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 OF PETITIONER

TEAM #23,
Counsel for Petitioner.

January 18, 2024

ISSUES PRESENTED

1. Under 11 U.S.C. § 348, does a post-petition, pre-conversion increase in equity in the Debtor's property inure to the benefit of the bankruptcy estate upon conversion of a case from chapter 13 to chapter 7 under the broad definition of "property of the estate" as included in 11 U.S.C. § 541?
2. Under 11 U.S.C. §§ 363 and 704, which require the trustee to reduce the property of estate to money and authorize the trustee to sell such property subject to court approval, does a chapter 7 trustee's ability to avoid and recover transfer payments pursuant to 11 U.S.C. §§ 547 and 550 constitute property of the estate within the broad definition of "property of the estate" as included in 11 U.S.C. § 541?

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JURISDICTIONAL STATEMENT

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

STATEMENT OF THE CASE

Eugene Clegg (the "Debtor") holds a 100% membership interest in The Final Cut, LLC (the "Final Cut"), an entity that owns and operates a movie theater. R. at 5. To pay for renovations to the movie theater, the Debtor borrowed $850,000 (the "Loan") from the Eclipse Credit Union (the "Credit Union"). *Id.* To secure the debt, the Credit Union was granted first priority liens on the movie theater and the Debtor executed an unsecured personal guaranty in an unlimited amount. *Id.* After completion of the work, the Debtor had not used the entirety of the Loan. *Id.* He decided to give away the remaining proceeds of the Loan—approximately $75,000—without informing the Credit Union. *Id.*

Because the movie theater struggled during the COVID-19 pandemic, the Debtor decided to borrow $50,000 from his mother, Emily "Pink" Clegg, on an unsecured basis. *Id.* at 6. After the movie theater reopened, attendance did not return to its pre-pandemic levels. *Id.* As a result, the Debtor did not take his salary from the movie theater and subsequently incurred significant credit card debt, falling behind on his mortgage payments to Another Brick in the Wall Financial Corporation (the "Servicer"). *Id.* The Servicer initiated foreclosure proceedings. *Id.* The Debtor petitioned for relief under chapter 13 of the Bankruptcy Code on December 8, 2021 (the "Petition Date"). *Id.*; *see* 11 U.S.C. §§ 1321–1330. At the time of the Petition, Debtor's home was valued at $350,0000. *Id.* On Schedule C, the Debtor claimed a state law homestead exemption for $30,000. *Id.* In his Statement of Financial Affairs, the Debtor noted that he had made payments to Ms. Clegg in the amount of $20,000 in the year prior to the Petition. *Id.* at 7.

Under his chapter 13 plan, the Debtor proposed to make monthly payments to the Servicer through a chapter 13 trustee over the course of three years. *Id.* at 7; *see* 11 U.S.C. §§ 1322(b)(5), 1326(c). One provision of the plan noted that the Debtor maintained no equity in his

home as of the Petition Date. R. at 7. At the meeting of creditors, the Credit Union learned about the $75,000 the Debtor has given away. *Id.* The Credit Union was expectedly upset, and promptly and timely initiated an adversary proceeding to have the Loan declared non-dischargeable pursuant to 11 U.S.C. § 523(a)(2)(A). *Id.*; s*ee* 11 U.S.C. § 523(a)(2)(A). In addition, the chapter 13 trustee objected to the Debtor's plan under 11 U.S.C. § 1325(a)(4) for failing to provide each creditor with no less than it would receive in a hypothetical liquidation under a chapter 7 plan. R. at 7; *see* 11 U.S.C. § 1325(a)(4). Accordingly, the chapter 13 trustee argued that the alleged preferential transfer to Ms. Clegg should be recovered and distributed to the creditors. R. at 7. In response, the Debtor amended the plan to increase payments by $20,000 and the chapter 13 trustee agreed that she would not seek to recover the previous payments made to Ms. Clegg. *Id.* at 7-8.

Although initially objecting to the chapter 13 plan, the Credit Union withdrew its objection in exchange for a claim of $150,000, of which $250,000 was deemed non-dischargeable even in the event of conversion. *Id.* at 8. The Debtor's plan incorporated the settlement with the chapter 13 trustee and stated that all property of the estate vested in the Debtor. *Id*. The bankruptcy court confirmed the plan and entered an order approving the settlement between the Debtor and Eclipse. *Id.* The Debtor made timely payments under the plan for the first eight months, but the theater continued to suffer due to the pandemic and permanently closed in October 2022. *Id*. This caused Eclipse to commence foreclosure proceedings against Final Cut. *Id.* The Debtor could no longer make payments under the plan and chose to convert the chapter 13 plan to a chapter 7 plan. *Id.*; *see* 11 U.S.C. §§ 348, 1307. The bankruptcy court entered an order confirming the conversion. R. at 8.

In the final report, the chapter 13 trustee stated she had distributed $10,000 to the servicer under the plan and that she returned the funds that were reserved for Eclipse to the Debtor upon conversion. *Id.* at 8-9. The Debtor's conversion documents stated that, as of the Petition Date, a value of $350,000 was ascribed to the Debtor's home. *Id.* at 9. They also stated that the Debtor owed $200,000 to Eclipse due to his guarantee of the Loan after foreclosure. *Id.* The Debtor's statement of intention showed his intention to reaffirm the mortgage debt that he owed to the Servicer and remain in his home. *Id.*; *see* 11 U.S.C. § 524(c).

Upon appraisal of the Debtor's home, it was confirmed that the non-exempt equity in it had increased by $100,000 since the Petition Date. R. at 9. The Trustee began marketing the home for sale, which was consistent under the Trustee's duty to "collect and reduce to money the property of the estate for which such trustee serves" for the benefit of his creditors. *Id.*; 11 U.S.C. § 704(a)(1). Eclipse then offered to purchase the home and the alleged preference claim against Pink for $470,000. R. at 9. The Truste agreed to this offer and filed a motion (the "Sale Motion") to sell both the home and preference claim to Eclipse under section 363(b). *Id*.

The Debtor objected to the Sale Motion, arguing: (1) that any post-petition, pre-conversion increase in the equity of his home should inure to his benefit, and (2) the Trustee's statutory ability to avoid and recover transfers under sections 547 and 550 cannot be sold. *Id*. at 10. The bankruptcy court ruled in favor of the Debtor on both issues, denying the Sale Motion. *Id*. The Trustee filed a timely appeal, where the appellate court affirmed both rulings. *Id*.

SUMMARY OF THE ARGUMENT

First, the Bankruptcy Code provides an honest, but unfortunate debtor an opportunity to obtain a fresh start by undertaking a repayment plan under chapter 13 while also holding on to their property. Many debtors, like the Debtor here, are unable to successfully complete such a plan and the Code also allows these debtors to convert to a chapter 7 plan. Under section 348(f)(1), the property of the estate at the time of conversion consists of the property of the Debtor at the time the petition was filed. 11 U.S.C. § 348(f)(1). Although this section does not include a definition of the phrase "property of the estate," it relies on the definition provided by 11 U.S.C. § 541(a)(1), which states that the property of the estate consists of all legal and equitable interests of the Debtor at the commencement of the case. Because the Debtor's home was in the possession of the Debtor at the time of conversion, its increase in equity, which is a part of the Debtor's ownership interest, inures to the benefit of the bankruptcy estate, not the debtor. Since the plain language of Section 348(f)(1) is clear, this Court should reverse and remand the judgment of the United States Circuit Court for the Thirteenth Circuit.

Second, the lower court incorrectly held that the Trustee's avoidance powers are not the property of the estate because the trustee's ability to avoid and recover preferential transfers against Pink are causes of action that constitute an equitable interest in property. A chapter 7 trustee has a fiduciary duty to reduce the property of the estate to money. 11 U.S.C. § 704(a)(1). The trustee is authorized to sell the property of the estate with court approval. 11 U.S.C. § 363(b)(1). The property included within the estate is to be interpreted broadly and numerous sections within the Code bring various assets into the property of the estate. A chapter 5 cause of action is an equitable interest in property that the trustee must reduce to money. Like derivative standing, the Trustee selling their avoidance action to Eclipse is merely an alternative means of

obtaining the underlying property's value by receiving the economic value for the asset of the right to pursue the equitable interest in property.

STANDARD OF REVIEW

Questions of statutory interpretation are reviewed *de novo*. *See Castleman v. Burman (In re Castleman)*, 75 F.4th 1052, 1055 (2023) (reviewing the issue of whether a post-petition, pre-conversion appreciation in equity inures to the benefit of the bankruptcy estate as a question of law). The second issue involves the legal question of whether the lower court incorrectly held that the Trustee's avoidance action cannot be sold as property of the estate. See *Pitman Farms v. ARKK Food Co. (In re Simply Essentials, LLC)*, 78 F.4th 1006, 1008 (8th Cir. 2023) (bankruptcy legal conclusions are reviewed *de novo*).

ARGUMENT

I. A POST-PETITION, PRE-CONVERSION CHANGE IN EQUITY INURES TO THE BANKRUPTCY ESTATE UPON CONVERSION OF A CASE FROM CHAPTER 13 TO CHAPTER 7.

Although courts have been split on whether a pre-petition, post-conversion appreciation in value inures to the bankruptcy estate or to the debtor, only one approach comports with the plain meaning of Section 348(f)(1). 11 U.S.C. § 348(f)(1). Under this Section, the property of the bankruptcy estate includes all legal and equitable interests of the Debtor in property that remain in his possession on the date of conversion. *Id.*; 11 U.S.C. § 541(a)(1). Because appreciation in the Debtor's home is not a distinct property interest, it is part of the "property of the estate" pursuant to Section 348(f)(1), the Debtor's home belongs to the creditors upon conversion. This Court should accordingly reverse the decision of the Thirteenth Circuit Court.

A. Under the plain meaning of 11 U.S.C. § 348(f), equity in the property of the estate is not a new asset to pre-petition property and inures to the benefit of the bankruptcy estate, not the debtor.

An increase in equity prior to conversion of a case from chapter 13 to chapter 7 is property of the bankruptcy estate. Under Section 348(f)(1), "property of the estate in the converted case shall consist *of property of the estate, as of the date of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion*." 11 U.S.C. § 348(f)(1) (emphasis added). Although Section 348 does not provide a definition of "property of the estate," another section supplies this missing definition. *See King v. St. Vincent's Hosp.*, 52 U.S. 215, 221 (1991) (noting that a cardinal rule of statutory construction requires the Bankruptcy Code "to be read as a whole"). The definition of "property of the estate" is provided in Section 541(a)(1) as "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). In the present case, Debtor's home is

"property of the estate" on the Petition Date as it was property of the chapter 13 estate on that date and remained in the Debtor's possession on the date of conversion.

The increase in appreciation in the value of a home is not a distinct property interest from the home itself. Courts have declined to treat post-petition, pre-conversion appreciation as a separate asset from pre-petition property, holding that it inures to the bankruptcy estate, not the debtor. *See In re Castleman,* 75 F.4th at 1055*; Wilson v. Rigby*, 909 F.3d 306, 312 (9th Cir. 2018); *In re Hyman*, 967 F.2d 1316, 1321 (9th Cir. 1992); *In re Reed*, 940 F.2d 1317, 1323 (9th Cir. 1991); *see also In re Goetz*, 647 B.R. 412, 416 (Bankr. W. D. Miss.) (2022) (holding that the broad definition of "property of the estate" in § 541(a) "captures the debtor's entire ownership interest in each asset that exists on the petition date without fixing the estate's interest to the precise characteristics the asset has on that date").

Other courts have relied on Section 541 to reach the same broad interpretation of "property of the estate." Specifically, section 541(a)(6) clarifies that "[p]roceeds, product, offspring, rents or profits of or from property of the estate . . . after the commencement of the case." 11 U.S.C. § 541(a)(6). Consistent with this section of the Bankruptcy Code, these courts have held that any post-petition increase in equity is "[p]roceeds, product, offspring, rents or profits of or from property of the estate." *Potter v. Drewes (In re Potter)*, 228 B.R. 422, 424 (B.A.P. 8th Cir. 1999); *In re Peter*, 309 B.R. 792, 794–95 (Bankr. D. Or. 2004). Regardless of either rationale and despite the split among courts, the view that best comports with the plain meaning of Section 348(f)(1) is that this post-petition appreciation in the value of estate property belongs to the estate, not the debtor.

An analysis under the plain language of the statute is sufficient here because the language is clear. The Supreme Court has stated that proper analysis of a statute should begin and end with

the language of the statute itself. *United States v. Ron Pair Enters.*, 489 U.S. 235, 241 (1989). When a statute's language is plain, "the sole function of the courts is to enforce it according to its terms." *Id*. Here, the statute in question is clear and unambiguous. *See* 11 U.S.C. § 348(f)(1). Accordingly, it is inappropriate to look to legislative history for guidance. *Ratzlaf v. United States*, 510 U.S. 135, 147–48 (1994).

The Ninth Circuit has recently adopted this approach in *Castleman v. Burman* (*In re Castleman*). 75 F.4th 1052 (9th Cir. 2023). Like the present case, the debtor's chapter 13 plan was converted to chapter 7, and the property appreciated in value post-petition. *Id.* at 1054. This led to a $200,000 increase in equity from the time of petition to the time of conversion. *Id.* The court found that this increase in equity would belong to the chapter 7 estate, stating that the plain language of Section 348(f)(1) holds that any property of the estate at the time of the original filing that is still in debtor's possession at the time of conversion becomes property of the chapter 7 estate, and any change in the value of the home was also part of the estate. *Id*. at 1055. In making this decision, the Ninth Circuit Court of Appeals cited *Griffin v. Oceanic Contractors*, where the Supreme Court held that the plain meaning of legislation should be conclusive. *Griffin v. Oceanic Contractors*, 458 U.S. 564, 571 (1982).

Even further, when Congress seeks to exclude specific assets from the bankruptcy estate, it knows how to do so. In 11 U.S.C. § 541(b), Congress took the time to exclude post-petition earnings explicitly from the definition of "property of the estate." 11 U.S.C. § 541(b). Reading Section 348(f)(1) to implicitly exclude an appreciation in equity of the Debtor's property from inuring to the benefit of the bankruptcy estate would render Section 541(b) superfluous. *See Montclair Prop. Owners Ass'n v.* Reynard, 250 B.R. 241, 246 (Va. Bankr. Ct. 2000) ("When two provisions conflict a construction that renders one superfluous or insignificant should be

avoided.") Even though Section 348 has been amended four times since its passage in 1979, Congress still has not taken steps to amend Section 348 or Section 541 to suggest that appreciations in equity inure to the debtor. *See* 11 U.S.C. § 348(f)(1) (amended 1986, 1994, 2005, and 2010). Although Congress had the occasion to make such a clarification in Section 348(f)(1) by explicitly disclaiming an appreciation in a property's value as "property of the estate," it chose not to.

Moreover, section 1327(b) is consistent with section 348(f)(1)(A) of the Bankruptcy Code. According to section 1327, "[e]xcept as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor." 11 U.S.C. § 1327. Under this Section, the Debtor's home is certainly his property at the time the chapter 13 plan was confirmed. However, section 348(f)(1) indicates that the Debtor's home became the property of the bankruptcy estate at the time of conversion from chapter 13 to chapter 7. As a result, both of these sections are consistent because section 348(f)(1) specifically outlines a post-petition scenario in which the Debtor's property inures to the benefit of the bankruptcy estate upon conversion. *See Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384–85 (1992) ("[I]t is a commonplace of statutory construction that the specific governs the general . . . ."). Regardless, section 1327(b) is relevant to chapter 13 cases only, not the converted chapter 7 plan at issue here. *Harris v. Viegelahn*, 575 U.S. 510, 520 (2015) ("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.")

The Supreme Court has made it clear that a proper analysis of a statute begins with its plain meaning, and the analysis ends there if the statute is unambiguous. Because Section

348(f)(1) is clear and unambiguous, the analysis must end here. Accordingly, the pre-petition post-conversion appreciation in value of Debtor's home belongs to the bankruptcy estate.

B. The legislative history and policy of § 348(f)(1) support the conclusion that an appreciation in value is property of the bankruptcy estate for the purposes of conversion.

i. *Legislative History*

Even if the statute was ambiguous, the legislative history and policy goals still conclude that post-petition, pre-conversion property belongs to the estate upon conversion.

The legislature's intent does not change the interpretation of the statute this issue. Congress's intent in enacting section 348(f) can be seen on the House Floor. *See* H.R. REP. NO. 103-835, at 57 (1994), *as reprinted in* 1994 U.S.C.C.A.N. 3340, 3366. The goal was to correct an interpretation of the statute by some courts that the property that the debtor first acquired during the course of the chapter 13 case became property of the chapter 7 estate upon conversion. *Id*. The addition of this statute made it clear that only property held by the debtor at the time that the original chapter 13 petition was filed would become part of the estate. *Id*. The intent was not related to appreciation in value at all.

While it is true that the House Report discussed a scenario which supports the opposing interpretation of section 348(1), this cannot be used to assume legislative intent or meaning. *See* H.R. REP. NO. 103-835, at 57 (1994), *as reprinted in* 1994 U.S.C.C.A.N. 3340, 3366. The scenario discusses a home's value which appreciates during the course of a chapter 13 case. *Id.* This on its own is not enough to assume that the intention of the legislature in enacting this statute was to deal with this exact type of issue. "Congress's failure to address the example included in the legislative history does not mean this omission was inadvertent." *In re Goetz,* 651 B.R. 292, 299 (B.A.P. 8th Cir. 2023). Statutes are often enacted as the result of a compromise.

Id. The mere fact that this scenario was discussed and not specifically addressed by Congress in the statute is not enough to assume Congress's intention was to address this very type of issue. *Id*. The published language of the statute is clear, and Congress chose not to specifically exclude appreciated value from the estate, regardless of the discussion in the House Report. *See* 11 U.S.C. § 348(f)(1).

Although it is contended that section 348(f)(2) would be superfluous with section 348(f)(1) under the plain language interpretation, these sections are distinct in that they cover different types of property. Section 348(f)(2) of the statute gives the court discretion when the debtor converts in bad faith. *See* 11 U.S.C. § 348(f)(2). It reads, "[i]f the debtor converts a case under chapter 13 of this title to a case under another chapter under this title in bad faith, the property of the estate in the converted case shall consist of the property of the estate as of the date of conversion." *Id.*

Specifically, it allows the court to order that all property held at the time of conversion shall constitute property of the estate in the converted case. *See id*. This, unlike section 348(1), can be applied to property first acquired during the chapter 13 case. Section 348(f)(1) refers only to property that is "in possession of or is under the control of the debtor on the date of conversion," rendering these sections distinct and not superfluous. 11 U.S.C. § 348(f)(1).

Although the outcome in this case may seem harsh, this will not always be the reality under this interpretation of the statute. The debtor here loses out because the value of the property increased post-petition and pre-conversion, while in other cases, the value of the property might instead decline during this time. *In re Castleman*, 631 B.R. 914, 919 (2021). This is the reality of market conditions, which sometimes will benefit the debtor and sometimes benefit the estate. *Id*.

ii. Policy

A broad reading of the phrase "property of the estate" not only comports with the plain meaning of Section 348 but the policy of a chapter 13 to chapter 7 conversion. Under the Bankruptcy Code, an honest but unfortunate debtor is provided a chance to have a "fresh start." *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 367 (2007). A major advantage of Chapter 13 bankruptcy is that the debtor can retain his property if he obtains court approval of "a plan to repay his debts over a three-to-five-year period." *See* 11 U.S.C. § 1325(a); *In re Castleman,* 74 F.4th at 1055 (quoting *Harris v. Viegelahn*, 575 U.S. 510, 513–14 (2015)). Because most debtors, like the Debtor here, fail to follow through with a Chapter 13 repayment plan, Congress provided conversion to chapter 7 as a remedy. *Harris*, 575 US. At 514. In enacting Section 348(f)(1), a few courts have warned that Congress was concerned about creating "a serious disincentive to chapter 13 filings" because debtors would fear the loss of property attained after conversion. *See In re Nichols*, 319 B.R. 854, 856 (Bankr. S. D. Ohio 2004); *see also In re Robinson*, 472 B.R. 854, 857 (Bankr. M.D. Fla. 2012). However, despite these concerns, Congress did not make the effort to distinguish the role of pre-petition, post-petition appreciations in equity in Section 348, even though it was aware of these concerns. *See Hartford Underwriter Ins. Co. v. Union Planters Bank, N.A.*, 530 U. S. 1, 6 (2000) (quoting *Connecticut Nat. Bank v. Germain*, 503 U.S. 249, 254 (1992)) ("Congress 'says in a statute what it means and means in a statute what it says there.'") Moreover, this approach provides equity to creditors who, upon conversion, may be prejudiced by a diminished bankruptcy estate. Robert J. Volpi, *Property of the Bankruptcy Estate After a Conversion from Chapter 13 to Chapter 7: The Need for a Definite Answer*, 68 Ind. L. J. 489 (1993). Some even contend that a debtor converting from Chapter 13 to Chapter 7 loses the privileges afforded by Chapter 13. *See id.* (arguing that the

bankruptcy estate must obtain the benefit of an appreciation in equity to prevent prejudice to the creditors who are unaware of the changes to the bankruptcy estate). Because both the plain language and the policy of Section 348(f)(1) comport with the purposes of the Bankruptcy Code, this Court need not look further. *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989) (quoting *Caminetti v. United States*, 242 U.S. 470, 485 (1917)).

C. Reading Section 348(f)(1) to include a post-petition, pre-conversion appreciation in equity of the Debtor's property as property of the bankruptcy estate does not result in absurdity.

Finally, the plain language interpretation of the statute does not achieve an absurd result. Because a broad interpretation of the term "property of the estate" is evident from the plain language of Section 348(f)(1), an appreciation in equity is consistent with Congressional intent and the policies of conversion. Although Congress has expressed a reluctance to discourage debtors from pursuing conversion out of a fear of losing their property, Congress took no steps to alleviate this concern. In fact, Section 348(f)(1)(B) suggests that courts should not rely on the valuations of property made at the time a chapter 13 plan was confirmed. 11 U.S.C. § 348(f)(1)(B). In contrast, Section 541(a)(6) takes steps to recognize that post-petition, pre-conversion proceeds inure to the bankruptcy estate. Accordingly, even if the Court finds that the Debtor's home is a distinct property interest from the Debtor's equity in the home, the appreciation in equity still belongs to the estate. Because the plain language of section 348(f)(1) is clear that appreciation in equity inures to the benefit of the bankruptcy estate, this reading is consistent with both the broad definition of "property of the estate" as used throughout the Bankruptcy Code and the policies of Congress as a whole. Since no section of the Bankruptcy Code is rendered superfluous by this reading, this result cannot be absurd and this Court should adopt this approach.

II. CHAPTER 5 AVOIDANCE ACTIONS ARE PROPERTY OF THE ESTATE AND THE COURT BELOW INCORRECTLY HELD THAT THE TRUSTEE CANNOT SELL TO ECLIPSE THE ABILITY TO AVOID AND RECOVER TRANSFER PAYMENTS FROM PINK.

A chapter 7 trustee has a statutory duty to "collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest." 11 U.S.C. § 704(a)(1). To do so, a trustee may sell the property of the estate with court approval. *See* 11 U.S.C. § 363(b)(1). Linking the two statutes is "property of the estate." R. at 30-31. The Trustee may sell, as property of the estate, the ability to avoid and recover transfers pursuant to 11 U.S.C. §§ 547 and 550 to Eclipse because: (1) the Code provides statutory support for including avoidance actions in the property of the estate under 11 U.S.C. § 541; and (2) selling avoidance actions is an alternative means for obtaining the underlying property's value for the benefit of the estate in a manner consistent with the Code's policy. Accordingly, this Court should reverse the decisions of the court below.

A. The court below incorrectly held that the Trustee's avoidance action is not the property of the estate because a proper reading of the Code provides statutory basis for including avoidance actions in the property of the estate under 11. U.S.C. § 541.

The statutory basis for the Trustee's avoidance powers belonging to the property of the estate is first found in 11 U.S.C. § 541. Wherever located and by whomever held, the estate includes "all legal and equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). It's necessary to first recognize that avoidance powers are "property" or an "interest in property" *Id.* Although the Code does not define these terms, Congress recognized that there are property interests in litigation. *See* H.R. Rep. No. 95-595, at 175, (1978) *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6136 (noting that section 541(a)(1)'s

reference to "interests in property the debtor has [as of] the commencement of the case" includes choses in action and causes of action).

Section 926 of the Code describes avoidance powers as causes of action. R. at 31. If the debtor in a municipal bankruptcy refuses to pursue a *cause of action* under section 544, *547*, 548, [or] 549(a)…" then the court, at a creditor's request, "may appoint a trustee to pursue such cause of action. 11 U.S.C. § 926(a) (emphasis added). Furthermore, this Court has referred to Chapter 5 avoidance powers as causes of action. *See*, *e.g.*, *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 53 (1989) (describing the "right to recover a fraudulent conveyance under 11 U.S.C. § 548(a)(2)" as a "statutory cause of action.").

Although the Code and legislative history refer to the avoidance provisions as the "avoiding powers," nothing indicates that Congress used these labels to ensure that avoidance actions would not be deemed property of the estate. *See* Brendan Gage, *Is there a Statutory Basis For Selling Avoidance Actions?*, 22 J. Bankr. L. & Prac. 3 Art. 1 (2013). Additionally, nothing prohibits a power from being a property interest. *Id.*; *see also In re Guillot*, 250 B.R. 570, 599 (Bankr. M.D. La. 2000) ("the only way to interpret the 'rights and powers' clause of § 544(a) is as a statute that creates a property interest"); 11 U.S.C. § 544(a). Had Congress intended to exclude avoidance powers from the property of the estate, it could have, like it did with eleven other categories of property, expressly prohibited avoidance actions from the property of the estate. *See* 11 U.S.C. §541(b).

The next step is recognizing that avoidance actions are an interest of the debtor "as of the commencement of the case." Although avoidance powers are created upon the commencement of the bankruptcy case, the equitable interest in property should not be excluded from the property of the estate "as of" the petition date. The Code does not specify what is included upon

the commencement of bankruptcy, however multiple courts have interpreted "as of" to include any avoidance actions created on the petition date. *See*, *e.g.*, *Securities Investor Protection Corp. v. Bernard L. Madoff Inv. Securities, LLC*, 460 B.R. 106, 114, (Bankr. S.D. N.Y. 2011), order aff'd, 474 B.R. 76, (S.D. N.Y. 2012) (emphasis added); *In re Zwirn*, 362 B.R. 536, 539 (Bankr. S.D. Fla. 2007); *In re Bridge Info. Sys., Inc.*, 293 B.R. 479, 485 (Bankr. E.D. Mo. 2003). Even if avoidance actions did not create an interest in property "as of" the commencement of the case, "such causes of action would fall within the scope of section 541(a)(7), which includes in the estate '[a]ny interest in property that the estate acquires after the commencement of the case.'" R. at 32; 11 U.S.C. § 541(a)(7).

Despite avoidance actions not being expressly included in section 541(a), section 541(a) is not exhaustive because it states that the "estate is comprised of all the following property," not that the "estate is *only* comprised of all the following property." 11 U.S.C. §541(a); *see also* Gage, *supra*, 3 Art. 1. In *Whiting Pools, Inc.* (1983), this Court held that property of the estate includes "any property made available to the estate by other provisions of the Bankruptcy Code," including "property in which the debtor did not have a possessory interest [as of] the time the bankruptcy proceedings commenced." 462 U.S. at 205. This Court reasoned that section 541(a) functions "as a definition of what is included in the estate, rather than as a limitation." *United States v. Whiting Pools, Inc.*, 462 U.S. at 202. The same reasoning applies to avoidance actions because they claw back payments that the debtor only had an equitable or contingent interest in prior to the bankruptcy filing. R. at 33. Because of the inherent property interest avoidance actions have, Chapter 5 cause of actions "must be seen alongside [section] 541(a) as part of the overall mechanism by which the bankruptcy estate is created. *Murray v. Guillot (In re Guillot)*, 250 B.R. 570, 599 (2000).

Additionally, the most recent Circuit Court opinion on the issue supports including avoidance actions in the property of the estate under Section 541. *In re Simply Essentials, LLC*, 78 F.4th at 1011. In *Simply Essentials*, the Eighth Circuit held that chapter 5 causes of action are property of the estate that can be sold by the trustee and affirmed the order approving the chapter 7 trustee's motion to sell what he believed to be meritorious avoidance claims against the owner. *Id*. There, because the trustee lacked the funds to prosecute the causes of action, he proposed to sell them to a creditor. *Id.* at 1008. The court reasoned that the property of the estate includes avoidance actions because they are inchoate or contingent interests held by the debtor prior to the filing of bankruptcy, and avoidance actions "clearly qualify as property of the estate under subsection (7)." *Id.* at 1009.

Similarly, other Circuits addressing related issues provide support for including avoidance actions in the property of the estate. *See*, *e.g.*, *In re Moore*, 608 F.3d 253, 262 (5th Cir. 2010) (internal citation omitted) ("We conclude, therefore, that the fraudulent-transfer claims are property of the estate under § 541(a)(1)… In the alternative the fraudulent-transfer claims became estate property under § 544(b) and—like other estate property—may be sold pursuant to § 363(b)"); *Morley v. Ontos, Inc. (In re Ontos, Inc.)*, 478 F.3d 427, 431 (1st Cir. 2007) (noting that including fraudulent conveyance actions within Section 541(a)(1) is "well established"); *Nat'l Tax Credit Partners, L.P. v. Havlik*, 20 F.3d 705, 708–09 (7th Cir. 1994) ("the right to recoup a fraudulent conveyance… is property of the estate."); *Briggs v. Kent (In re Professional Investment Properties of America)*, 955 F.2d 623, 626 (9th Cir. 1992) (upholding a trustee's transfer of the estate's avoidance actions under Section 544).

Additionally, section 541(a) provides statutory support for including avoidance actions in the property of the estate in subsections (3), (4), and (6). Subsection (3) includes in the property

of the estate "[a]ny interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title." 11 U.S.C. §541(a)(3). Section 550 provides that "to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred. 11 U.S.C. §550(a). Although subsection (3) addresses "property... that the trustee recovers" and section 550(a) refers to "property transferred," one should not think that Congress might have only intended to include avoidance recoveries within the definition of property of the estate. *See United States v. Nordic Vill. Inc.*, 503 U.S. 30, 37 (1992) (this Court did not read two subsections of Code section 106 (governing waiver of sovereign immunity) independently because it would bar the government's claim "since the right to recover a postpetition transfer under § 550 is clearly a 'claim' (defined in § 101(5)(A)) and is 'property of the estate'" under section 541(a)(3); *see also* Gage, *supra*, 3 Art. 1 ("[i]n other words, [this] Court believes that a trustee's right to recover an avoidable transfer under section 550 is a claim under section 101(5)(A) which constitutes property of the estate under section 541(a)(3)").

Similarly, although subsections (4) and (6) seemingly only address the consequences of avoidance rather than avoidance actions themselves, they indirectly provide statutory support for including Chapter 5 avoidance actions in the property estate. *See* 11 U.S.C. §541 (a)(4), (a)(6). First, "subsections (4) and (3) both address property interests arising from avoided transfers," and, "because Congress clearly intended that multiple subsections of 541(a) tackle the effect of avoidance, the view that Congress somehow carefully circumscribed avoidance actions from constituting property of the estate is suspect." Gage, *supra*, 3 Art. 1. Second, subsection (4) illustrates that property of the estate is not a static concept, limited to the property interests the

debtor held or could have recovered prepetition, because "to have 'property preserved' first requires the successful prosecution of an avoidance action." *Id.*

Lastly, avoidance actions can be characterized as "proceeds… of or from property of the estate. *See* 11 U.S.C. §541 (a)(6); *see also* S. Rep. No. 95-989, 95th Cong., 2d Sess. 83 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5869 ("[p]roceeds [in subsection (a)(6)] is not used in a confining sense... but is intended to be a broad term to encompass all proceeds of property of the estate."); H.R. Rep. No. 95-595, 95th Cong., 2d Sess. 368 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6324 (same). Thus, in addition to subsection (1), statutory support for including avoidance actions in the property of the estate are found in subsections (3), (4), and (6).

B. The court below incorrectly held that the Trustee's avoidance action is not property of the estate because the Trustee selling the avoidance action to Eclipse merely provides an alternative means of fulfilling the trustee's fiduciary duty in a manner consistent with the Code's policy.

Selling chapter 5 avoidance actions is merely an alternative means of obtaining the underlying property's value for the benefit of the estate. *See* Christopher W. Frost, *Settlements, Sales, and the Unsettled Ownership of Bankruptcy Litigation*, 30 No. 9 Bankr. L. Letter 1 (2010) (selling a cause of action "simply accelerates the liquidation of litigation's value and permits the estate to distribute that value earlier than it would otherwise). Put simply, "avoidance powers have value… and there is little reason to believe that [bankruptcy courts] cannot be trusted with the decision to sell avoiding power claims. *Id.* In the instant case, the lower court's majority cites to a Third Circuit opinion seemingly at odds with including avoidance actions in the property of the estate. R. at 18. In *Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery (In re Cybergenics Corp.)*, the Third Circuit stated that state law fraudulent transfer claims under section 544 had not been sold to a purchaser of the estate's assets because they "were never

assets of [the debtor]." 226 F.3d 237 (3d Cir. 2000). However, the majority fails to note that "the Third Circuit itself recently described its statements in *Cybergenics* as dicta," not holding that trustees cannot transfer causes of action. R. at 34. Moreover, the Third Circuit's "somewhat artificial separation between an asset--the right to avoid a transfer--and the power to recover the value of that asset… seemingly has little purpose outside of the narrow context of the trustee's right to sell the cause of action." *See* Frost, *supra*, 30 No. 9 Bankr. L. Letter 1.

Rather than looking at selling avoidance actions as an impermissible sale of a trustee's powers, the better view is to look at selling avoidance actions as merely an alternative means of obtaining the underlying property's value. *See In re Ames Dep't Stores, Inc.*, 287 B.R. 112, 122 (Bankr. S.D.N.Y. 2002); *see also* Frost, *supra*, 30 No. 9 Bankruptcy Law Letter 1 (what was really being sold was the economic value of the leases, not merely the power to assume and assign them). The Fifth Circuit in *In re Mortgage America Corp.*, a case the Fifth Circuit relied on in *In Re Moore*, the court held that a state law fraudulent transfer action was property of the estate in part because the property that would be recovered itself would be property of the estate upon its return. 714 F.2d 1266, 1277 (5th Cir. 1983); *see also* 30 No. 9 Bankruptcy Law Letter 1 (the Fifth Circuit's approach recognized "that it is difficult to distinguish between an asset with value and the right to pursue that value").

The Trustee selling the avoidance action to Eclipse is also consistent with the Code's policy. The Code assigns avoidance and recovery powers to the trustee in a Chapter 7 bankruptcy. See 11 U.S.C. §§ 547, 550. As the lower court notes, creditors can obtain derivative standing to pursue avoidance actions for the benefit of the estate. R. at 23. However, the dissent better explains the significance of derivate standing. As the dissent explains, derivate standing illustrates that avoidance actions are flexible and not solely restricted to the trustee. R. at 32.

Derivative standing essentially allows for the estate, through the creditors, to obtain the value of the underlying property for the benefit of the estate. *See Simply Essentials*, 78 F.4th at 1008 ("Whether the avoidance action is brought by the trustee or by a creditor, the action is brought *for the benefit of the estate* and therefore belongs to the estate") (emphasis added). Here, allowing the Trustee to sell the avoidance action to Eclipse would provide an alternative means to the estate obtaining the value of the underlying property associated with the avoidance action for the benefit of the estate.

Additionally, the Trustee selling the avoidance action to Eclipse would not threaten the integrity of the bankruptcy process. R. at 23-24. Citing to *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, the lower court assumes that interpreting the Code to allow a trustee to sell their avoidance powers would compromise the integrity of the bankruptcy system by allowing creditors to pursue personal vendettas. *Id.* This assumption overlooks the fact that all such sales would need bankruptcy court approval. *See* 11 U.S.C. §363(b)(1). Also, this Court described in a footnote a potential exception to its holding, where a third party receives consent by the trustee and bankruptcy court to bring a 506(c) claim. *Hartford Underwriters Ins. Co.*, 530 U.S. 1, 13, 14, n.5 (2000). Unlike the petitioner in *Hartford Underwriters*, with the Trustee's and bankruptcy court's approval, Eclipse would not be asserting an independent right. *Id.* at 4. Instead, Eclipse would be exercising the trustee's right to bring the avoidance action (which it purchased) rather than some independent right, without any assignment, to bring the action. *See* Gage, *supra*, 22 J. Bankr. L. & Prac. 3 Art. 1. Thus, the lower court incorrectly held that the Trustee's avoidance actions are not part of the property estate because, like derivative standing, it is an alternative means for exercising avoidance powers and obtaining the underlying property's value to benefit the estate.

CONCLUSION

For the foregoing reasons, Petitioner respectfully requests that this Court reverse and remand the judgment of the United States Court of Appeals for the Thirteenth Circuit.

Respectfully submitted,
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/s/ #23
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