do" when maximizing the value of the property of the estate. Levin & Sommer, *supra*, ¶ 704.02. Hence, no matter how narrowly one may interpret §§ 547 and 550, this Court has recognized that Congress intended for a trustee to determine whether these secondary duties may be delegated to maximize the estate's value. *See id.*

The Trustee does not assert that any pre-Code practice allows for preference actions to be sold and prosecuted by a purchaser. *See* Gage, *supra*, Sections I.B, III.A.1. Additionally, the Trustee does not assert that derivative standing is appropriate here because cases analyzing derivative standing have held it is appropriate only when a trustee is "either unwilling or unable to bring the action." Levin & Sommer, *supra*, ¶ 547.11[6]; *see also Nangle v. Lauer (In re Lauer)*, 98 F.3d 378, 388 (8th Cir. 1996); *Canadian Pac. Forest Prods. v. J.D. Irving, Ltd. (In re Gibson Group, Inc.)*, 66 F.3d 1436, 1446 (6th Cir. 1995); *Official Unsecured Creditors Committee of Suffola, Inc. v. U.S. National Bank (In re Suffola, Inc.)*, 2 F.3d 977, 979 n.1 (9th Cir. 1993); *Unsecured Creditors' Comm. v. Noyes (In re STN Enters., Inc.)*, 779 F.2d 901, 904 (2d Cir. 1985). Here, the facts demonstrate that the Trustee is willing to sell the preference action—it is the Debtor who objects. R. at 10. Both the Trustee and Eclipse negotiated a deal and sought to execute the sale before the bankruptcy court. *Id.* There are no facts to support that the Trustee was "unwilling or unable" to prosecute the preference action. *Lauer*, 98 F.3d at 388.

Hence, the third *Hartford Underwriters* exception is triggered because the Sale Motion exhibits the Trustee's consent for Eclipse to prosecute the preference, *id.*, and to fully satisfy this exception, the bankruptcy court must consent to the sale. Gage, *supra*, Section III.A.1; *see generally* 11 U.S.C. § 363 (detailing the bankruptcy court's role in the sale of property of the estate as one which ensures benefit to the estate).

The sale here benefits the estate under the language of the statute and the underlying policy of Chapter 7 proceedings. The upfront cash payment to the estate is one benefit derived from the sale. *See, e.g.*, *Mellon Bank, N.A. v. Dick Corp. (In re Qualitech)*, 351 F.3d 290, 292-93 (7th Cir. 2003). As *Mellon* and other courts recognize, a benefit to the estate can occur even if the benefit is indirect, such as savings in administrative expenses. *Id.* (holding that a sale of preference actions was the best course of action to benefit the estate during bankruptcy); *see also Kipperman v. Onex Corp.*, 411 B.R. 805, 877 (N.D. Ga. 2009) ("*Mellon* makes clear that an ex ante benefit is all that section 550 requires"); *Mt. McKinley Ins. Co. v. Lac D'Amiante Du Quebec Ltee (In re ASARCO LLC)*, 513 B.R. 499, 506 (S.D. Tex. 2012) ("the potential to recover funds from preference recipients was put to use for the estate's benefit") (quoting *Mellon*, 351 F.3d at 293); *Tronox Inc. v. Anadarko Petroleum Corp. (In re Tronox Inc.)*, 464 B.R. 606, 614 (Bankr. S.D.N.Y. 2012) ("the benefit from an avoidance action can come from an assignment of a cause of action prior to the litigation's resolution, and need not be obtained at the time of recovery"); *In re Murray Metallurgical Coal Holdings*, LLC, 623 B.R. 444, 515 (Bankr. S.D. Ohio 2021) ("[l]est [its] way of resolving the issue be taken to assume that § 550(a) requires that some benefit flow to unsecured creditors, we add that the statute does not say this") (quoting *Mellon*, 351 F.3d at 293).

Here, the Debtor raised no objection to the fairness and reasonability of the sale, likely because any objection is implausible considering Eclipse has agreed to pay one hundred cents on

the dollar, in cash, for the value of the preference. *See* R. at 9. So, not only will the estate recognize the entire preference value of $20,000 immediately, but the Trustee procured the preference value with negligible administrative expense. A reduction in administrative expenses is an indirect benefit permissible under the *Mellon* progeny, which is sufficient to satisfy the Code's mandate for any sale to benefit the estate. § 550(a). Simply put, there are no grounds for a bankruptcy court to find the sale unfair or unreasonable. *See* 11 U.S.C. § 363(b), (c), (e).

The sale to Eclipse allows the Trustee to perform her paramount duty—maximizing the estate's value—while other Code provisions actively shield the Debtor from the harms of bad faith sales, improperly limiting the role of the Trustee, and the appearance of impropriety between the Trustee, Eclipse, and the bankruptcy court. *See* Gage, *supra*, Section IV.A-E (discussing concerns of allowing preference sales).

The requirement for a bankruptcy court to approve a sale prior to its execution squarely addresses bad faith attempts. Most bankruptcy courts require a trustee's consent as a preliminary condition for its approval, and even if a trustee consents, the court is free to deny the sale upon a finding that the buyer or the trustee acted in bad faith. *See In re Metro. Elec. Mfg. Co.*, 295 B.R. 7, 13-14 (Bankr. E.D.N.Y. 2003). Moreover, this dual-approval limitation does not inhibit a trustee's role or make it superfluous: if a trustee's consent is subject to the bankruptcy court's oversight of whether the sale would benefit the estate, the trustee continues to perform a foundational role. *Cadle Co. v. Mims (In re Moore)*, 608 F.3d 253, 265 n.24 (5th Cir. 2010). In fact, any reason in support or against a sale is irrelevant so long as the sale price maximizes the estate's value. *Id.* ("Concerns about why [the creditor] is willing to pay what it is willing to pay are irrelevant to the analysis, the proper focus of which is maximization of the estate's assets.").

Lastly, concerns of impropriety are inconsequential due to the two Code protections above: if part of the trustee's fiduciary duty is to maximize the estate's value, *actual* impropriety occurs only when a trustee prefers a low-bidding creditor over a high-bidding creditor. *In re Boynewicz*, No. 02-30250, 2002 WL 33951315, at *3 (Bankr. D. Conn. Nov. 27, 2002). This is especially true when the "creditor-buyer holds nearly all of the claims against the estate and makes the highest offer for the avoidance actions." *Id.* ("a significant criterion to evaluate whether a proposed assignment to a single creditor benefits the estate involves considering whether the assignment might result in an inequitable distribution among the remaining creditors."); *In re Greenberg*, 266 B.R. 45, 50-51 (Bankr. E.D.N.Y. 2001) (noting the potential for impropriety is negligible since the assignee-creditor held 99% of the claims and offered a significant amount of money for the assignment); Gage, *supra*, Section IV.D.

Similar to *Boynewicz* and *Greenberg*, since Eclipse is the only secured creditor here, there is little potential for impropriety. Even if the Trustee tried to force the sale in bad faith, the bankruptcy court would likely deny the Sale Motion; and if the bankruptcy court erroneously approved the sale, their judgment is always subject to review on appeal. The safeguards within the Code are responsive to the Thirteenth Circuit's concerns regarding bad faith and impropriety in these kinds of sales. A strict prohibition on a trustee selling a preference action would not mitigate these fears—it would only disservice the bankruptcy system and cause unneeded restraint.

For all the foregoing reasons, this Court should reverse the Thirteenth Circuit, and find that a preference action is property of the estate that may be sold by the Chapter 7 Trustee.

CONCLUSION

We respectfully request that this Court reverse the Thirteenth Circuit's decision and remand this case to the District Court to allow the Sale Motion to proceed, with instructions to (I) establish that post-petition, pre-conversion appreciation in the Debtor's home inures to the benefit of the estate, and (II) allow the trustee to sell the preference action against the Debtor's mother to maximize the value of the estate.

Respectfully Submitted,
/s/ Team 21
Counsel for Petitioner