Team 26

No. 23-0115

In the

Supreme Court of the United States

October Term, 2023

In Re Eugene Clegg, Debtor

VERA LYNN FLOYD, CHAPTER 7 TRUSTEE,

Petitioner

v.

Eugene Clegg,

Respondent

On Writ of Certiorari
From the United States Court of Appeals
For the Thirteenth Circuit

BRIEF FOR THE RESPONDENT

Counsel for Respondent
TEAM NUMBER 26

Questions Presented for Review

1. Does a post-petition equity increase in a debtor's property benefit the debtor or the bankruptcy estate after the conversion of a case from a Chapter 13 to a Chapter 7 case under 11 U.S.C. § 348 and § 541?

2. May a Chapter 7 trustee sell, as property of the bankruptcy estate, the ability to avoid and subsequently recover preference transfers under 11 U.S.C. § 547 and § 550?

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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 Facts

After retiring from the military in 2011, Cpl. Eugene Clegg acquired Final Cut LLC from Mr. Clegg's mother, Emily "Pink" Clegg. (R. 5). Final Cut owned and operated a historic theatre. *Id*. At the time Pink transferred Final Cut to Mr. Clegg, it was free of liabilities and generating consistent profit. *Id*.

In 2016, Final Cut borrowed $850,000 (referred to as the "Loan") from Eclipse Credit Union (Eclipse) to renovate the theatre. *Id*. Clegg personally guaranteed the loan giving Eclipse first priority on Final Cut's real and personal property. *Id*. Local veterans volunteered in the renovations creating a surplus of $75,000 from the Loan. In appreciation, Clegg donated the remaining funds to the VFW (Veterans of Foreign Wars) in 2017. *Id*.

Unfortunately, Final Cut was forced to close its doors in March 2020 in response to Covid 19. (R. 6). During the shutdown, Clegg borrowed an unsecured $50,000 from Pink. The theatre was able to reopen in 2021 but never recovered. *Id*. Clegg's situation began to decline. First, he had to sacrifice his salary for the sake of the company. He began incurring significant credit card debt and eventually fell behind on his home mortgage. *Id*. The mortgage servicer, Another Brick in the Wall Financial Corporation (the Servicer), sought foreclosure following Clegg's failure to make monthly payments. *Id*.

On December 8, 2021, Clegg filed for relief under Chapter 13 of the Bankruptcy Code, the petition date. *Id*. Mr. Clegg's filings show his house was valued at $350,000, he owed $320,000 to the Servicer, and he owed an undisclosed amount to Eclipse. (R. 7). Clegg claimed the max state law homestead exemption of $30,000 and disclosed a payment of $20,000 towards his unsecured debt to Pink within a year of the petition date. *Id*.

Under the plan, Clegg was to make payments over three years solely from earnings made by Final Cut. *Id*. Before the plan was confirmed, Clegg agreed to increase the aggregate payments to creditors by $20,000 in return for assurance that the Chapter 13 trustee would not seek to avoid and recover the payments made to Pink. (R. 8). The plan was officially confirmed on February 12, 2022. *Id*.

Clegg made the planned payments for eight months until the theatre closed permanently in October of 2022. *Id*. As a result, Eclipse commenced the stayed foreclosure proceedings against Final Cut, and Clegg converted the bankruptcy case from Chapter 13 to Chapter 7. *Id*. The conversion schedule stated Clegg was indebted to Eclipse for $200,000 and Clegg stated his intent to reaffirm the mortgage debt owed to the Servicer while remaining in possession of his home. (R. 9).

While the estate was initially found to be devoid of assets, Clegg claimed that the value of his home had increased due to significant market observed during Covid. *Id*. The trustee then commissioned an appraisal confirming a $100,000 equity increase since the petition date. *Id*. The trustee began marketing the home. Eclipse offered to purchase the home and Pink's renaming claim for a combined total of $470,000. *Id*.

The Chapter 7 trustee, Vera Lynn Floyd, filed a motion to sell. Clegg objected on two grounds, (1) that he should benefit from the increase in home value and (2) that the trustee's ability to avoid and recover transfers cannot be sold. (R. 10). The United States Bankruptcy Court for the District of Moot sustained the objections and denied the sale in Mr. Cregg's favor. *Id*. The trustee appealed to the United States Court of Appeals for the Thirteenth Circuit which affirmed the decision on both issues. *Id*.

Summary of the Argument

This Court, by affirming the Thirteenth Circuit's decision, has an opportunity to reinforce the "fresh start" principles underlying the Bankruptcy Code and to halt the efforts of creditors that seek to circumvent long-standing policies with narrowly tailored interpretations. Both issues presented before This Court hinge on what constitutes property of the bankruptcy estate.

The first involves an increase in equity in the debtor's residence post-petition but pre-conversion from a Chapter 13 to a Chapter 7 case. This increase in value should inure the debtor or to the Chapter 7 estate's benefit. A jurisprudential consensus exists in finding that Chapter 13 is designed to incentivize debtors to pay off their debts rather than filing under Chapter 7. A primary incentive, illustrated in the preliminary works of section 348(f), includes assurances that debtors will not be left in a worse position than they would have been had they originally filed under Chapter 7. While the circuits are split on this issue, decisions finding that debtors are entitled to the post-petition, pre-conversion equity increases best serve the purpose of section 348. This is because they reinforce an assurance that the debtor will not be in a worse position. Conversely, adverse decisions rely on an erroneously narrowed interpretation of 348(f)(1)(A). Such interpretations not only conflict with other Bankruptcy Code provisions, they undermine the legislative intent intrinsic to section 348(f). In sum, a finding that any post-petition, pre-conversion equity belongs to the debtor is most faithful to the language of the provision, the purpose of the provision, and the policy interests underlying the Bankruptcy Code.

The second issue is whether a Chapter 7 trustee may transfer or assign their statutory authority to avoid preference claims. Historical treatment of the trustee's ability dictates that the ability to avoid is a distinct and inalienable power, separate from recovery, exclusive to the trustee. This treatment is substantiated by the fact that such power is not an ordinary property interest. Rather, it is a statutory power bestowed upon trustees to better enable them to administer the estate for the benefit of all creditors. While the circuits seemingly diverge on the second issue, the majority agree that the trustee's avoidance powers are not assignable in a Chapter 7 case. Court cases that reach a different result are distinguishable or fail to make crucial distinctions between types of bankruptcy. Lastly, allowing such transfers would absurdly allow self-interested creditors to leverage their position against the interests of all creditors.

Argument

I. Property of The Estate Does Not Include Any Post-Petition, Pre-Conversion Increase of Equity in a Debtor's Residence.

The Bankruptcy Code supplies the legal framework for encumbered debtors to seek a "fresh start" from their financial obligations. *Harris v. Viegelahn*, 575 U.S. 510, 514, 135 S. Ct. 1829, 1835, 191 L. Ed. 2d 783 (2015); *Marrama v. Citizens Bank of Massachusetts*, 549 U.S. 365, 367, 127 S. Ct. 1105, 1107, 166 L. Ed. 2d 956 (2007) (*quoting Grogan v. Garner*, 498 U.S. 279, 286, 287, 111 S. Ct. 654, 112 L.Ed.2d 755 (1991)). The two courses of action relevant to this matter are Chapters 13 and 7.

Chapter 7 provides the debtor a clean slate from his outstanding financial burden in exchange for the "prompt liquidation of the debtor's assets." *Harris v. Viegelahn*, 575 U.S. 510, 513, 135 S. Ct. 1829, 1835, 191 L. Ed. 2d 783 (2015). Notably, the debtor's wages earned and assets acquired after the bankruptcy filing are not included in the Chapter 7 estate. On the other hand, Chapter 13 provides an alternative option for debtors with regular income to reorganize their financial affairs under a repayment plan. *See id*. at 514.

In a Chapter 13 proceeding, the debtor continues to make payments to satisfy the debts of creditors, and the debtor is able "to retain, without penalty, his home, car, and other property . . ." *Id*. at 514. Upon filing the petition, certain property is placed into an estate, and a Chapter 13 trustee is appointed. 11 U.S.C. § 541, 1302. Then, the debtor proposes a repayment plan that if confirmed, "vests all the property of the [bankruptcy] estate in the debtor," and "renders that property free and clear of any claim or interest of any creditor provided for by the plan." 11 U.S.C. § 1321-1326; *Bullard v. Blue Hills Bank*, 575 U.S. 496, 135 S. Ct. 1686, 191 L. Ed. 2d 621 (2015). Once all payments are satisfied under the confirmed plan, the debts are discharged.

11 U.S.C. § 1328; *See United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 267-77, 130 S. Ct. 1367, 1375-85, 176 L. Ed. 2d 158 (2010). However, most debtors fail to successfully complete their repayment plan. *See* Porter, *The Pretend Solution: An Empirical Study of Bankruptcy Outcomes*, 90 Texas L. Rev. 103, 107-111 (2011) (only one-third of Chapter 13 cases result in discharge). Such instances result either in converting the case to another chapter or dismissal. 11 U.S.C. § 348, 349, 1307. A debtor can convert a case from Chapter 13 to Chapter 7 at any time and, in the absence of bad faith, limit the Chapter 7 estate to the debtor's property "as of the date the original Chapter 13 petition was filed." *Harris*, 575 U.S. 510, 513, 135 S. Ct. 1829, 1835. When a Chapter 13 case is converted to Chapter 7, the case does not restart; rather, it continues as a Chapter 7 case without "effecting a change in the date of the filing of the petition." 11 U.S.C. § 348; see *Harris*, 575 U.S. 510, 515, 135 S. Ct. 1829, 1837.

The issue here concerns whether the post-petition, pre-conversion increase in equity, generated by the appreciation of the debtor's home and the mortgage payments he made, belongs to the debtor or the estate. Petitioner prays This Court finds that the Chapter 7 estate is the beneficiary of any post-petition appreciation in Clegg's home despite the estate recognizing no equity in the home on the Chapter 13 petition date. However, this contention conflicts with the statutory language, legislative history, and purpose of section 348(f). For these reasons, Respondent requests that This Court affirm the Thirteenth Circuit's decision and hold that the post-petition, pre-conversion increase in equity in the debtor's residence inures to his benefit.

In converted case such as this, property of the estate "consist[s] of property of the estate, as of the date of filing the petition, which remains in the possession of or is under the control of the debtor on the date of conversion." 11 U.S.C. § 348(f)(1)(A). Conversion, however, "does not affect a change in the date of the filing of the petition, the commencement of the case, or the order for relief." 11 U.S.C. § 348(a).

A. The Statutory Language of Section 348 Indicates That the Debtor Benefits From Any Post-Petition Increase in Equity in the Debtor's Property.

The statutory language of section 348 supports the Thirteenth Circuit's finding that any post-petition, pre-conversion increase in equity inures to the debtor's benefit. While Petitioner relies on an erroneously narrowed reading of section 348(f)(1), This Court has long recognized that the Bankruptcy Code is a complex configuration of laws that must "be read as a whole . . . since the meaning of statutory language, plain or not, depends on context." *King v. St. Vincent's Hosp.*, 502 U.S. 215, 221, 112 S. Ct. 570, 574, 116 L. Ed. 2d 578 (1991); *see also RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645, 132 S. Ct. 2065, 2070, 182 L. Ed. 2d 967 (2012) ("Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions"). Thus, to truly understand section 348, it must be contextualized by the Bankruptcy Code.

Section 348 of the Bankruptcy Code provides the framework for conversion. It reads, "[e]xcept as provided in paragraph (2) . . . property of the estate in a converted case shall consist of the estate, as of the date of filing of the petition, which remains in the possession of or is under the control of the debtor on the date of conversion." 11 U.S.C. § 348(f)(1)(A). Paragraph (2) provides that when the case is converted in bad faith, the estate "shall consist of the property of the estate as of the date of conversion." 11 U.S.C. § 348(f)(2). There is an apparent conflict when section 348 is applied to the debtor's situation.

Under the first paragraph, the debtor's property as of the petition date is deemed to be estate property if it remains in possession or is under the debtor's control upon conversion. Here, the debtor owned his home on the petition date, and it remained in his possession upon conversion. Thus, isolating the application of section 348 to the first paragraph seemingly dictates that the estate's property would include the debtor's home as of the petition date, including the increase in equity occurring after the petition date. However, such application ignores section 348(f)(2) despite section 348(f)(1) beginning with, "except as provided in paragraph (2)." 11 U.S.C. § 348(f)(1).

Under section 348(f)(2), a bad faith conversion results in the property of the estate consisting of the property of the estate "as of the date of conversion." 11 U.S.C. § 348(f)(2). This language expressly distinguishes the estate's property on the date of conversion from the petition date. Bad faith is punished, not rewarded. Thus, to have effect, section 348(f)(2) must operate to deprive the bad faith debtor of any benefit that materialized between the petition and conversion dates. Logic dictates that a debtor cannot be deprived of what is not his or hers.

Here, a pre-petition, post-conversion benefit existed in the form of increased non-exempt equity. Despite stipulating on a good faith conversion, Petitioner contends that the increased equity is property of the estate and prays for a result that equates the good and bad faith debtor. Such a result would "render superfluous another part of the same statutory scheme." *Corley v. United States*, 556 U.S. 303, 129 S. Ct. 1558, 1560, 173 L. Ed. 2d 443 (2009). ("[a] statute should be construed [to give effect] to all its provisions, so that no part will be inoperative or superfluous, void or insignificant") (internal citations omitted).

Further ambiguity arises when considering section 522, which provides that property interests are valued for the purpose of a debtor's exemptions on the petition date. 11 U.S.C. § 522(a)(2). Commonly referred to as the "snapshot" rule, section 522(a)(2) suspends the value of a debtor's assets in time. *See e.g. In re Rockwell*, 968 F.3d 12, 17 (1st Cir. 2020) (Court held that the value of debtor's homestead exemption is fixed as of petition date and cannot be amended). While section 522(a)(2) concerns the debtors' exemptions, like section 348(f)(1)(A), it expressly freezes the value of the property of the estate as of the petition date. 11 U.S.C. § 348(f)(1)(A); 11 U.S.C. § 522(a)(2).

Applying section 522(a)(2) here, the debtor's residence on the petition date is valued at $350,000. Petitioner asserts that section 348(f)(1)(A) is not subject to the snapshot rule and that the property of the estate as of the petition date should be valued at conversion. Such a result would absurdly establish two or more different valuations, made at different times, each representing the same property on the petition date.

Petitioner asks This Court to apply section 348(f)(1)(A) in a vacuum. However, Bankruptcy Code provisions are not established in a vacuum, rather, they are a designated piece to a greater whole. By discarding context, Petitioner's plain interpretation would not only deem section 348(f)(2) ineffective but would also result in an overly convoluted scheme of property valuations. Instead, This Court should consider section 348(f)(1)(A) alongside the other relevant provisions to not only promote harmony among the Bankruptcy Code but to also ensure its application is in line with the legislative intent on the matter.

B. Jurisprudence and Custom Support Finding That Any Post-Petition Equity Increase in a Debtor's Property Benefits the Debtor.

Recently, a split has formed in the circuits regarding this very issue. *See e.g. Matter of Castleman*, 75 F.4th 1052, 1055 (9th Cir. 2023); *In re Goetz*, 651 B.R. 292, 302 (B.A.P. 8th Cir. 2023); *In re Barrera*, 22 F.4th 1217, 1222 (10th Cir. 2022). Given the ambiguity outlined above, the Tenth Circuit's approach in *Barrera* most faithfully applies to section 348(f)(1)(A).

In *Barrera*, the Tenth Circuit found that proceeds were generated from the post-petition, pre-conversion sale of the debtor's residence. *Rodriguez v. Barrera* (*In re Barrera*), 22 F. 4th 1217 (10th Cir. 2022). There, the estate did not have an equity interest in the debtors' residence on the petition date. *Id*. at 1221. The debtors kept up with their payments under the Chapter 13 plan until they were forced to convert to Chapter 7. *Id*. at 1221. While the court declined to rule on the issue of post-petition, pre-conversion increases in equity that results from payments and or appreciation of the property, it noted that its holding was consistent with the legislative history of section 348(f)(1)(A). *See id*. at 1226.

That rationale applied to the facts at hand supports a finding that post-petition, pre-conversion increases in equity inure to the debtor's benefit. Here, like *Barrera*, the estate carried no equity interest at the time the debtor filed the petition. Also, like *Barrera*, the debtor complied with the payments under the Chapter 13 plan until conversion was inevitable. Here, the only difference is that the debtor did not sell his residence, realize the profits, and spend them elsewhere.

Conversely, Petitioner relies on jurisprudence sharing the view that section 348(f)(1)(A) is unambiguous and should be applied plainly. In *Castleman*, the Ninth Circuit found that the post-petition, pre-conversion increase in equity appreciation belongs to the estate when a case is converted from Chapter 13 to Chapter 7. 75 F.4th 1052, 1055 (9th Cir. 2023). In that case, there was no equity in the home on the petition date, and the home's value increased by $200,000 upon the conversion date. *Id*. The Ninth Circuit applied the "plain" language of section 348 (f)(1) to find that any change in the value of the home was also part of the estate and reasoned that such fluctuation in value "is simply a happenstance of market conditions, which sometimes will benefit the debtor and sometimes benefit the estate." *Id*. at 1058. While this reasoning seemingly promotes fairness, fairness is only achieved if the estate has an equity interest in the home at the petition date.

Without any equity interest in the debtor's home when Chapter 13 is filed, the estate bears no risk that the home's value will decrease. Here, upon the Chapter 13 petition, the estate maintained $0 of value attributable to the debtor's residence. If the residence decreased in value, the estate's interest would remain at $0. The notion that this approach "sometimes will benefit the debtor and sometimes benefit the estate" is a fiction when applied to cases where the estate has no equity interest because it places the estate in an extremely advantageous position where the estate reaps all benefits from appreciation and is shielded of any loss in the event of depreciation.

Petitioner also relies on the Eighth Circuit's decision in *Goetz*, where the court found that post-petition increases in equity in a debtor's residence become the property of the debtor's converted estate. *See In re Goetz*, 651 B.R. 292. Like Castleman, the court referred to section 541 to define property of the converted estate to include "all legal or equitable interest of the debtor in property as of the commencement of the case." 11 U.S.C. 541(a)(1); *In re Goetz*, 651 B.R. 292, (B.A.P. 8th Cir. 2023). The Eighth Circuit applied that definition to find that the property of the estate captures the entire asset at the time of the petition, but it is not limited to the asset's value at that time. *Id*. at 297. Notably, the Eighth Circuit found that the distinction between property of the estate upon the petition and conversion dates operated to protect newly acquired property and not increase equity in already existing property. *Id*. at 300.

The Eighth Circuit's rationale in *Goetz* was misguided. While acknowledging the distinction between estate property as of the conversion date and estate property on the petition date, the court's application directly conflicts with the legislative history behind section 348(f).

The court's decision not only conflicts with the legislative history, but the court expressly declined to even consider the legislative history due to the possibility that the example, illustrated in H.R. REP. No. 103-835, "may not have been inadvertent." *Id*. at 299. Ironically, in doing so, the Eighth Circuit did interpret legislative intent by assuming that the omission of the example from the statutory text is an affirmative denouncement of such an example. To truly capture Congress' intent, we turn to the legislative history behind section 348(f)(1)(A).

C. Legislative History of Section 348(f) Further Supports That Any Post-Petition, Pre-Conversion Equity Increase Inures to The Debtor as Congress Intended.

Section 348(f)(1)(A) was added to the Code to address the issue of what constitutes property of the estate upon conversion from Chapter 13 to Chapter 7. The accompanying House Report discussion sheds light on Congress's intent:

> This amendment would clarify the Code to resolve a split in the case law about what property is in the bankruptcy estate when a debtor converts from chapter 13 to chapter 7. The problem arises because in chapter 13 . . . any property acquired after the petition becomes property of the estate, at least until confirmation of a plan. Some courts have held that if the case is converted, all of this after-acquired property becomes part of the estate in the converted chapter 7 case, even though the statutory provisions making it property of the estate do not apply to chapter 7. Other courts have held that the property of the estate in a converted case is the property the debtor had when the original chapter 13 petition was filed.

H.R. REP. No. 103-835, at 57 (1994), *as reprinted in* 1994 U.S.C.C.A.N. 3340, 3366. Notably, this legislative history indicates that post-petition, pre-conversion property interests are not included in the Chapter 7 estate because the statutory provisions that would make it estate property do not apply to Chapter 7. Although the legislative history seemingly suggests that may only be addressing newly acquired property, the following example quickly discredits such implication:

> These later courts have noted that to hold otherwise would create a serious disincentive to chapter 13 filings. For example, a debtor who had $10,000 equity in a home at the beginning of the case, in a State with a $10,000 homestead exemption, would have to be counseled concerning the risk that after he or she paid off a $10,000 second mortgage in the chapter 13 case, creating $10,000 in equity, there would be a risk that the home could be lost if the case were converted to chapter 7 (which can occur involuntarily). If all the debtor's property at the time of conversion is property of the chapter 7 estate, the trustee would sell the home, to realize the $10,000 in equity for the unsecured creditors and the debtor would lose the home.

Id. Congress clearly intended to encourage debtors to try and pay off their debts under a Chapter 13 plan. This language shows that Congress did not intend to burden Chapter 13 debtors with the risk that they may lose their home upon conversion when they would have kept the home had a Chapter 7 been originally filed. Instead, Congress intended to encourage debtors to try and pay off their debts under a Chapter 13 plan. *See* 11 U.S.C. § 554(b); *In re Barrera*, 620 B.R. 645, 653 (Bankr. D. Colo. 2020), *aff'd*, No. BAP CO-20-003, 2020 WL 5869458 (10th Cir. BAP (Colo.) Oct. 2, 2020), *aff'd*, 22 F.4th 1217 (10th Cir. 2022); *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242, 109 S. Ct. 1026, 1031, 103 L. Ed. 2d 290 (1989) ("The plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.").

Nearly identical to the example, here the debtor's equity in his residence is wholly attributable to the homestead exemption. Thus, because the estate did not have any equity interest in the debtor's residence on the petition date, the estate would have abandoned the property, or the case would have been dismissed. The debtor also made mortgage payments under the Chapter 13 plan, which created additional equity. While the example does not mention increased equity as a result of appreciation, the example illustrates Congress's concern about the same disincentive that will occur here if Petitioner's interpretation is applied.

Here, the drafters intended to incentivize Chapter 13 filings over Chapter 7. Petitioner's plain interpretation of section 348(f)(1)(A) results in disincentivizing Chapter 13 filings. Thus, Petitioner's assertion that the plain meaning of section 348(f)(1)(A) produces "a result demonstrably at odds with the intention of its drafters." *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242, 109 S. Ct. 1026, 1031, 103 L. Ed. 2d 290 (1989). This legislative history further supports Congress's intent to incentivize Chapter 13 filings where it says:

> This amendment overrules the holding in cases such as *Matter of Lybrook*, 951 F.2d 136 (7th Cir. 1991) and adopts the reasoning of *In re Bobroff*, 766 F.2d 797 (3d Cir. 1985). However, it also gives the court discretion, in a case in which the debtor has abused the right to convert and converted in bad faith, to order that all property held at the time of conversion shall constitute property of the estate in the converted case.

H.R. REP. No. 103-835, at 57 (1994), *as reprinted in* 1994 U.S.C.C.A.N. 3340, 3366

In *Lybrook*, the Seventh Circuit found that real estate a debtor inherited post-petition, but pre-conversion was property of the estate. *Matter of Lybrook*, 951 F.2d 136 (7th Cir. 1991). Conversely, the Third Circuit in *Bobroff*, held that post-petition, pre-conversion tort claims are not included in the Chapter 7 estate. *In re Bobroff*, 766 F.2d 797 (3d Cir. 1985). Given the favoring of *Bobroff*, it is apparent that Congress intended to reassure debtors that they would not be in a worse position than if they had originally filed Chapter 7. Turning to the purpose and policy of the Bankruptcy Code, we find further support that the debtor benefits from the post-petition, pre-conversion in equity in his property.

D. Benefiting the Debtor in These Instances Furthers the Purpose and Policies Underlying the Bankruptcy Code.

One primary purpose of the Bankruptcy Code is "to provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.'" *Grogan v. Garner*, 498 U.S. 279, 286, 111 S. Ct. 654, 659, 112 L. Ed. 2d 755 (1991) (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244, 54 S. Ct. 695, 699, 78 L. Ed. 1230 (1934). Notably, the purpose of Chapter 13 is to incentivize debtors to repay debts with assurances that a Chapter 7 trustee will not be able to seize any post-petition, pre-conversion equity of the estate upon conversion. *See In re Hodges*, 518 B.R. 445, 449-50 (E.D. Tenn. 2014).

Here, creditors are not worse off than they would have been had the debtor originally filed for relief under Chapter 7. If the debtor originally filed for relief under Chapter 7, the estate would not have benefitted at all from the house. The house was valued at $350,000. (R. 6, 9). $30,000, of that total value, is exempt and attributable to the debtor, and the remaining $320,000 is secured in a mortgage by the Servicer. (R. 6). Without any equity leftover for the estate, the trustee would have disclaimed interest in the house, and the creditor may have moved forward to file for removal. Thus, while the creditors would be better off if the $100,000 increase in equity is deemed property of the estate, they would not be worse off if the increase belonged to the debtor.

Further, even when the case was converted to Chapter 7, all parties thought the home was worth $350,000. The Chapter 7 administrator initially concluded that the estate was "mostly bereft" of assets. (R. 9). It was not until Clegg mentioned that homes nearby were selling at a premium that an appraisal was commissioned and determined the home to be worth $100,000 more than it was on the petition date. *Id.*

By finding for the debtor, This Court will further the policy underlying Chapter 13 by incentivizing debtors to try and pay back their debts rather than starting with a Chapter 7 filing. Conversely, a finding otherwise would effectively punish debtors by requiring the liquidation of property they would have retained had they originally filed for relief under Chapter 7. Such a result would establish a substantial risk to the debtor in Chapter 13 cases. A debtor petitioning for Chapter 13 would risk losing the property if the property appreciates it. This risk directly opposes the purpose of Chapter 13 because rather than incentivizing Chapter 13 filings, it encourages debtors to commence their case under Chapter 7 to protect any increases in equity that accrues post-petition. For these reasons, Respondent respectfully requests that This Court affirm the Thirteenth Circuit's decision on the first issue of this matter.

II. Chapter 7 Trustees May Not Sell Their Avoidance Powers as Property of the Estate.

A Trustee in a Chapter 7 case has the primary role to maximize the property of the estate for the benefit of the creditors. *See* 11 U.S.C. § 541 (defining property of the estate). In support of this role, the Bankruptcy Code statutorily grants power and discretion solely to trustees to avoid preference payments to creditors. *See* 11 U.S.C. § 544 - 553 (avoidance powers, preferences, and liability of transferees). This is a non-transferable power for the following reasons. Historically, trustees could not sell this distinct power, and the property of the estate included only the interests in transfers conditioned upon the trustee's avoidance. The many amendments throughout legislative history did not change this practice outside of certain trustees. Unfortunately, conflation between the types of bankruptcy and the different types of trustees has led to legal errors and circuit splits which This Court has an opportunity to address. Finally, allowing this sale would create an absurd result for the debtor and the meaning of other provisions in the Code.

A. In Chapter 7 Cases, Limiting Avoidance Powers to the Trustee is in Keeping with the Traditional Practices and Purpose of Bankruptcies of This Type.

Historically, bankruptcy has been seen as an equitable alternative for overburdened debtors to find relief without unfairly prejudicing creditors for the greater benefit of the economy and commerce. Bankruptcy practices predate the founding of the United States, and the Constitution gives Congress express power to establish uniform Bankruptcy Laws throughout the United States. U.S. Const. art. I, § 8, cl. 4. At that time, many States had their own bankruptcy systems which were considered pro-creditor. Karen M. Gebbia, *The Keepers of the Code: Evolution of the Bankruptcy Community*, 91 Am. Bankr. L.J. 183 (2017). Congress first attempted to regulate bankruptcy in The Bankruptcy Act of 1800, which allowed only involuntary bankruptcies for merchants recognizing public policy interests in commerce and trade. *Id*. This legislation only lasted three years and States continued their Bankruptcy Systems. *Id.* Debtor's Prison was abolished for Federal Bankruptcy in 1833 (1843 for some States). *Id*. The Bankruptcy Act of 1841 introduced the concept of voluntary bankruptcies which extended bankruptcy to nonmerchants. *Id.* The Bankruptcy Act of 1867 created a more conclusive body of law covering different situations and allowed, for the first time, voluntary bankruptcies for any individual debtor regardless of merchant status. *Id*. The Bankruptcy Act of 1898 is considered to be the first nationwide comprehensive and "permanent" legislation which controlled until it was reformed in The Bankruptcy Reform Act of 1978 which codified this area of law. *Id*.

The Bankruptcy Reform Act of 1978 established the Bankruptcy Code and organized it into the various Chapters we know today. *Id*. It is important to note that throughout this history policymakers have tried to account for different circumstances in which debtors may need relief making distinctions between individual and business activities which can be seen in the organization of The Bankruptcy Code. *Id*.; *see also* 11 U.S.C. § 103 (setting forth the application of statutes to their corresponding sections).

Under the pre-code era of bankruptcy practices of the 18th century, a trustee's avoidance powers were non-transferable. In 1930, the Ninth Circuit held that under The Bankruptcy Act of 1898, the trustee's avoidance powers could not be transferred. *Grass v. Osborn*, 39 F.2d 461 (9th Cir. 1930); *see also*, *Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 372-73 (2006) (discussing the Constitutional history of bankruptcy and distinguishing the declaration of avoidance from other powers). In fact, courts considered it a "well-settled principle that [n]either a trustee in bankruptcy, nor a debtor in possession, can assign, sell, or otherwise transfer the right to maintain a suit to avoid a preference." *United Capital Corp. v. Sapolin Paints, Inc.* (*In re Sapolin Paints, Inc.*), 11 B.R. 930, 937 (Bankr. E.D.N.Y. 1981); *citing Grass v. Osborn*, 39 F.2d 461 (9th Cir. 1930); *Belding-Hall Mfg. Co. v. Mercer & Ferdon Lumber Co.*, 175 F. 335 (6th Cir. 1909); *Texas Consumer Finance Corp. v. First National City Bank*, 365 F. Supp. 427, 430 (S.D.N.Y.1973); *Parker v. Hand*, 299 Ill. 420, 132 N.E. 467 (1922).

The language Congress used in section 547 discussing "Preferences" and section 550 discussing "Liability of transferee of avoided transfer" in the Bankruptcy Code of 1978 did not materially alter the language from The Bankruptcy Act of 1898 where it says, "The trustee may avoid any transfer . . . and may recover . . . from the person to whom it was transferred, unless he was a bona fide holder for value prior to the date of adjudication." The Bankruptcy Act of 1898 ("Nelson Act", July 1, 1898, ch. 541, 30 Stat. 544). "When Congress use[s] the materially same language . . . it presumptively was aware of the longstanding judicial interpretation of the phrase and intended for it to retain its established meaning." *Lamar, Archer & Cofrin, LLP v. Appling*, 138 S. Ct. 1752, 1762 (2018). Thus, there is a reasonable presumption that Congress meant for avoidance powers to continue to be non-transferable without statutory authorization.

B. The Power to Avoid Only Arises out of Statutory Authorization and is a Strictly Personal, Non-Transferable Power without additional Legislative Authority.

Congress set forth the trustee's avoidance powers in sections 544-553 of The Bankruptcy Code which "can be invoked in only narrow circumstances." *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1663 (2019). Further, section 544 gives the "rights and powers" to the trustee, and sections 544 and 547 both state a "trustee may" avoid, under the provided circumstances, giving the trustee sole discretion to exercise this power. When the Bankruptcy Code uses the word "trustee," it means the trustee and no one else. *Hartford*

Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 6-7 (2000) ("Hen House"). Section 550(a) makes clear a distinction exists between an action to avoid and the subsequent action to recover in the second clause. 11 U.S.C. § 550(a). Section 541(a) (discussing the property of the estate) excludes any reference to section 550 or preferences. Therefore, Congress did not intend for avoidance claims to be included in the property. *See* Robert F. Williams, *Statutes As Sources of Law Beyond Their Terms in Common-Law Cases*, 50 Geo. Wash. L. Rev. 554, 563 (1982) (discussing the application of negative preemption or *argumentum a contrario*).

Thus, the general rule is that an estate's right to recover a transfer, as property to be distributed to creditors, is conditional to the trustee's discretional exercise of the avoidance powers, which is non-transferable. There is only one exception to this general rule which is derived from 11 U.S.C. § 1123(b)(3)(B).

> The pre-§ 1123(b)(3)(B) cases [referred] to do recite the rule that an avoidance action may be enforced only by the trustee. (citations omitted). However, the Bankruptcy Code is a statutory set of rules and Congress can change those rules. And to the extent that § 1123(b)(3)(B) authorizes the bankruptcy court to appoint "a representative of the estate . . . for that purpose," it alters the rule recited in these cases that an avoidance claim may be pursued only by the trustee or the debtor in possession. (citations omitted).

In re Sweetwater, 884 F.2d 1323, 1327-28 (10th Cir. 1989).

Jurisprudence and the language found in section 1123(b)(3)(B) have established a conditional exception to the general rule stated above. "If a creditor is pursuing interests common to all creditors or is appointed for the purpose of enforcement of the plan, he may exercise the trustee's avoidance powers." *In re Pro. Inv. Properties of Am.*, 955 F.2d 623, 626 (9th Cir. 1992). Effectively, the creditor must be (1) acting in the interest of *all* creditors and (2) be granted leave of court. This is the standard provided for in the cases cited by Petitioner.

However, even under this exception, Eclipse cannot step in the shoes of the trustee. First, they are clearly acting in only their vindictive interest outside of the interest of all creditors including Pink. Second, the Bankruptcy Court denied the request to transfer the avoidance action to Eclipse within its discretion. (R. 7; 10).

Regardless, it is unnecessary to consider the standard presented by Petitioner as this exception comes from a specific provision in the Bankruptcy Code, section 1123, which is *not* applicable to the entirety of the Code. Section 1123 falls under Subchapter II of Chapter 11 of the Bankruptcy Code: as such, it only applies to Chapter 11 (Reorganization) and Chapter 9 (Adjustment of Debt for Municipalities) cases. *See* 11 U.S.C. § 103(g). A legislative distinction here is again supported by the purpose and differences between types of bankruptcy cases. Chapter 9 cases are designed for the unique policy concerns that arise under circumstances where government municipalities as debtors and where creditors are unlikely to have conflicts of interest in some private corporate structure. Chapter 11 cases, unlike 13 and 7 cases, do not always have a trustee. These debtors often have significantly higher debt amounts as Chapter 11 is not subject to the same debt cap as a Chapter 13 case. They are usually managed by a debtor in possession, normally a business entity. Congress clearly intended for a trustee's avoidance powers to be strictly personal to the trustee and non-transferable except for in Chapter 11 and Chapter 9 cases where court approval is granted in the interest of all creditors.

C. Despite Circuit Splits, the Jurisprudence is Overwhelmingly in Favor of Limiting the Sale of Chapter 7 Trustee Avoidance Powers.

As the lower courts' opinions and dissent have clearly illustrated, there is a split among the circuits on this issue. One Sixth Circuit opinion noted this split, cataloged the various rationales from different courts, and came to the correct conclusion simply by recognizing more jurisprudence in favor of not allowing trustees to sell their avoidance powers. *In re Clements Mfg. Liquidation Co., LLC*, 558 B.R. 187 (BankR. E.D. Mich. 2016). Similarly, the following analysis looks at the various cases found in support of either interpretation.

Supreme Court

Several Supreme Court cases support Respondent's position. The most recent of which contrasts the trustee's avoidance power while discussing the power of rejection. *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1663 (2019). Here, The Court noted that "[a] trustee's avoidance powers are laid out in a discrete set of sections . . . [a]nd they can be invoked in only narrow circumstances." *Id*. Interestingly, The Court concluded a trustee could not use the power of rejection because that would render them functionally equivalent and the distinction matters. *Id*. It stands to reason that the inverse would be true. Before this, The Court noted in a footnote that the Sixth Circuit had allowed transfers of this type. *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 13, 120 S. Ct. 1942, 1951, 147 L. Ed. 2d 1 (2000) ("Hen House"). While This Court did not need to decide the issue to resolve Hen House, it did indicate disagreement saying, "even though the applicable Code provisions . . . mention only the trustee." *Id*.

In a 1991 case, This Court discusses the purpose of section 547 preferences providing all five conditions that must be present to exercise them. These include (1) benefit a creditor; (2) be on account of antecedent debt; (3) be made while the debtor was insolvent; (4) be made within 90 days before bankruptcy; and (5) enable the creditor to receive a larger share of the estate than if the transfer had not been made. *Union Bank v. Wolas*, 502 U.S. 151, 160-61 (1991). This Court recognized how none of the exceptions may be present. Id. Finally, The Court made a distinction between the right to recover and the right to avoid with the first being conditioned upon the latter. *Id*. This rationale supports that avoidance is a statutory power granted only in support of their duty. Just before this and in another case, This Court noted that when debtors have no interests in a claim pre-petition then there is nothing in the estate to sell. *Begier v. IRS*, 496 U.S. 53, 110 S. Ct. 2258, 110 L. Ed. 2d 46 (1990). This rationale, read with others cited below, supports that an avoidance claim for preference is not part of the estate because of the petition date and the claim should be precluded by res judicata and the settlement Clegg had made in his Chapter 13 plan. (R. 7). Put another way, it is not estate property where the estate relinquished its interest pre-petition. One final case from This Court provides important insights. If this claim were "property" of the estate, it would require turnover, a different remedy, rendering avoidance powers superfluous. *See United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983). The Court made clear that, assuming the property is useful to the debtor's estate, any property interest, no matter how worthless in the market, establishes the grounds for a trustee's turnover action. *See* Craig S. Provorny, *The Outer Limits of Section 542 of the Bankruptcy Code: United States v. Whiting Pools, Inc., Revisited*, 7 Cardozo L. Rev. 935 (1986). This reinforces the above arguments that avoidance of preference claims is a distinct power to be used only in the narrow circumstances provided for by Congress.

Petitioner relies on three Supreme Court cases to support their position; however, Petitioner fails to realize none of the cases directly conflicts with or challenges the rationales explained above. Two of these cases are substantially and factually similar with one being the above *United States v. Whiting Pools, Inc.* The other, *United States v. Nordic Vill. Inc.*, does not hold that avoidance claims are transferable, and merely states the "claims" are property of the estate as an oversimplification for the sake of timing. *United States v. Nordic Vill. Inc.*, 503 U.S. 30, 112 S. Ct. 1011, 117 L. Ed. 2d 181 (1992). The "claim" This Court was referring to is the interest the debtor still had on the date of the petition, not the right to avoid. We know this because the transfer The Court is referring to is a seizure by the IRS which did not convert the debtor's interest in title to the property. *See* Douglas Kahle, *United States v. Nordic Village, Inc.: "Unequivocal", Yet Unwarranted, Support for Sovereign Immunity*, 25 U. Tol. L. Rev. 325 (1994). "They stated . . . a trustee [may] assert avoiding powers under Title 11 against a governmental unit." *Id* at 335. "A suit for payment of funds from the Treasury is quite different from a suit for the return of tangible property in which *the debtor retained* ownership." *United States v. Nordic Vill. Inc.*, 117 L. Ed. 2d 181 (1992). In neither case did The Court need to decide the issue before us today. Further, the latter of these two cases has already been superseded, as stated in *Miller v. United States*, 71 F.4th 1247, 1253 (10th Cir. 2023). The next Supreme Court case referenced is completely distinguishable as it does nothing more than make the distinction that underlining State claims for fraudulent transfers with the right to a jury are independent of other claims being brought and still entitled to 7th Amendment protections. *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 109 S. Ct. 2782, 106 L. Ed. 2d 26 (1989). Further, it does describe avoidance as a cause of action, but never suggests anyone other than the trustee may bring that cause of action. *See id*. The dissent in the present case is failing to recognize the distinction and relationships between the claims of preference and other claims like fraud. *Id*.

<u>First Circuit</u>

The First Circuit has not spoken directly on this issue. However, the dissent in the present case tries to rely on a distinguishable case regarding a fraudulent conveyance, not a preference claim, to describe property of the estate. The quote from the case is the broad rule that, "property of the estate to be comprised of all legal or equitable interests of the debtor in property as of the commencement of the case." *In re Ontos, Inc.*, 478 F.3d 427, 431 (1st Cir. 2007). Again, the "debtor" does not have any legal interest in a preference claim at the commencement of that case because any recovery is conditional upon the trustee's distinct power.

<u>Second Circuit</u>

The majority of the cases arising out of the second circuit are favorable to Respondent. Cases found in support include *In re Vogel Van & Storage, Inc.*, 210 B.R. 27 (N.D.N.Y. 1997), *aff'd*, 142 F.3d 571 (2d Cir. 1998) (holding a well-settled principle that neither a trustee in bankruptcy, nor a debtor-in-possession, can assign, sell, or otherwise transfer the right to maintain a suit to avoid a preference; case suggest derivative standing is a separate and limited remedy); *In re 100 Lindbergh Blvd. Corp.*, 128 B.R. 53 (BankR. E.D.N.Y. 1991) (holding property of the estate is dependent on pre-petition interest; case further supports the *res judicata* arguments); and *In re Sapolin Paints, Inc.*, 11 B.R. 930 (BankR. E.D.N.Y. 1981) (holding the rights of the trustee are not assignable because the power is to be exercised in the interests of securing equality of distribution among creditors).

On the other hand, there is a case that held a creditor violated the automatic stay by trying to usurp avoidance claims because they are property of the estate, but still held the trustee still had the discretion to bring those claims. *Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec., LLC*, 460 B.R. 106 (BankR. S.D.N.Y. 2011), *aff'd*, 474 B.R. 76 (S.D.N.Y. 2012). Following this case would support that Eclipse is in violation of the automatic stay and that only Floyd can bring avoidance claims against Pink. The other case cited to support the sale, said the sales are not permitted if not for the benefit of all the creditors. *In re Boyer*, 372 B.R. 102, 106 (D. Conn. 2007), *aff'd,* 328 F. App'x 711 (2d Cir. 2009).

<u>Third Circuit</u>

Cases from the Third Circuit are favorable to Respondent. In the 2000 case, *In re Cybergenics Corp.*, the court looked at cases from the Ninth Circuit and decided the issue did not need to be addressed, concluding that there was no assignment of avoidance powers and that "neither the fraudulent transfer claim nor the avoidance power was an asset." 226 F.3d 237, 245 (3d Cir. 2000). The court also analogized the trustee's power to that of a public official which could not be part of the estate. *In re Cybergenics Corp.*, 226 F.3d 237, 245 (3d Cir. 2000). Nearly twenty years later a court addressed a similar issue and allowed derivative standing in Chapter 11 cases where the estate is managed by a debtor in possession who unreasonably refuses to pursue claims. *Artesanias Hacienda Real S.A. de C.V. v. N. Mill Cap. LLC*, 607 B.R. 189, 209 (E.D. Pa. 2019). The court was careful to limit the application only to Chapter 11 cases stating that there is no textual basis to do so in the Code. *Id* at 210 footnote 22. This court also took note of a Delaware bankruptcy case which extended derivative standing *In re Cybergenics Corp.* to a Chapter 7 case and declined to follow. *Id* at 210; *see also In re Pursuit Cap. Mgmt., LLC*, 595 B.R. 631 (BankR. D. Del. 2018). Thus, the Third Circuit has set a precedent that *In Re Cybergenics Corp.* cannot be extended to Chapter 7 Trustees.

<u>Fifth Circuit</u>

Similar to the First Circuit, the decent in the present case cites but one distinguishable case in support of selling avoidance actions. *See In re Moore*, 608 F.3d 253, 262 (5th Cir. 2010). This is another fraudulent transfer case looking at the underlying State law. Fraudulent conveyance should not be conflated with preference transfers. Debtors do not have any interest in a simple preference claim without the trustee's assertion of power whereas in a fraudulent case, the debtor would have an independent and actionable claim. Section 541 makes clear the property of the estate includes the debtor's interest which can be seen in most court analyses regarding future interests. Furthermore, the Fifth Circuit spoke more directly on this issue refusing to give a Chapter 7 creditor any standing to pursue avoidance claims. *In re Cooper*, 405 B.R. 801 (BankR. N.D. Tex. 2009).

Sixth Circuit

Cases throughout the Sixth Circuit are arguably supportive of the arguments presented that a Chapter 7 Trustee cannot sell avoidance actions. *See In re Clements Mfg. Liquidation Co., LLC*, 521 B.R. 231 (BankR. E.D. Mich. 2014) (analyzing cases from both sides and ruling the sale is estopped by law); *In re Parirokh*, DG 11-05409 (BankR. W.D. Mich., May 2, 2013) (holding section 544 avoidance actions are not property of the bankruptcy estate, and Chapter 7 trustee cannot sell them to a third party); *In re Bargdill*, 238 B.R. 711 (BankR. N.D. Ohio 1999) (holding that Congress did not intend for a Chapter 7 Trustee to assign their avoidance powers which was not to be conflated with delegation). Cases leaning in the other direction are all distinguishable. *See In re Murray Metallurgical Coal Holdings, LLC*, 623 B.R. 444 (BankR. S.D. Ohio 2021) (holding avoidance claims are a part of the estate and transferable, but only under the limited provisions of Chapter 11 cases); *see also In re Trailer Source, Inc.*, 555 F.3d 231 (6th Cir. 2009) (court found "no textual support in the Code for drawing such a distinction between the Chapter 7 and Chapter 11" without taking into account section 103 of the Code or the fundamental differences in the chapters); *see also In re Gibson Grp., Inc.*, 66 F.3d 1436 (6th Cir. 1995) (allowing derivative standing in the context of Chapter 11 with court approval after an abuse of discretion by the trustee or debtor in possession). The dissent in the present case cites *In re Parker* as evidence that the causes of action are legal and equitable interest of the estate.

499 F.3d 616, 624 (6th Cir. 2007). What the dissent overlooks is the language "that belongs to the debtor" in reference to underlining State claims for malpractice. *Id*.

Seventh Circuit

The Seventh Circuit has conclusively held that a Chapter 7 trustee may not assign preference claims or fraudulent conveyance claims. *In re Metal Brokers Int'l, Inc.*, 225 B.R. 920 (BankR. E.D. Wis. 1998) (rationalizing that only the trustee has standing to bring preference claims). This court also noted that not allowing the debtor to challenge the standing issue would violate due process. *Id* at 922.

Eighth Circuit

The Eighth Circuit has very recently spoken on this issue and is relied heavily upon by the dissent. *In re Simply Essentials, LLC*, 78 F.4th 1006, 1008 (8th Cir. 2023). A close reading of this case shows that the court relied almost exclusively on the "broad" definition of the estate and the dicta discussed above from *United States v. Whiting Pools, Inc.* and *United States v. Nordic Vill. Inc*. *See id*. This recent opinion also failed to address the president from within their own circuit:

> Generally speaking, individual creditors can not [*sic*] exercise a trustee's avoidance powers. *In re Bridges*, 29 B.R. 716, 717 (Bankr.W.D.Ky.1983). A creditor holding an allowed unsecured claim lacks standing to avoid a transfer. *Matter of Milam*, 37 B.R. 865 (Bankr.N.D.Ga.1984). It is typically the trustee who should weigh the merits of the action, the likelihood of success, the litigation cost to the estate and the ultimate net benefit to the estate. *Milam* at 868. An aggrieved creditor may bring the failure of a debtor in possession to pursue a section 547 action to the court's attention by appropriate motion; however, the court must balance the competing interests and determine whether the initiation of such an action at that time would forward the reorganization effort or, to the contrary, work against it. *Curry* at 828. A creditor may not bring a suit in its own behalf to avoid a preference

or fraudulent transfer. *Matter of Monsour Medical Center*, 5 B.R. 715, 718 (Bankr.W.D.Pa.1980).

Matter of Feldhahn, 92 B.R. 834, 836 (BankR. S.D. Iowa 1988).

Ninth Circuit

The Ninth Circuit is the only circuit that on its face seems to support Petitioner's positions. However, the line of cases relying on each other derives from a legal error. The most recent Appeals case held that a trustee may sell an estate's avoidance claim. *Silverman v. Birdsell*, 796 F. App'x 935 (9th Cir. 2020) (relying on *In re P.R.TC., Inc.*). Before this the court held a chapter 7 trustee can assign avoidance powers to a creditor misinterpreting the rule and relying on yet another older case. *In re P.R.T.C., Inc.*, 177 F.3d 774 (9th Cir. 1999) (relying on In re Professional Inv. Properties of America). In this older case, the court makes a significant legal error by adopting only part of the rule found in *In re Sweetwater* from the Tenth Circuit. *In re P.R.T.C., Inc.*, 177 F.3d 774 (9th Cir. 1999). The court here correctly notes that *In Re Sweetwater* was dealing specifically with the provisions under section 1123 of the Code but fails to recognize that this provision does not apply to the entirety of the Code as stated above. *Id*. The Court said "Nor have we found, any reason why a Chapter 11 trustee can transfer its avoidance powers outside a reorganization plan, but a Chapter 7 trustee cannot" adopting the standards of a Chapter 11 trustee and extending them to Chapter 7 trustees. *Id* at 782. This Tenth Circuit case, the court was reviewing, specifically noted that section 1123(b)(3)(B) superseded many of the long line of jurisprudence holding avoidance was an exclusive power, but only that section and its specific language. *In re Sweetwater*, 884 F.2d 1323, 1327 (10th Cir. 1989). Thus, any use of this exception carved out for Chapter 11 and 9 bankruptcies is a legal error when applied elsewhere.

<u>Tenth Circuit</u>

From the Tenth Circuit there is but one case which speaks directly on this issue other than *In re Sweetwater*. In *In re Waterford funding, LLC* a dispute arose over who owned the litigious rights to certain claims after a trustee assigned rights to collect and interest in a judgment. No. AP 11-2093, 2017 WL 439308 (BankR. D. Utah Feb. 1, 2017). After the judgment had been set aside, that same party tried to use the Trustee's power to revive the judgment. *Id*. The court noted the exclusive language in the Code and the all-encompassing language of the written assignment. In the bankruptcy court's discussion, they recognized that allowing the assignment of the trustee's power would potentially burden the Federal Court System. *Id*.

> The Court holds that even if the Trustee had intended to transfer the underlying claims to BRS through the assignment agreement, he could not have done so. At most, the Trustee assigned the judgment to BRS. Once that judgment was set aside, BRS lacked standing to prosecute any of the underlying claims.

In re Waterford Funding, LLC, No. AP 11-2093, 2017 WL 439308, at 3 (BankR. D. Utah Feb. 1, 2017).

<u>Eleventh Circuit</u>

Like the Seventh Circuit, the Eleventh Circuit has conclusively held "[t]his sale cannot be allowed, as a trustee cannot sell a preference or fraudulent conveyance claim. [A] trustee is prohibited from selling, transferring, or assigning the right to assert and maintain an estate's avoidance action to an individual creditor. '[I]t is also a well settled [*sic*] principle that neither a trustee in bankruptcy, nor a debtor-in-possession, can assign, sell, or otherwise transfer the right to maintain a suit to avoid a preference.' *In re Carragher*, 249 B.R. 817, 820 (BankR. N.D. Ga. 2000). The Court went on to describe extraordinary circumstances that would allow a creditor to bring suit, "(1) that the claim must be colorable; (2) that the intervention must be brought on behalf of the estate; and (3) that the trustee or debtor-in-possession has unjustifiably refused to bring the suit or abused its discretion in not suing." citing *In re McConnell*, 122 B.R. 41, 44 (BankR. S.D. Tex. 1989). However, the jurisprudence cited in support of these factors makes no such determination and is distinguishable as all from Chapter 11 cases. *See In re Louisiana World Exploration, Inc*., 832 F.2d 1391; *In re V. Sajino Oil & Heating Co.*, 91 B.R. 655 (BankR. E.D.N.Y. 1988); *In re Feldhahn*, 92 B.R. 834 (BankR. S.D. Iowa 1988). What these cases do provide is a robust body of jurisprudence holding that avoidance powers are non-transferable as a well-settled principle of law.

Summary

While the courts have clearly struggled to identify the correct rule at times, the jurisprudence is overwhelmingly supportive of Respondent's position. The analysis shows that any case cited in support of a sale can be distinguished, has been superseded, or relies on conflated legal standards. The debtor has no legal interest in a preference claim at the time of the petition and is therefore not part of the estate. Only a trustee or debtor in possession has standing to bring a preference action on its own and therefore is not assignable. Derivative standing may be granted by the bankruptcy court through an appointment for the benefit of all creditors under a Chapter 11 or Chapter 9 bankruptcy if the trustee or debtor unreasonably refuses to do so. In no instance can a trustee independently assign their statutory powers to a creditor. This rule does not affect any standing a creditor may have for underlying State claims or other remedies.

D. Allowing Sales of This Type Would Lead to Detrimental and Absurd Results.

When interpreting statutes courts should strive to give effect to all provisions of Congress's work, "so that no part will be inoperative or superfluous, void or insignificant." *Ysleta Del Sur Pueblo v. Texas*, 596 U.S. 685, 699, 142 S. Ct. 1929, 1939, 213 L. Ed. 2d 221

(2022); *Corley v. United States*, 556 U.S. 303, 129 S. Ct. 1558, 1560, 173 L. Ed. 2d 443 (2009). ("[a] statute should be construed [to give effect] to all its provisions, so that no part will be inoperative or superfluous, void or insignificant") (internal citations omitted). As the United States Court of Appeals for the Thirteenth Circuit already noted, interpreting the Bankruptcy Code in a way that allows avoidance claims to be included as property of the estate would violate this cannon because of the previously noted distinction between avoidance powers and interests in property "actually" recovered. (R. 22). Similarly, allowing Chapter 7 Trustees to sell their avoidance powers to creditors, especially under these facts, would render other areas of the Bankruptcy Code inoperative.

The primary purpose of bankruptcy is to give the debtor a "fresh start" which is ultimately accomplished through the injunction against collection efforts described in section 524. In assessing violations of the discharge injunction, the core issue is whether the creditor acted in such a way as to coerce or harass the debtor improperly. *In re Pratt*, 462 F.3d 14 (1st Cir. 2006); *see also In re Whitman-Nieves*, 519 B.R. 1 (BankR. D.P.R. 2014) (creditor violated discharge injunction when it sent payment booklet to co-debtor's mother).

Here, Eclipse is attempting to purchase leverage over Pink in the form of a preference claim. Pink is a close family member to Cregg and has been stipulated as an insider. (R. 18). The record clearly shows Eclipse's offer is purely retaliatory in nature; Eclipse was reportedly "livid" about the donation to the VFW. (R. 7). Additionally, Eclipse made an offer to pay exactly $20,000 ($470,000 - $450,00 home value = $20,000) for these litigious rights which only offers a chance to recover $20,000. (R. 9). This is indicative of Eclipse's motive as they offered to pay the full potential value for a "chance" to recover in what would be an aleatory contract. Allowing Eclipse to purchase this type of leverage over Pink would be to sanction a preemptive attempt to continuously harass Clegg's family. This would violate any injunctive relief the court grants through discharge, rendering section 524 and related statutes inoperative, undermining the entirety of the bankruptcy.

Conclusion

For the foregoing reasons, Respondent respectfully asks this Court to affirm the decisions of the United States Court of Appeals for the Thirteenth Circuit and the United States Bankruptcy Court for the District of Moot in favor of Mr. Clegg on both questions presented for review.

Dated: January 18th, 2024

Respectfully submitted,

Team 26
Counsel for Respondent