No. 23-0115

IN THE
Supreme Court of the United States

In Re Eugene Clegg, Debtor

VERA LYNN FLOYD, CHAPTER 7 TRUSTEE, PETITIONER

v.

EUGENE CLEGG, RESPONDENT.

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

BRIEF FOR PETITIONER

31P
Counsel for Petitioner

QUESTIONS PRESENTED

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

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

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OPINIONS BELOW

The Thirteenth Circuit Court of Appeals' decision is available at No. 22-0359 and reprinted starting at Record 3. Both the bankruptcy court and the bankruptcy appellate panel for the Thirteenth Circuit decided in favor of Debtor Eugene Clegg. On appeal, the United States Court of Appeals for the Thirteenth Circuit affirmed.

STATEMENT OF JURISDICTION

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

PERTINENT STATUTORY PROVISIONS

At issue in this case is the application of the following pertinent provisions of the United States Bankruptcy Code.

The relevant portion of 11 U.S.C. § 348(f) provides:

> (f)(1) Except as provided in paragraph (2), when a case under chapter 13 of this title is converted to a case under another chapter under this title—
>
> > (A) property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion; [...]
>
> (2) If the debtor converts a case under chapter 13 of this title to a case under another Chapter under this title in bad faith, the property of the estate in the converted case shall consist of the property of the estate as of the date of conversion.

The relevant portion of 11 U.S.C. § 541(a) provides:

> (a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
>
> > (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.
> >
> > (2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is—
> >
> > > (A) under the sole, equal, or joint management and control of the debtor; or
> > >
> > > (B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.
> >
> > (3) Any interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title.
> >
> > (4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title.

(5) Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date –

(A) by bequest, devise, or inheritance;

(B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or

(C) as a beneficiary of a life insurance policy or of a death benefit plan.

(6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.

(7) Any interest in property that the estate acquires after the commencement of the case. [...]

The relevant portion of 11 U.S.C. § 547(b) provides:

(b) Except as provided in subsections (c) and (i) of this section, the trustee may, […] avoid any transfer of an interest of the debtor in property –

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made–

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if –

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

The relevant portion of 11 U.S.C. § 550 provides:

(a)Except as otherwise provided in this section, 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, or, if the court so orders, the value of such property, from--

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.

(b)The trustee may not recover under section (a)(2) of this section from--

(1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or

(2) any immediate or mediate good faith transferee of such transferee.

(c)If a transfer made between 90 days and one year before the filing of the petition--

(1)is avoided under section 547(b) of this title; and

(2)was made for the benefit of a creditor that at the time of such transfer was an insider; […]

STATEMENT OF THE CASE

Factual History

In 2011, Eugene Clegg ("Debtor") retired from military service and was gifted full ownership of his mother's business, a single-screen movie theater called The Final Cut, LLC ("Final Cut"). R.5. At the time that Debtor's mother, Emily "Pink" Clegg ("Pink"), transferred the business to her son, Final Cut had no liabilities and consistently generated annual net profits. *Id.* Final Cut provided Debtor's sole source of income. *Id*.

In 2016, Debtor obtained an $850,000 loan (the "Loan") from Eclipse Credit Union ("Eclipse") to remodel Final Cut. Eclipse perfected first priority liens on Final Cut's real and personal property and required Debtor to provide an unconditional, unsecured personal guarantee on the Loan. *Id*. at 5. Debtor personally led the theater's renovation work with the assistance of local veterans who volunteered their time. *Id*. In 2017, Debtor donated the remaining $75,000 of the Loan to an affiliated organization, Veterans of Foreign Wars (the "VFW"). *Id.*

Final Cut was profitable until March 2020, when the COVID-19 pandemic caused operations to halt for nearly a year. *Id.* On September 8, 2020, Debtor borrowed $50,000 from his mother, Pink, on an unsecured basis. *Id*. In February 2021, Final Cut reopened but continued to struggle. *Id*. During this continued downturn, Debtor fell behind on his home mortgage. *Id*. The mortgage was serviced by Another Brick in the Wall Financial Corporation (the "Servicer"), who commenced foreclosure proceedings after Debtor failed to pay his mortgage for several months. *Id.* at 6.

Debtor Files for Chapter 13 Bankruptcy

In an attempt to retain his home, Debtor filed for chapter 13 bankruptcy on December 8, 2021 (the "Petition Date"). On Schedule A/B, Debtor declared a home value of $350,000. On schedule D, Debtor declared a non-contingent, liquidated, and undisputed secured debt of

$320,000 owed to Servicer. *Id*. at 6. On Schedule C, Debtor claimed a $30,000 homestead exemption, the maximum allowed in the State of Moot. *Id.* at 6-7. *See* § 522(b).[1] Debtor also disclosed that he had repaid his mother, Pink, $20,000 within one year of the Petition Date. *Id.* at 7.

Debtor filed a chapter 13 plan and proposed a three-year period to repay creditors. *Id*. Per the plan, Debtor would cure his prepetition mortgage deficiency as well as make continuous monthly payments to the chapter 13 Trustee who would act as a conduit for Servicer. *See* §§ 1322(b)(5), 1326(c). On Petition Date, Debtor declared that he had no equity in his home due to his mortgage debt and homestead exemption. R.7. Debtor intended to fund the chapter 13 plan solely with anticipated future earnings from Final Cut. *Id.* All interested parties were optimistic that Final Cut would immediately recover from the COVID-19 economic downturn. *Id.*, *See* § 1325(a)(6).

The meeting of creditors proceeded. R.7, *See* § 341; Fed. R. Bankr. P. 2003. Eclipse was furious to learn, for the first time, that Debtor caused Final Cut to donate $75,000 of its $850,000 Loan. In turn, Eclipse alleged that Debtor fraudulently conveyed Loan proceeds to VFW, and it sued to have the Loan declared non-dischargeable. R.7, *See* § 523(a)(2)(A).

In the run-up to confirmation, the chapter 13 Trustee objected because Debtor's plan failed to meet the requirements of § 1325(a)(4). *Id*. This section mandates that each creditor under the chapter 13 plan should receive no less than they would in a hypothetical liquidation under chapter 7. *See* § 1325(a)(4). The chapter 13 Trustee argued that under chapter 7, Debtor's repayments to his mother were avoidable as preferential transfers to an insider. *Id*., *see* §547(b).

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

To address this objection, Debtor made amendments to the plan, increasing the aggregate payments to creditors by $20,000 over the applicable commitment period. R.7. In turn, the chapter 13 Trustee agreed that she would not seek to avoid and recover Debtor's payments to his mother. *Id*. at 8.

Eclipse also objected to the plan, alleging that Debtor did not make the proposal in good faith. *Id*., *see* § 1325(a)(3). However, after weeks of negotiation, Eclipse agreed to withdraw its objection in exchange for an estimated claim of $150,000 so long as $25,000 of its Loan was deemed non-dischargeable. R.8. The bankruptcy court confirmed Debtor's plan on February 12, 2022, thereby vesting all property in Debtor. *Id*., *see* § 1327(b). The court also approved Debtor's settlement with the chapter 13 Trustee and Eclipse. R.8.

Debtor Converts to Chapter 7

Debtor complied with the confirmed plan for a mere eight months before he became ill and permanently closed Final Cut in October 2022. *Id.* At that time, Eclipse commenced foreclosure proceedings against Final Cut. *Id*. Without a source of income, Debtor filed to convert his case to chapter 7, which the court approved.[2] *Id.*, See §§ 348, 1307. The chapter 13 Trustee reported that she had distributed $10,000 to Servicer under the plan and that she returned the funds to Debtor that had been held in reserve for Eclipse. R.8-9.

The bankruptcy court appointed Very Lynn Floyd, petitioner in this case, as Trustee ("Trustee") of Debtor's chapter 7 estate. *Id*. at 9. Debtor's conversion schedules valued his home at $350,000 on the Petition Date. Post-conversion, Eclipse foreclosed on the $850,000 Loan to Final Cut. However, Debtor remained in debt to Eclipse by approximately $200,000 stemming from his personal guarantee of the Loan. *Id*. Debtor disclosed the alleged preferential transfers to

[2] No interested party contends that Debtor converted in bad faith.

his mother. *Id*. Debtor stated that he intended to reaffirm the mortgage debt he owed to Servicer and to remain in his home. *Id*., *see* § 524(c).

The Trustee initially concluded that the estate was effectively bare and commissioned an appraisal of Debtor's home. R.9. Since the Petition Date, the property value had appreciated to $450,000. *Id*. Upon this new valuation, Debtor held $100,000 in non-exempt equity in the home. *Id*. In an attempt to fulfill her duty to liquidate the estate for the benefit of the creditors, the Trustee put the home on the market. *Id*., *see* § 704(a)(1).

Eclipse offered to purchase both the home and the alleged $20,000 preference claim against Debtor's mother for a total of $470,000. R.9. Because this offer represented the fair market value of the home and the maximum value that the Trustee would otherwise be able to recover in an avoidance action against Pink, the Trustee filed a Sale Motion under § 363(b). *Id*.

Procedural History

Debtor objected to the Sale Motion, arguing that (1) any post-petition, pre-conversion increase in the equity of his home should inure to his benefit, and that (2) the Trustee could not sell her ability to avoid and recover preferential transfers under §§ 547 and 550 because such action was a statutory power vested solely in the Trustee, meaning it was not property of the estate. R.10. The bankruptcy court ruled in favor of the Debtor. *Id*. The Trustee then filed a direct appeal to the United States Court of Appeals for the Thirteenth Circuit, which affirmed the bankruptcy court on both objections.

STANDARD OF REVIEW

This Court reviews questions of law, such as interpretations of the Bankruptcy Code, *de novo*. *See In re Simpson*, 557 F.3d 1010, 1014 (9th Cir. 2009).

SUMMARY OF THE ARGUMENT

This Court should reverse the Thirteenth Circuit decision; allowing the Debtor to retain post-petition, pre-conversion home appreciation contradicts the Code. Debtor seeks an unjust windfall, leaving creditors with nothing from his virtually empty bankruptcy estate.

Section 348(f) is clear: property in Debtor's possession since the chapter 13 filing becomes part of the chapter 7 estate upon conversion. Equity is inseparable from the home, not a distinct asset. Section 541 supports the notion that equity is not a separate right or interest. If anything, appreciation in home equity most strongly resembles post-petition "proceeds, product, offspring, rents, or profits," which all expressly inure to the benefit of creditors under § 541(a)(6).

Moreover, this Court should reverse the decisions below, as preventing the Trustee from selling a cause of action stemming from an avoidable preferential transfer would go against the Code and lead to unnecessary waste. Post-conversion, the chapter 13 Trustee attempted to assign the avoidance and recovery action to a creditor in exchange for the face value of Debtor's impermissible transfer. The Code imposes a duty on the Trustee to maximize the bankruptcy estate's distribution to creditors. Here, the Trustee has a willing buyer offering to pay the recovery value of the claim. This would allow the Trustee to forgo the administrative and legal costs of pursuing an avoidance action directly.

Simply put, preference actions are avoidance actions. Avoidance actions are causes of action. Causes of action are property of the estate. A chapter 7 trustee must liquidate all non-exempt property for creditors' benefit. Selling the avoidance claim to Eclipse relieves estate of administrative and financial burdens, ensuring a more certain outcome than pursuing the action directly.

ARGUMENT

The Bankruptcy Code offers a "fresh start to the honest but unfortunate debtor." *Matter of Castleman*, 75 F.4th 1052, 1055 (B.A.P. 9th Cir. 2023) (quoting *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 367 (2007)). The Code offers individual debtors two routes: they can attempt to reorganize their debts under chapter 13, or they can seek full discharge under chapter 7. *Harris v. Viegelahn*, 575 U.S. 510, 514 (2015).

Chapter 13 is a voluntary process by which the debtor proposes a three-to-five-year repayment plan funded primarily from the debtor's future earnings. § 1322(a)(1). If the court approves the debtor's repayment plan, all pre-petition debts are discharged after successful completion. § 1328. Chapter 13 is mutually beneficial: debtors are able to retain their assets and creditors collect at least as much as they would under a chapter 7 liquidation. *See* § 1325(a)(4). However, if the debtor fails to make payments according to the chapter 13 confirmed plan, the court can dismiss the chapter 13 case. §§ 348, 349, 1307.

Alternatively, a failed chapter 13 debtor can convert their case to chapter 7 and seek discharge by way of liquidation. §§ 1307(a); 348(f). When a case is converted from chapter 13 to chapter 7 in good faith, the converted bankruptcy estate consists of any property that was in the estate on the chapter 13 petition date that is still in the possession of the debtor on the conversion date. § 348(f)(1)(A). From the time of conversion onward, chapter 7's provisions apply exclusively. *See Harris*, 575 U.S. at 520 ("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 Code imposes a fiduciary duty upon the chapter 7 trustee to maximize the value of the estate for the benefit of the creditors by collecting the debtor's non-exempt property within a so-called bankruptcy estate and reducing it to money. § 704(a)(1). In general, estate property includes virtually every conceivable interest in property that the debtor holds as of the

bankruptcy case's commencement. § 541(a)(1). Estate property also includes post-petition proceeds, products, offspring, rents, or profits from estate property. § 541(a)(6). In other words, estate property encompasses most post-petition economic fruits of petition-date property, such as any payments for the use or occupancy of property. *Id*. In order for a trustee to sell a debtor's interest under § 363, such interest must constitute property of the estate under § 541(a). *See In re Moore*, 608 F.3d 253, 258 (B.A.P. 5th Cir. 2010) ("A trustee may sell only assets that are property of the estate." (internal citations omitted).

The lower court erred in ruling that a debtor is entitled to post-petition, pre-conversion apperception in the debtor's homestead because (1) the home was in the debtor's possession on the Petition Date and the Conversion Date, which is consistent with § 348(f), and (2) equity in property is regarded as an attribute or incident of the property per § 541, not a separate interest of right in the property. Additionally, the lower court erred in ruling that a trustee could not sell the preferential avoidance action because (1) the Trustee has a legitimate cause of action for a preference claim under § 547, and (2) such causes of action are recoverable for the benefit of the estate as expressly referenced in § 550.

I. ANY POST-PETITION, PRE-CONVERSION INCREASE IN EQUITY IN A DEBTOR'S HOME INURES TO THE BENEFIT OF THE ESTATE UPON CONVERSION OF A CASE FROM CHAPTER 13 TO CHAPTER 7 PURSUANT TO 11 U.S.C. §§ 348 AND 541.

The property of a converted chapter 7 estate is defined by § 348(f), which lays out the property included in the estate upon conversion. Additionally, a debtor's filing of a bankruptcy petition creates an estate comprising "all legal or equitable interests of the debtor in property as of the commencement of the case." § 541(a)(1).

In this case, the Court is being asked to determine whether any post-petition, pre-conversion increase in equity in a debtor's home inures to the benefit of the debtor upon conversion of a case from a chapter 13 to chapter 7 pursuant to §§ 348 and 541.

Currently, courts are deeply divided on this issue. *See e.g.*, *Matter of Castleman,* 75 F.4th 1052 (B.A.P. 9th Cir. 2023) (holding that appreciation is property of the estate when a case is converted from chapter 13 to chapter 7.); *In re Adams*, 641 B.R 147 (Bankr. W.D. Mich. 2022) (holding that among the interests included within the estate is the right to sell the property and enjoy the proceeds of sale, including any post-petition appreciation in value, so long as the appreciation is not allocable to a debtor's post-petition earnings.); *Coslow v. Reisz*, 811 Fed. Appx. 980, 983 (B.A.P. 6th Cir. 2020) ("[i]n general, post-petition increases in equity do become part of the bankruptcy estate, as long as the equity isn't payment for post-petition services."); *In re Goetz,* 651 B.R. 292, 297 (B.A.P. 8th Cir. 2023) ("[i]f the asset is property of the converted bankruptcy estate, the increase in equity- whether by appreciation or reduction of encumbrances- is also property of the estate); *In re Potter*, 228 B.R. 422, 424 (B.A.P. 8th Cir. 1999) (relying on § 541 to conclude that post-petition pre-conversion equity increases accrue to the benefit of the bankruptcy estate.); *In re Goins,* 539 B.R. 510 (Bankr. E.D. Va. 2015) (holding that the Debtor is not entitled to the appreciation in his property that accrued during the course of his chapter 13 case, and the Trustee is entitled to sell the property); *see also In re Barrera,* 22 F.4th 1217 (B.A.P. 10th Cir. 2022) (finding that a proper interpretation of "property" under § 348(f)(1)(A) "is the property as it existed on the petition date, with all its attributes including the amount of equity that existed on that date." (emphasis in original)); *In re Hodges,* 518 B.R. 445 (Bankr. E.D. Tenn. 2014) (holding that increase in debtors' equity in their residence, as result of mortgage payment which they made while case was proceeding under chapter 13, was not included in

"property of the estate" upon conversion of case).; *In re Lynch*, 363 B.R. 101, 106 (B.A.P. 9th Cir. 2007) (finding that equity resulting from debtors' post-petition payments on loans secured by their residence and property appreciation inures to the debtors' benefit upon conversion from chapter 13 to chapter 7).

Although there is a deep split in the caselaw on this issue, the plain interpretation of statutory text provides that any post-petition, pre-conversion increase in equity in debtor's property belongs to the estate upon conversion.

A. Pursuant to 11 U.S.C. § 348(f) equity in property that remains in the possession of the debtor becomes property of the estate upon conversion.

Prior to its amendment in 2005, Bankruptcy Code § 348(f)(1)(B) stated "valuations of property and of allowed secured claims in the chapter 13 case shall apply in the converted case, with allowed secured claims reduced to the extent that they have been paid in accordance with the chapter 13 plan." § 348(f)(1)(B) (pre-BAPCPA) (emphasis added).

In 2005, Congress amended § 348(f)(1)(B), as part of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) Amendments to the Code. As a result, § 348(f)(1)(B) now states "valuations of property and of allowed secured claims in the chapter 13 case shall apply only in a case converted to a case under chapter 11 or 12, but not in a case converted to a case under chapter 7". § 348(f)(1)(B).[3]

A "cardinal rule" of statutory construction requires the Bankruptcy Code "to be read as a whole…since the meaning of statutory language, plain or not, depends on the context. *King v. St. Vincent's Hosp.,* 502 U.S. 215, 221 (1999).

[3] Congress left § 348(f)(1)(A) untouched.

1. The Plain Language Of § 348(F)(1)(A) Is Unambiguous And Legislative History Does Not Mandate A Different Outcome.

There is no ambiguity in § 348(f)(1)(A). This section plainly provides that property of the estate in a converted case consist of property of the estate, as the date of filing of the petition, that remains in the debtor's possession on the date of conversion (emphasis added). In this case, the Debtor's home was property of the chapter 13 estate on the petition date, and it remained in the possession and control of the Debtor as of the date that he converted the case to chapter 7. Therefore, it is appropriate to conclude that based on the plain reading of the statute, equity in the Debtor's home inures to the benefit of the bankruptcy estate upon conversion of the case.

The House Judiciary Committee's report on the Bankruptcy Reform Act of 1994 indicates that § 348(f)(1)(A) was enacted to 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. H.R. Rep. No. 103–835, at 57 (1994), as reprinted in 1994 U.S.C.C.A.N. 3340, 3366. Although the scenario provided by Congress mentioned an example of how this statute could apply where a home's value appreciates during a chapter 13 case, the facts in this case are distinctively different. If Congress intended for § 348(f)(1)(A) to be specially construed to equity appreciation in a debtor's property, then Congress would have incorporated this concept clearly in the statutory text. Well articulated, the court in *In re Goetz* reasoned that:

> [c]ongress' failure to address the example included in the legislative history does not mean this omission was inadvertent. Recognizing that statutes are often the result of compromise, we decline to accept [the debtors] invitation to assume that Congress intended that debtors may retain post-petition pre-conversion market appreciation and equity resulting from debt payments without language articulating this intent.

651 B.R. at 299.

The majority in the Thirteenth Circuit Court of Appeals stated that if Congress intended to include post-petition, pre-conversion interests in property as property of the estate under §

348(f)(1)(A), it would not have needed to enact § 348(f)(2); However, § 348(f)(2) specifically penalizes debtors who convert to another chapter in bad faith. The Trustee in this case is not arguing that the Debtor has converted in bad faith. *See e.g., In re Adams*, 641 B.R. at 150 ("[T]he court finds that the Debtors converted their case in good faith within the meaning of § 348(f). As a result, property of the estate in the Debtors' chapter 7 case consists of the property that remained in the possession or under the control of the Debtors on the Conversion Date").

Although § 348(f) does not define the word "property" or the phrase "property of estate," "property of the estate" is a term of art which appears throughout the Bankruptcy Code. *Matter of Castleman*, 75 F.4th at 1056; *See, e.g.*, §§ 541, 554(a), 726(a), 1306(a). As noted, the Bankruptcy Code requires "to be read as whole." *See e.g., Robinson v. Shell Oil Co.,* 519 U.S. 337, 340, (1997) ("The plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole."). Accordingly, § 348(f)(1)(B) further provides that valuations of property and of allowed secured claims in the chapter 13 case shall apply only in a case converted to a case under chapter 11 or 12, but not in a case under chapter 7. Although the majority for the Thirteenth Circuit finds § 348(f)(1)(B) irrelevant to the issue in this case because it addresses the rights of a secured creditor in the context of valuation of specific property, this section is relevant because the Debtor indicated that he intended to reaffirm the mortgage debt that he owned to the Servicer, who is a secured creditor. Therefore, § 348(f)(1)(B) appears to instruct courts not to rely on valuation determinations made in chapter 13 cases that are later converted to chapter 7. [4]

[4] *See* R.28

When § 348(f)(1)(A) is read in conjunction with § 541 and case law interpreting "property of the estate" it includes all debtors interests, both legal and equitable. §541 (defining property of the estate); *see In re Goetz*, 651 B.R. at 298 citing *In re Potter,* 228 B.R. at 424 ("[n]othing in Section 541 suggests that the estate's interest is anything less than the entire asset, including any changes in its value which might occur after the date of filing).

Furthermore, "as of the date of filing petition" in § 348(f)(1)(A) must be interpreted concisely. "Proper reconciliation of 11 USCS § 348(f)(1)(A) and 11 USCS § 1327(b) is that 11 USCS § 348(f)(1)(A) effects revesting of property of debtor into chapter 7 estate to extent that on date of conversion debtor remains in "possession" or "control" of interests in that property which caused that property to be property of chapter 13 estate." *In re Krick,* 373 B.R. 593, 606 (Bankr. N.D. Ind. 2007). Unlike *In re Golden*, where the Debtor relinquished possession of his home and sale proceeds pre-conversion, the Debtor in this case was still in possession or control of his home on the date of conversion. 528 B.R. 803, 809 (Bankr. D. Colo. 2015).

The Trustee acknowledges that some courts have found § 348(f) to be ambiguous. However, the existence of a division of judicial authority does not itself establish ambiguity in statutory text. *Matter of Castleman*, 75 F.4th at 1061 n.4 citing *Roberts v. Sea-Land Servs., Inc.*, 566 U.S. 93 (2012) (holding provision of Longshore and Harbor Workers' Compensation Act is unambiguous despite disagreement between Fifth, Ninth and Eleventh Circuits); *Mohamad v. Palestinian Auth.*, 566 U.S. 449 (2012) (holding term used in Torture Victim Protection Act was unambiguous despite disagreement among several circuits*); Reno v. Koray,* 515 U.S. 50, 64–65 (1995) ("[a] statute is not ambiguous for purposes of lenity merely because there is a division of judicial authority over its proper construction."). Even if § 348(f) in isolation might be

ambiguous, when read in connection with the remainder of the bankruptcy statute, its meaning becomes clear. *Matter of Castleman*, 75 F.4th at 1061 n.4.

2. Equity In Property Is Not A Distinct Asset But Rather A Characteristic Or Attribute Of Property Included Within A Particular Asset.

Appreciation is not a distinct property interest that the Debtor acquired. For example, in *In re Adams*, the court regards the value of any property as an attribute or incident of the property, not a separate right or interest in the property. 641 B.R. at 151; *see also In re Castleman*, 631 B.R. 914, 919 (Bankr. W.D. Wn. 2021) ("[p]ost-petition appreciation is not treated as a separate asset from pre-petition property and inures to the bankruptcy estate, not the debtor."); *In re Goetz*, 651 B.R. at 298 (quoting *In re Potter)*, 228 B.R. at 424 ("[n]othing in Section 541 suggests that the estate's interest is anything less than the entire asset, including any changes in its value which might occur after the date of filing"). Hence, equity is "inseparable" from the property itself. *See In re Goins*, 539 B.R. at 516.

Circuit Judge Barrett from the Thirteenth Circuit states in his dissent that the distinct question here is whether the non-exempt equity resulting from market appreciation and payments made to the Servicer during the chapter 13 case is property of the estate or property of the Debtor. R.25. The Supreme Court in *Schwab v. Reilly* highlighted that when a debtor claims an exemption in property of the estate, they are simply claiming an interest in estate property up to a certain dollar amount, not removing the entire asset from the estate. 560 U.S. 770, 782 (2010). Therefore, if a homeowner's equity in the property exceeds the size of an allowable homestead exemption, then the trustee could sell the property and use the non-exempt sale proceeds to pay creditor claims. *See e.g., In re Goetz*, 651 B.R. at 301 ("[S]ection 513.475 (the state homestead law) entitles [debtor] to 'remove' from the estate only a portion of the value of the homestead-equity in the maximum sum of $15,000."); *In re Adam*, 641 B.R. at 153-154 ("where property

values are generally increasing, debtors are at risk of having to surrender their homes to their chapter 7 bankruptcy trustees who, charged with the statutory duty to reduce estate property to money, may seek to sell a debtors home."). A post-petition depreciation in home value does not inure to the detriment of a debtor, so an increase in home value should also not inure to the benefit of the debtor.[5]

Section 522(a)(2) defines "value" as "means fair market value as of the date of the filing of the petition or, with respect to property that becomes property of the estate after such date, as of the date such property becomes property of the estate." This section is also known as the "snapshot" rule. Courts have argued that this section should be interpreted identical to the text of § 348(f)(1)(A); however, the text does not explicitly mention the effect of equity in property in a conversion case. "Note that, for example, the debtor's homestead exemption is fixed as of the "snapshot" value on the date of the original filing. *See In re Hyman*, 967 F.2d 1316, 1321 (B.A.P. 9th Cir. 1992) ("Were we to accept the Hymans' argument that they're entitled to post-filing appreciation, we would also have to hold that a debtor is subject to post-filing depreciation, which would give debtors in falling property markets less than the [homestead exemption] guaranteed them by state law."); *see also Matter of Castleman* at 1058 n.5. Therefore, the "snapshot" rule does not apply to cases in post-petition, pre-conversion equity increases in property.

B. Pursuant to 11 U.S.C. § 541, equity in property is regarded as an attribute or incident of the property, not a sperate right or interest in the property.

Section 541 is central to the purposes to be achieved by the Bankruptcy Code. 5 *Collier on Bankruptcy* P 541.01 (16th 2023). Therefore, it is necessary and desirable that the property

[5] Depreciation in homes in fact benefit the debtor; it requires the trustee to abandon the home- removing the home from the bankruptcy estate- because selling the home would create no value of creditors.

included in the estate be as inclusive as possible. In addition to § 541, § 1306(a)(1) states that property of the estate "includes all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7…"

1. The "preservation" approach best harmonizes §§ 1306 and 1327(b).

The Trustee recognizes that there is apparent contradiction between § 1306 and § 1327(b). The plain language of § 1306(a) renders all property until "the case is closed, dismissed, or converted," property of the estate. However, the plain language of § 1327(b) vests all property with the debtor post-confirmation. Due to this paradox, courts have adopted five different approaches in their attempts to reconcile § 1306 and § 1327: the termination approach[6]; the transformation approach[7]; the conditional vesting approach[8]; preservation approach[9]; and the replenishment approach[10]. *In re Baker*, 620 B.R. 655, 663-64 (Bankr. D. Colo. 2020) (citing LUNDIN).

The preservation approach best harmonizes § 1306 and § 1327(b) in this case. Under the preservation approach the vesting of property in the debtor under § 1327(b) does not remove any property from the estate, whether acquired before or after confirmation; property remains in the

[6] *In re Baker*, 620 B.R. 655, 663 (Bankr. D. Colo. 2020) ("At confirmation, the estate ceases to exist and all property of the estate, whether acquired before or after confirmation, becomes property of the debtor.").

[7] *Id.* ("At confirmation, all property of the estate becomes property of the debtor except property essential to the debtor's performance of the plan; the Chapter 13 estate continues to exist, but it contains only property necessary to performance of the plan, whether acquired before or after confirmation.").

[8] *Id.* at 664 ("At confirmation, vesting gives the debtor an immediate and fixed right to use estate property, but that right is not final until the debtor completes the plan and obtains a discharge.").

[9] Id. at 663–64 ("The vesting of property in the debtor under § 1327(b) does not remove any property from the chapter 13 estate, whether acquired before or after confirmation; property remains in the estate until the case is closed, dismissed, or converted. The debtor's rights and responsibilities with respect to property of the estate may change somewhat at confirmation, but the existence and composition of the estate are not disturbed by § 1327(b).").

[10] *Id.* at 663 ("At confirmation, all property of the estate becomes property of the debtor; the Chapter 13 estate continues to exist and 'refills' with property defined in § 1306 that is acquired by the debtor after confirmation, without regard to whether that property is necessary to performance of the plan.").

estate until the case is closed, dismissed, or converted. The debtor's rights and responsibilities with respect to the property of the estate may change somewhat at confirmation, but the existence and composition of the estate are not disturbed by § 1327(b). *Id.* at 664.

Two recent courts rejected the preservation approach and found the replenishment approach applicable where there's an increase in equity in a debtor's property post-petition, post-confirmation of a plan; but both had different results. *See In re Marsh* 647 B.R. 725 (Bankr. W.D. Mo. 2023) (holding that proceeds from the post-confirmation gains from the sale of the debtors' home were newly acquired property that replenish the estate and are available for unsecured creditors); *see also In re Elassal* 654 B.R. 434 (Bankr. E.D. Mich. 2023) (holding that post-confirmation gains from the sale of the debtors' home were not newly acquired property and were the debtors to retain). The estate replenishment theory attempts to reconcile the conflict between § 1306 and § 1327 by giving application to both statutes but in different phases of the chapter 13 case (emphasis added).

The facts in this case are distinct from *In re Marsh* and *In re Elassal* because in both cases the debtors voluntarily sold their home to acquire the gains of appreciation accrued. Most importantly, conversion was not at issue in either case[11] Due to the facts in both cases, it was appropriate to find the replenishment approach most suitable to determine whether the sale proceeds were property of the estate or not.

However, in this case, the Debtor retained full possession of his home post-petition and experienced a significant increase in equity prior to converting. The replenishment approach does not help the issue before us because it only serves to identify who property at confirmation

[11] . *See also* Krispen Carroll, *Tug of War over Post Confirmation Appreciation in Chapter 13*, ABI J. 69, 70 (2023) ("it is reasonable to assume that when such a sale generates funds above the amount of the debtor's exemption, the additional funds should be considered property of the estate and made available for distribution to unsecured creditors.")

inures to and who "newly" acquired property inures to. There is no clear language on how to use this approach in cases where conversion is at issue.

Moreover, although *In re Barrera* did not use any of the foregoing approaches, the case explicitly involved a pre-conversion sale of the debtors' home, and the Tenth Circuit *declined* to decide whether post-petition, pre-conversion appreciation would be included in a converted estate when the property remained in the debtor's possession at conversion. 22 F.4th at 1223 n.1. The Tenth Circuit concluded that § 541(a)(6) is "operative only before confirmation of the chapter 13 plan because confirmation vests all of the property of the estate in the debtor and quoted § 1327(b) to further support that the property no longer belongs to the estate." *Id.*

However, under the preservation approach, the vesting of property in the debtor upon confirmation of a chapter 13 plan under § 1327(b) does not remove any property from the estate upon conversion. The Trustee acknowledges that upon confirmation of the Debtor's chapter 13 plan, the home vested in the Debtor. However, pursuant to the unambiguous language of § 348(f)(1), the home became property of the chapter 7 estate upon conversion from chapter 13. Consistent with accepted canons of statutory construction, the more specific (*i.e.,* § 348(f)(1)) governs the more general (*i.e.*, § 1327). *See Morales v. Trans World Airlines*, *Inc.* 504 U.S. 374, 384-85 (1992) ("[I]t is a commonplace of statutory construction that use the specific governs the general…"). In addition, when a case is converted to another chapter under Title 11, then the previous chapters provisions no longer govern. *See Harris v. Viegelahn*, 575 U.S. at 520 ("When a debtor exercises his statutory right to convert, the case is placed under Chapter 7's governance, and no Chapter 14 provision holds sway.").

2. § 541(a)(6) further supports that equity in property is not a separate asset and belongs to the estate upon conversion.

Equity in property is not a separate asset and belongs to the estate upon conversion. Included as property of the estate under § 541(a)(6) are all proceeds, products, offspring, rents, or profits of or from property of the estate acquired after the case is commenced. 5 *Collier on Bankruptcy* P 541.15.

Numerous cases relying on § 541(a)(6) have held that post-petition appreciation in property belongs to the estate. *See In re Hyman,* 967 F.2d 1316; *In re Reed*, 940 F.2d 1317, 1323 (B.A.P. 9th Cir.1991) ("appreciation [i]nures to the bankruptcy estate, not the debtor"); *In re Potter,* 228 B.R. at 424 ("[e]xcept to the extent of the debtor's potential exemption rights, post-petition appreciation in the value of property accrues for the benefit of the trustee"); *In re Moyer,* 421 B.R. 587, 594 (Bankr. S.D. Ga. 2007); *In re Shipman,* 344 B.R. 493, 495 (Bankr. N. D.W. Va. 2006) ("the trustee is entitled to any post-petition appreciation in value of the property"); *In re Bregni,* 215 B.R. 850, 854 (Bankr. E.D. Mich. 1997); *In re Paolella,* 85 B.R. 974, 977 (Bankr. E.D. Pa. 1988) ("[b]ecause sale does not generally, if ever, occur simultaneously with formation of a bankruptcy estate, § 541(a)(6) mandates that the estate receive the value of the property at the time of the sale. This value may include appreciation or be enhanced by other circumstances creating equity which occur post-petition").

In *Matter of Castleman*, the Ninth Circuit considered an appeal questioning whether pre-conversion real estate appreciation belongs to the estate or the debtors who converted from chapter 13 to chapter 7. 75 F.4th 1052. Similar to the facts in this case, due to unfortunate circumstances the debtors could no longer make their required payments under their chapter 13 plan and voluntarily converted to chapter 7. *Id.* at 1054. In the interim, their home had risen in value and the trustee filed a motion to sell the debtors home to recover the value for creditors. *Id.*

The debtors objected to the sale on the basis that the post-petition appreciation value (*i.e.,* the "new" equity) was property of the debtor and not of the estate. *Id.* The court noted that post-confirmation property of the estate is not defined by § 1306 but rather § 348(f). Therefore, the court found that because the appreciation was not "property" acquired post-petition, merely a change in valuation of pre-petition property, the court concluded that the broad scope of §541(a), and especially §541(a)(6), means that post-petition appreciation inures to the bankruptcy estate, not the debtor. *Id.* at 1055-56. [12] There is a strong parallel in facts and issues between *Matter of Castleman* and the case before us. It is therefore appropriate to conclude that § 541(a)(6) further supports that equity in property is not a separate asset and belongs to the estate upon conversion.

As precisely stated by Circuit Judge Barrett Dissent in the Thirteenth Circuit, "when Congress wanted to exclude assets from the bankruptcy estate, it did so with specificity." R.29. *See* § 541(a)(6); *see also* § 541(b) ("Property of the estate does not include…). So, if Congress intended to exclude post-petition, pre-conversion appreciation from being property of the estate it could have easily done so.

II. THE CHAPTER 7 TRUSTEE MAY SELL AS PROPERTY OF THE BANKRUPTCY ESTATE, THE ABILITY TO AVOID AND RECOVER TRANSFERS PURSUANT TO 11 U.S.C §§ 547 AND 550.

Upon the filing of a voluntary petition for relief, an estate comprised of certain property "wherever located and by whomever held" is created. §§ 301, 541(a). Section 541(a) of the Bankruptcy Code lays out seven subsections for what is considered property of the estate. *See* §§ 541(a)(1)-(7). Accordingly, a trustee is permitted to sell any "property of the estate" with court

[12] Hon. Elizabeth L. Gunn, Shelby Kostolni, *Post-Petition Appreciation: Whose Line (Item) Is It, Anyway?,* ABI J. 57, 59 (2023)

approval. § 363(b). It is important to emphasize that this Court has held that the estate's property is defined by, but not limited to, property set forth in § 541(a), and that § 541(a)'s definition of "property of the estate" was intended to be "broad" and "all-encompassing." *Patterson v. Shumate*, 504 U.S. 753, 757 (1992); *see also United States v. Whiting Pools*, Inc., 462 U.S. 198, 203, 205 (1983) (holding that § 541(a) acts "as a definition of what is included in the estate, rather than as a limitation" and includes within estate property "any property made available to the estate by other provisions of the Bankruptcy Code."). Sections 541(b) and (c)(2) provide specific property interests that Congress intended to have excluded from property of the estate. § 541(b), (c)(2). Preference actions not among them.

Chapter 5 of the Bankruptcy Code sets forth a trustee's avoidance powers which allows a trustee to bring actions to avoid and recover certain pre- and post-petition transfers of the debtor's property. *See, e.g.,* §§ 544 - 553. Under § 547, the trustee can avoid preference payments a debtor makes within ninety days (or, in this case, one year because Pink is an insider) prior to the petition date. § 547(b), (c). Then, once a trustee avoids a transfer, a trustee can recover the payment under § 550(a) so that the funds can be shared pro rata among all creditors. § 550. This Court has held that one of the primary purposes for § 547 is to facilitate the equality of distribution among creditors of the debtor. *Union Bank v. Wolas*, 502 U.S. 151, 160-61 (1991) (citation and quotation omitted). Therefore, it is an important policy of the Bankruptcy Code that creditors get paid and treated equally.

Section 704(a) provides that 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." § 704(a)(1).

To put it succinctly, if the preference action sold to Eclipse constitutes property of the estate, then pursuant to § 704(a)(1), the Trustee had a duty to reduce such action to money and, pursuant to § 363(b)(1), was authorized to sell the preference action to Eclipse to complete that duty.

A. Preference Actions are Property of the Estate Under 11 U.S.C. § 541(a)

Preference actions must constitute property of the estate under § 541(a) to be eligible for sale under § 363(b). Section 541(a) contains subsections that lay out exactly what constitutes property of the estate. § 541(a). Though it is true that preference actions are not specifically mentioned in 541(a), this Court has previously held that § 541(a)'s definition of property of the estate was intended to be broad, and the legislative history itself describes the scope of the debtor's estate as "all embracing." *Patterson*, 504 U.S. at 757; *See* H.R. REP. NO. 95-595, at 549 (1977), as reprinted in 1978 U.S.C.C.A.N. 5963, 6455. Further, Congress appears to have indicated a similar intent through the enactment of § 544(a), which brings into the estate additional property interests that are not specifically laid out in § 541(a). *See* § 544(a).

1. Avoidance Actions are Causes Of Action That are Judicially and Legislatively Recognized as Property of the Estate.

It is important to first acknowledge that this Court has consistently characterized all avoidance powers as "causes of action." *See Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 53-54 (1989). Further, Congress also characterizes avoidance powers as causes of action under § 926(a). With that, several circuits have concluded that causes of actions constitute property of the estate. *See, e.g., Moratzka v. Morris (In re Senior Cottages of Am., LLC)*, 482 F.3d 997, 1001 (B.A.P. 8th Cir. 2007) (It is well established that "causes of action are interests in property and are therefore included in the estate."); *Parker v. Goodman (In re Parker)*, 499 F.3d 616, 624 (B.A.P. 6th Cir. 2007) (citation omitted) ("As 'legal and equitable interests,' causes of action . . .

constitute property of the estate under § 541(a)(1).”). Through a simple plain meaning assessment, preference actions are regarded as property of the bankruptcy estate because they are classified as 'causes of action,' which are commonly recognized as a form of property. To reinforce this point, the fact that Congress explicitly excluded specific powers from the estate's property suggests that powers are generally included. *See* § 541(b)(1). Had Congress intended for avoidance powers to be excluded, it could have specifically done so, indicating their inclusion as property of the estate by default. The view that the absence of a reference to § 547 in § 541(a) implies a deliberate omission is countered by the fact that avoidance powers are similarly not mentioned in § 541(b)(1). This parallel lack of inclusion suggests that such an omission does not necessarily indicate intent and this Court’s broad characterization of § 541(a) is reaffirmed. Even this Court itself has previously held that § 541(a) should be interpreted to list what is included in the estate, as it is non-exclusive. *see Whiting Pools*, 462 U.S. at 205.

Preference actions are *also* property of the estate under §§ 541(a)(1), 541(a)(7), and 1123 (b)(3). Therefore, the sale to Eclipse was statutorily permissible.

2. Preference Actions are Property of the Estate under 11 U.S.C § 541(a)(1) because the Debtor had an Equitable and Contingent Interest in the Preference Action as of the Commencement of his Case.

Section 541(a)(1) includes as property of the estate “all legal or equitable interests of the debtor in *property as of the commencement of the case*.” § 541(a)(1) (emphasis added). Therefore, to constitute property of the estate and be sellable under § 363(b), preference actions must either be property or an interest in property. In this case, the preference action in question squarely fits within the broad definition of estate property because prior to the commencement of the case, the Debtor had a legal *and* equitable interest in the action, rendering it property of the estate.

a. The Debtor Had an Equitable Interest in the Preference Action When His Case Commenced.

Preference actions are also property of the estate under § 541(a)(1) as a debtor possesses a legal and equitable interest in the action as of their case's commencement. As "legal and equitable interests," *causes of action* that belong to the debtor constitute property of the estate under § 541(a)(1). *In re Cannon*, 277 F.3d 838, 853 (B.A.P. 6th Cir.2002); *see also Bauer v. Commerce Union Bank, Clarksville, Tenn.*, 859 F.2d 438, 441 (B.A.P. 6th Cir.1988). Furthermore, rights derived from the debtor's causes of action represent an interest in property that becomes part of the estate. *See In re O'Dowd*, 233 F.3d 197, 202 (B.A.P. 3d Cir. 2000) ("[W]ith limited exceptions ..., the estate encompasses everything that the debtor owns upon filing a petition, as well as any derivative rights, such as property interests the estate acquires after the case commences."). Further, § 541(a)(1) includes all "conditional, future, speculative, and equitable interests of the debtor." *United States ex rel. Gebert v. Transp. Admin. Servs.*, 260 F.3d 909, 913 (B.A.P. 8th Cir. 2001).

In the present case, the Debtor possessed an equitable interest in the money that was transferred to Pink, even though it no longer retained a possessory interest. *See Rine & Rine Auctioneers, Inc. v. Douglas Cnty. Bank & Trust Co. (In re Rine & Rine Auctioneers, Inc.)*, 74 F.3d 854, 861 (B.A.P. 8th Cir. 1996) (relying on authority "holding that the debtor had an equitable interest in the money transferred for purposes of applying § 547(b)"); *see also Whiting Pools*, 462 U.S. at 205 (holding that estate property includes property that the estate no longer has a possessory interest in because it had been prepossessed prepetition).

b. The Debtor Had a [Legal] Contingent Interest in the Preference Action When His Case Commenced.

The Debtor also had a contingent interest in the avoidance actions before filing the bankruptcy case. *See Longaker v. Boston Sci. Corp.*, 715 F.3d 658, 661 (B.A.P. 8th Cir. 2013) ("[Section 541(a)(1)] encompasses a debtor's contingent interests [arising] pre-petition."); *Parks v. Dittmar (In re Dittmar)*, 618 F.3d 1199, 1208 (B.A.P. 10th Cir. 2010) ("[C]ontingent interests are property of the bankruptcy estate even if the rights do not accrue or are uncertain until a date after the bankruptcy filing.").

In *Pitman Farms v. ArKK Food Co. (In re Simply Essentials, LLC)*, the Eighth Circuit Court of Appeals held that contingent interests held by a debtor are property of the estate that a chapter 7 trustee can sell. 78 F.4th 1006, 1011 (B.A.P. 8th Cir. 2023). In that case, a chapter 7 trustee had what he believed was a meritorious avoidance claim but lacked the funds to prosecute the causes of action and thus, proposed to sell the action to a creditor. *Id.* at 1007. The Circuit Court asserted that a pre-petition transfer gives a debtor an "inchoate, or not yet fully realized," right to recover the property, contingent upon the debtor filing for bankruptcy. *Id.* at 1009. It relied on this Court's decision in *Segal v. Rochelle* for their holding. *See Segal v. Rochelle*, 382 U.S. 375, 379, 86 S. Ct. 511, 15 L.Ed. 2d 428 (1966) ("the term 'property' has been construed most generously and an interest is not outside its reach because it is novel or contingent or because enjoyment must be postponed."). The Circuit Court ultimately held that "[b]ecause debtors have the right to file for bankruptcy and the... Trustee may file avoidance actions to recover property, the debtor has an inchoate interest in the avoidance actions prior to the commencement of the bankruptcy proceedings. Therefore, avoidance actions are property of the estate under § 541(a)(1)" and the Trustee can sell such action to a creditor. *Id.*

Compared to *Simply Essentials,* the Debtor in our case had an inchoate, contingent interest in the prepetition transfer he made to Pink. Following the same rationale from the Eighth Circuit Court of Appeals, that interest suffices to characterize the preference action as property of the estate.

Several remarks made by this Court in *U.S. v. Whitting Pools* also suggest that preference avoidance actions are property of the estate under subsection (a)(1). *See* 462 U.S. at 203. In that case, this Court held that property seized by the IRS constituted property of the estate under § 541(a) and that § 541(a) is intended to include in the estate any property made available to the estate by any other provision of the Bankruptcy Code, including "property in which the debtor did not have a possessory interest." *Id.* at 205. Upon the bankruptcy case's commencement, chapter 5 made the avoidance claims available to the estate. *See* §§ 544, 547-50. The avoidance actions are therefore property of the estate under *Whiting Pools*.

3. Preference Actions are Property of the Estate Under 11 U.S.C. § 541(a)(7) Because they Originate from the Estate's Pre-Petition Interests.

Preference actions are also considered property of the estate under § 541(a)(7). This section provides that the property of the estate includes "any interest in property that the estate acquires after the commencement of the case" which includes property interests that are "traceable to or arise out of any prepetition" interest included in the bankruptcy estate." *TMT Procurement Corp. v. Vantage Drilling Co. (In re TMT Procurement Corp.)*, 764 F.3d 512, 525 (B.A.P. 5th Cir. 2014); § 541(a)(7); *see also McLain v. Newhouse (In re McLain)*, 516 F.3d 301, 312 (B.A.P. 5th Cir. 2008) ("Congress enacted § 541(a)(7) to clarify its intention that § 541 be an 'all-embracing definition and to ensure that property interests created with or by property of the estate are themselves property of the estate."').

A cause of action that develops after the petition is filed becomes part of the estate's property as per § 541(a)(7), provided it relates to or arises out of property that is already part of the estate. *See Spenlinhauer v. O'Donnell*, 261 F.3d 113, 118 n.5 (B.A.P. 1st Cir. 2001); *see also Drewes v. Vote (In re Vote)*, 276 F.3d 1024, 1027 (B.A.P. 8th Cir. 2002). A notable example is found in *In re O'Dowd*, where a legal malpractice claim that accrued post-petition was held to be estate property. 233 F.3d at 203-04. This is because the claim originated from a pre-petition cause of action belonging to the debtor. *Id.* The pre-petition cause of action was property of the estate under § 541(a)(1), and the connection between the post-petition malpractice claim and the pre-petition action was sufficient to make the malpractice claim property of the estate under § 541(a)(7). The Third Circuit Court of Appeals highlighted that the malpractice reduced the estate's value because the estate would have been larger if it were not for the malpractice. *Id*. at 204.

Following this logic, avoidance actions fall under the estate's property according to § 541(a)(7). They aim to recover the debtor's pre-petition equitable interest in assets transferred, which are included in the bankruptcy estate under § 541(a)(1). Similar to the situation in *O'Dowd*, in this case the preference action is considered estate property as it is meant to rectify damages to the estate. For instance, if not for the assets transferred to Pink, the estate's value would have been greater. Consequently, avoidance actions clearly fall within the realm of estate property as defined by § 541(a)(7).

B. Preference Actions are Property of the Estate Under 11 U.S.C. § 1123(b)(3) because Eclipse is a Representative of the Estate.

Section 1123(b)(3) permits plan provisions providing for "the retention and enforcement... by a representative of the estate" of a claim or interest belonging to the estate. § 1123(b)(3). In other words, the question to consider here is whether the sale provides a benefit to

the estate under this section of the Code. To determine whether a party is considered a "representative of the estate" courts have been primarily concerned with "whether a successful recovery by the appointed representative would benefit the debtor's estate and particularly, the debtor's unsecured creditors." *Matter of Texas General Petroleum Corp.*, 52 F.3d 1330, 1135, 27 Bankr. Ct. Dec. (CRR) 399, Bankr. L. Rep. (CCH) P 76512 (B.A.P. 5th Cir. 1995) (citation omitted).

The Trustee respectfully requests that this Court take a broad reading of § 1123(b)(3) to support the policy goal of maximizing the value of the estate to the benefit of all creditors in the present case. A broad view would allow Eclipse to be considered a representative of the estate which would be fitting in that the sale of the avoidance action to Eclipse allows the Trustee to efficiently convert that asset into cash for pro rata distribution for the creditors. The sale expedites the case by alleviating the estate from the financial burdens associated with avoidance litigation and transfers them all to Eclipse. *See Norton Bankruptcy Law and Practice* 3d § 112:12 (selling avoidance actions expeditiously liquidates an asset while relieving the estate from protracted litigation); *Carlson, Bankruptcy's Organizing Principle*, 26 Fla. St. U. L. Rev. 549, 622 n.218 (1999) (advocating sale of avoidance actions to buyers better equipped to prosecute them); *C.H.U., Comment, Bankruptcy-Fraudulent Transfers-Trustee's Assignee*, 32 Mich. L. Rev. 369, 378 (1933-1934) (selling speculative fraudulent transfer actions could provide estate with substantial sum while transferring litigation risks onto buyer).

In conclusion, a broad interpretation of § 1123(b)(3) in this context aligns well with the underlying principle of maximizing the estate's value for the benefit of all creditors. By allowing Eclipse to be regarded as a "representative of the estate," the sale of the avoidance action not only facilitates a more efficient conversion of this asset into liquid funds for equitable

distribution among creditors but also strategically offloads the financial and administrative burdens of avoidance litigation from the estate.

C. The Trustee Could Sell the Preference Action to Eclipse under 11 U.S.C. § 704(a) Because it is Property of the Estate, and she was Fulfilling her Duty to Maximize the Value of the Estate.

A chapter 7 trustee's duty to 'maximize the value of the estate,' is fundamental to the equitable administration of bankruptcy proceedings. *See Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 352 (1985). This duty, rooted in § 704(a) of the Bankruptcy Code, requires the trustee to not only liquidate the property of the estate efficiently, but also to do so in a way that aligns with the best interests of all parties involved. § 704(a)(1). The extensive powers granted to chapter 7 trustees by Congress are a clear indication of a strong legislative intent to further the goal of maximizing the value of a debtor's estate. *See* §§ 547 (the trustee is granted the discretion to avoid, subject to certain defenses, transfers of property a debtor made within a certain time before the petition date), 544(a) ("the trustee shall have... the rights and powers of, or may avoid any transfer of property of the debtor..."); 550 (in the event the trustee avoids a transfer, the trustee may then "recover, for the benefit of the estate, the property transferred, or if the court so orders, the value of such property..."), 363(b) (a trustee is permitted to sell any "property of the estate" with court approval). Congress's statutory grant of powers to trustees shows an intent for trustees to do more than just sell assets; they're expected to actively manage the estate, addressing past transactions, and handling complex assets to ensure maximum value for creditors. *See IRS v. Luongo (In re Luongo)*, 259 F.3d 323, 340 n.16 (B.A.P. 5th Cir. 2001).

Consequently, it is justifiable for trustees to sell preference actions because not only are they property of the estate, but their sale aligns with the overarching goal of maximizing the estate's overall value. By selling the preference action to Eclipse, the Trustee guarantees the full

amount of the transfer ($20,000) as an addition to the value of the estate without spending a dime from the estate on litigating the transfer. With this, the Trustee completes her duty of maximizing the estate's value, thereby maximizing the value distributed pro-rata among all creditors. It is erroneous to assert that Eclipse would be recovering for its own benefit as the estate and the creditors would be benefiting as well.

D. The Pre-Bankruptcy Code's "Well-Settled Principle" is Superseded by Precedent

There is a clear distinction between cases decided before the enactment of the 1978 Bankruptcy Code (during the era of the 'Bankruptcy Act') and cases decided after. The cases decided prior to the Bankruptcy Code generally stand for the proposition that preference actions cannot be sold. *See e.g., Grass v. Osborn,* 39 F.2d 461 (9th Cir. 1930) ("[T]he trustee in bankruptcy could not sell his right to set aside a preferential transfer."); *Texas Consumer Finance Corp. v. First Nat. City Bank,* 365 F. Supp. 427, 429-30 (S.D. N.Y. 1973) ("Section 60(b) of the Bankruptcy Act, provides that preferences may be avoided by the trustee. But he may not assign his claim.") (internal citation and punctuation omitted); *Parker v. Hand,* 299 Ill. 420, 132 N.E. 467, 469 (1921) (holding that avoidance actions are not "assignable by the trustee in bankruptcy and an attempted assignment cannot be enforced."). The main rationale that led to these holdings was the "well-settled principle" that the trustee cannot assign, sell, or otherwise transfer avoidance claims. *In re Sapolin Paints, Inc.*, 11 B.R. 930, 937 (Bankr. E.D.N.Y. 1981) (collecting cases). The Court of Appeals in this case asserts that because Congress did not materially amend the statutory language or otherwise indicate an intent to deviate from the predecessor of the Bankruptcy Code, they see no reason to depart from the principle today. This assertion is erroneous because it fails to account for the significant shifts in the legal landscape that have occurred since the enactment of the 1978 Bankruptcy Code. While it is true that the

statutory language may not have been materially amended, the interpretation and application of the law must evolve to reflect current realities and the numerous precedents that have since then been established. *See e.g., In re Lahijani*, 325 B.R. 282, 288, 44 Bankr. Ct. Dec. (CRR) 247 (B.A.P. 9th Cir. 2005) ("While there is some disagreement among courts about the exercise by others of the trustee's bankruptcy-specific avoiding power causes of action, the Ninth Circuit permits such actions to be sold or transferred."); *Delgado Oil Co., Inc. v. Torres*, 785 F.2d 857, 861 & n.11 (B.A.P. 10th Cir. 1986) (holding that a preference action is "property of the estate"); *In re Qualitech*, 351 F.3d 290, 42 Bank. Ct. Dec. (CRR) 68, Bankr. L. Rep. (CCH) P 80011 (7th Cir. 2003). Though the circuits are split on whether avoidance actions (specifically preference actions) are property of the estate, most circuits have issued opinions that they are.

E. Exceptions to Hartford Underwriters

The majority in this case use the narrow construction in *Hartford Underwriters* to further their opinion that only the trustee is authorized to exercise the powers of avoidance and recovery. *See Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 7 (2000). In *Hartford Underwriters*, this Court previously held that, in the context of § 506(c), when the Bankruptcy Code uses the word "trustee", it means the trustee and no one else. *Id.* at 6-7.

However, what the majority failed to account for was the fact that this Court intentionally did not determine whether another party in interest can "act in the trustee's stead" meaning that *Harford Underwriters* does not provide precedent for the issue in *this* case. *Id.* at 13 n.5. Further, in Footnote 5, the Court indicates a possible exception to their narrow construction where a third party receives the consent of the trustee and the bankruptcy court to bring a § 506(c) claim. *Id.* This same rationale should be extended to other sections of the bankruptcy code such as § 547 and § 550. If this Court agrees, then the dispute in the present case can be

solved as the Trustee *did* seek approval from the bankruptcy court to allow Eclipse to purchase and pursue the preference claim.

In conclusion, bankruptcy trustees play a pivotal role in maximizing the value of the chapter 7 estate, which they can do by selling preference actions. Under the broad and all-encompassing definition provided by § 541(a), which is supported by evolving judicial interpretations and legislative intent, preference actions are indeed property of the estate. These actions, by their nature as causes of action, fall squarely within the estate's assets.

The sale of the preference action to Eclipse aligns with the Trustee's duty to liquidate the estate's assets efficiently and equitably as outlined in § 704(a). Selling the preference action would also allow the Trustee to strategically shift the financial and administrative burdens of litigation away from the estate. Moreover, the involvement of a third party like Eclipse as a representative of the estate under § 1123(b)(3) further supports this strategy, ensuring that the estate's value is maximized to the fullest extent possible for all creditors.

CONCLUSION

This Court should reverse the decision of the Thirteenth Circuit Court of Appeals and hold that (1) post-petition, pre-conversion appreciation in property inures to the estate because the fair market value of property is an inherent characteristic, not a separate asset, and (2) avoidance and recovery actions may be sold by a trustee because legal actions are property of the estate, and a chapter 7 estate's non-exempt property shall be reduced to money.