Team 32

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 FOR THE
UNITED STATES COURT OF APPEALS
FOR THE THIRTEENTH CIRCUIT

BRIEF IN SUPPORT OF RESPONDENT

Team 32
Counsel for Respondent

QUESTIONS PRESENTED

I. Under 11 U.S.C. §§ 348 and 541, do post-petition, pre-conversion increases in equity in a debtor's property inure to the benefit of the debtor upon conversion of a case from chapter 13 to chapter 7?

II. Does 11 U.S.C. §§ 547 and 550 authorize a chapter 7 trustee to sell their power to avoid and recover transfers as part of the bankruptcy estate?

TABLE OF CONTENTS

QUESTIONS PRESENTED i

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES iv

OPINIONS BELOW x

STATEMENT OF JURISDICTION x

STATUTORY PROVISIONS x

STATEMENT OF FACTS 1

STANDARD OF REVIEW 3

SUMMARY OF THE ARGUMENT 4

ARGUMENT 5

I. POST-PETITION, PRE-CONVERSION INCREASES IN HOME EQUITY INURE TO THE BENEFIT OF THE DEBTOR BECAUSE SUCH AN INCREASE IS NOT PROPERTY OF THE ESTATE UNDER SECTIONS 348 AND 541. 5

A. When read in the context of the Code, the language of section 348(f)(1)(A) states that a post-petition, pre-conversion increase in home equity inures to the benefit of the debtor. 5

1. The "snapshot rule" and section 522(a)(2) apply to section 348(f)(1)(A). 6

2. The canon against superfluity conforms with the Thirteenth Circuit's holding that a post-petition, pre-conversion increase in equity inures to the benefit of the debtor upon conversion. 8

i. When the debtor converts in good faith, any post-petition increase in equity inures to the benefit of the debtor. 8

ii. Mr. Clegg's interest in the home is separate from his interest in the increase in equity. 9

3. Section 1327(b) vested all property of the chapter 13 estate in Mr. Clegg upon confirmation, so any post-confirmation appreciation in equity belongs to him. 10

B. The legislative history of section 348(f) reveals that congress intended for post-petition, pre-conversion increases in home equity to inure to the benefit of the debtor. 12

C. Policy also supports the interpretation that post-petition, pre-conversion increases in home equity inure to the benefit of the debtor. 14

1. Affirming the Thirteenth Circuit supports Congress's goal of encouraging debtors to file chapter 13 cases. 14

2. Freezing the home value on the Petition Date and valuing the home and the increase in equity as separate interests serves the Code's goal of providing a fresh start to the honest but unfortunate debtor. *16*

II. THE CODE DOES NOT PERMIT A CHAPTER 7 TRUSTEE TO SELL THE RIGHT TO AVOID AND RECOVER PREFERENTIAL TRANSFERS PURSUANT TO SECTIONS 547 AND 550 .... **18**

A. The plain language of the Code does not permit the sale of a trustee's power to avoid a preferential transfer pursuant to section 547(b) because it is not property of the estate. **19**

1. The trustee's avoidance power cannot be property of the estate because the debtor has no interest in the trustee's statutory power to recover funds. *19*

2. The trustee's avoidance powers do not constitute after-acquired property under section 541(a)(7). *22*

3. The funds recovered through the trustee's avoidance power are property of the estate, while the avoidance power itself is not. *23*

4. The trustee's right to avoid preferential transfers is exclusive to the trustee and cannot be exercised by other parties. *25*

B. Circuits that have held the trustee's avoidance powers to be property of the estate have not provided an adequate justification **26**

C. Categorizing the trustee's avoidance power as property of the estate does not conform with established rules of statutory construction. **30**

1. Treating the trustee's avoidance powers as property renders sections 541(a)(3) and 551 superfluous. *30*

2. Permitting the sale of the trustee's avoidance powers is contrary to Congress's intent as informed by the history of the Code. *31*

3. Permitting the sale of the trustee's avoidance powers is contrary to Congress' intent as informed by the history of the Code. *32*

D. The sale of a trustee's avoidance power undermines bankruptcy policies and corrodes the structure of the Code. **33**

CONCLUSION **35**

TABLE OF AUTHORITIES

Cases

Artis v. D.C., 583 U.S. 71 (2018)....................20

Bank of Utah v. Hiawatha Coal Co. (In re C.W. Mining. Co.), 477 B.R. 176 (B.A.P. 10th Cir. 2012), *aff'd*, 749 F.3d 895 (10th Cir. 2014)....................25

Begier v. I.R.S., 496 U.S. 53 (1990) 19, 20, 30

Bethlehem Steel Corp. v. Moran Towing Corp. (In re Bethlehem Steel Corp.), 390 B.R. 784 (Bankr. S.D.N.Y. 2008)....................26

BFP v. Resolution Trust Corp., 511 U.S. 531 (1994)....................34

Black v. Leavitt (In re Black), 609 B.R. 518 (B.A.P. 9th Cir. 2019)....................11

Bullard v. Blue Hills Bank, 575 U.S. 496 (2015)....................11

Cadle Co. v. Mims (In re Moore), 608 F.3d 253 (5th Cir. 2010)....................27, 28, 29

Castleman v. Burman (In re Castleman), 75 F.4th 1052 (9th Cir. 2023)....................8, 9

Chicago v. Fulton, 141 S. Ct. 585 (2021)....................31

Citicorp Acceptance Co. Inc. v. Robison (In re Sweetwater), 884 F.2d 1323 (10th Cir. 1989).....35

Glenny v. Langdon, 98 U.S. 20 (1878) 33, 34

Guttman v. Martin (In re Railworks Corp.), 325 B.R. 709 (Bankr. D. Md. 2005) 31

Harris v. Viegelahn, 575 U.S. 510 (2015)....................7, 10, 16

Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1 (2000).....26, 27, 33, 34

Hyundai Translead Inc. v. Truck & Trailer Repair, Inc. (In re Trailer Source, Inc.), 555 F.3d 231 (6th Cir. 2009)....................36

In re Bargdill, 238 B.R. 711 (Bankr. N.D. Ohio 1999)....................27, 35, 36

In re Bobroff, 766 F.2d 797 (3d Cir. 1985)....................14

In re Cofer, 625 B.R. 194 (Bankr. D. Idaho 2021)....................12

In re Goins, 539 B.R. 510(Bankr. E.D. Va. 2015)....................8, 9

In re Hodges, 518 B.R. 445 (E.D. Tenn. 2014)....................9

In re Nichols, 319 B.R. 854 (Bankr. S.D. Ohio 2004)....................13, 17

In re Peter, 309 B.R. 792 (Bankr. D. Or. 2004)....................8, 9

In re Pruneski, 343 B.R. 714 (Bankr. M.D. Fla. 2006)....................14

In re TMT Procurement Corp. v. Vantage Drilling Co., (*In re TMT Procurement Corp.*), 764 F.3d 512 (5th Cir. 2014)....................21, 23

Jackson v. Novak (In re Jackson), 593 F.3d 171 (2d Cir. 2010)....................21

Kendall v. Lynch (In re Lynch), 363 B.R. 101 (B.A.P. 9th Cir. 2007)....................16, 17

Kirtsaeng v. John Wiley & Sons, Inc., 568 U.S. 519 (2013)....................27

Kroh Brothers Dev. Co. v. United Mo. Bank of Kansas City (In re Kroh Bros. Dev. Co.), 100 B.R. 487 (Bankr. W.D. Mo. 1989)....................30, 31

Matter of Lybrook, 951 F.2d 136 (7th Cir. 1991)....................14

Mellon Bank, N.A. v. Dick Corp. (In re Qualitech Steel Corp.), 351 F.3d 290 (7th Cir. 2003)....................27, 29

Miller v. Stone (In re Waterford Funding, LLC), 2017 WL 439308, at *3 (Bankr. D. Utah Feb. 1, 2017)....................36

Mission Prod. Holdings, Inc. v. Tempnology, LLC, 139 S. Ct. 1652 (2019)....................24, 35

Niz-Chavez v. Garland, 593 U.S. 155 (2021)....................27

N.Y. & Presbyterian Hosp. v. U.S., 881 F.3d 877 (Fed. Cir. 2018)....................25

O'Dowd v. Trueger (In re O'Dowd), 233 F.3d 197 (3d Cir. 2000)....................23

Official. Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery, 330 F.3d 548 (3d Cir. 2003)....................37

Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery (In re Cybergenics Corp.), 226 F.3d 237 (3d Cir. 2000)....................20, 21, 28

Pitman Farms v. ARKK Food Co. (In re Simply Essentials, LLC), 78 F.4th 1006 (8th Cir. 2023)....................23, 24, 27, 29

Pursuit Cap. Mgmt. LLC v. Pursuit Inv. Mgmt. LLC (In re Pursuit Cap. Mgmt., LLC), 595 B.R. 631 (Bankr. D. Del. 2018)....................36

Rajala v. Spencer Fane LLP (In re Generation Res. Holding Co.), 964 F.3d 958 (10th Cir. 2020)....................28, 29, 32

Republic Credit Corp. v. Boyer (In re Boyer), 372 B.R. 102 (D. Conn. 2007)....................36

Robinson v. Shell Oil Co., 519 U.S. 337 (1997)....................7

Rockwell v. Hull (In re Rockwell), 968 F.3d 12 (1st Cir. 2020)....................8

Rodriguez v. Barrera (*In re Barrera)*, 22 F.4th 1217 (10th Cir. 2022) 10, 12, 18

Rushton v. Bank of Utah (In re C.W. Min. Co.), 477 B.R. 176 (B.A.P. 10th Cir. 2012), *aff'd*, 749 F.3d 895 (10th Cir. 2014)....................31

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)....................23

Segal v. Rochelle, 382 U.S. 375 (1966) 33, 34

Simantob v. Mashian (*In re Lahijani)*, 325 B.R. 282 (B.A.P. 9th Cir. 2005)....................27, 30

Smith v. Greenhaw Oil and Gas (In re Greenhaw Energy, Inc.), 359 B.R. 636 (Bankr. S.D. Tex. 2007)....................24

Smith v. State of Main Bureau of Revenue Servs. (In re Smith), 910 F.3d 576 (1st Cir. 2018)......21

Southwest Airlines Co. v. Saxon, 596 U.S. 450 (2022) 7, 20

Spradling & Metzger (In re P.R.T.C., Inc.), 177 F.3d 774 (9th Cir. 1999)....................30

Texas v. Soileau (In re Soileau), 488 F.3d 302 (5th Cir. 2007)....................4

Titan Real Est. Ventures, LLC, *v. MJCC Realty Ltd. P'ship (In re Flanagan)*, 415 B.R. 29 (D. Conn. 2009)....................23

Trinity Gas Corp. (Reorganized) v. I.R.S. (In re Trinity Gas Corp. (Reorganized)), 242 B.R. 344 (Bankr. N.D. Tex. 1999)....................24

TRW Inc. v. Andrews, 534 U.S. 19 (2001)....................9, 31

Union Bank v. Wolas, 502 U.S. 151 (1991)....................28

Upper Crust v. Tobins (In re Upper Crust, LLC), 554 B.R. 23 (Bankr. D. Mass. 2016).........22, 30

U.S. v. Gen. Res., Ltd., 204 F.Supp. 872 (D. Colo. 1962)..33, 34

U.S. v. Nordic Vill. Inc., 503 U.S. 30 (1992)..25

U.S. v. Whiting Pools, Inc., 462 U.S. 198 (1983)...22

Warren v. Peterson, 298 B.R. 322 (N.D. Ill. 2003)...16, 18

Wis. Pub. Intervenor v. Mortier, 501 U.S. 597 (1991)..13

Zibman v. Tow (In re Zibman), 268 F.3d 298 (5th Cir. 2001)...8

Statutes

11 U.S.C. § 101(5)....24

11 U.S.C. § 522(a)(2) 8

11 U.S.C. § 348(a)....16

11. U.S.C. § 348(f)(1)(A) 7

11 U.S.C. § 348(f)(2) 10, 13, 18

11 U.S.C. § 363(b)....20

11 U.S.C. § 503(b)(3)(B) 36

11 U.S.C. § 506(c) 27

11 U.S.C. § 541(a) ....passim

11 U.S.C. § 542(a)....22

11 U.S.C. § 544....19. 29

11 U.S.C. § 547....19, 26, 27

11 U.S.C. § 548....19

11 U.S.C. § 549(a) 26

11 U.S.C. § 550(a) 19, 20, 25, 32

11 U.S.C. § 551....20, 25

11 U.S.C. § 704(a)(1)....20

11 U.S.C. § 1107(a) 19

11 U.S.C. § 1327(b)....11

11 U.S.C. § 1325(a)(4)....16

11 U.S.C.A. § 96(b) (repealed 1978)....33, 34

Other Authorities

H.R. REP. NO. 103-835 (1994), *as reprinted in* 1994 U.S.C.C.A.N. 3340.................................14

MERRIAM-WEBSTER DICTIONARY (2022) 25

OPINIONS BELOW

The Bankruptcy Court for the District of Moot, the United States District Court for the District of Moot, and the United States Court of Appeals for the Thirteenth Circuit all decided in favor of the Debtor on both issues. The Thirteenth Circuit's decision is available at No. 22-0359 and reprinted at Record 3.

STATEMENT OF JURISDICTION

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

STATUTORY PROVISIONS

11 U.S.C. § 348 – Effect of Conversion
(a) – (e) [omitted]
(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
> **(B) – (C)** [omitted]

(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.

11 U.S.C. § 522 – Exemptions
(a) In this section--

> **(1)** [omitted]
> **(2)** "value" 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.

(b) – (q) [omitted]

11 U.S.C. § 541 – Property of the Estate
(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) – (5) [omitted]
(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) [omitted]
(b) – (f) [omitted]

11 U.S.C. § 551 – Automatic Preservation of Avoided Transfer
Any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) of this title, or any lien void under section 506(d) of this title, is preserved for the benefit of the estate but only with respect to property of the estate.

11 U.S.C. § 1327 – Effect of Confirmation
(**a**) [omitted]
(b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.
(c) [omitted]

STATEMENT OF FACTS

Eugene Clegg (the "Debtor") retired from the United States Army in 2011 after a decorated and honorable career of service. R. at 5. Less than a year after his retirement, the Debtor received 100% ownership interest in The Final Cut, LLC ("Final Cut") from his mother ("Pink"). R. at 5. Final Cut owns and operates a historic movie theater in the City of Moot. R. at 5. The theater had a history of profitability and was the Debtor's sole source of income. R. at 5.

The Debtor executed an $850,000 loan (the "Loan") through Final Cut to renovate the theater in 2016. R. at. 5. The funds were borrowed from a "community-based financial institution" called Eclipse Credit Union ("Eclipse"). R. at 5. The Debtor secured the Loan by executing "an unconditional, unsecured personal guaranty in an unlimited amount." R. at 5. The Debtor personally renovated the theater alongside other veterans who "graciously volunteered their time." R. at 5. As a result, the cost of labor was reduced, and the proceeds of the Loan were not exhausted. R. at 5. To show his gratitude to those who volunteered, the Debtor chose to donate the remaining proceeds of the Loan to the Veterans of Foreign Wars (the "VFW") in early 2017. R. at 5. The proceeds—and ultimate donation—were approximately $75,000. R. at 5. Following renovations, the theater reopened to the community and residents of the City of Moot "took great civic pride in the [] theater and all that it represented." R. at 5–6.

Unfortunately, after three successful and profitable years post-renovation, the COVID-19 pandemic hit, prompting the Governor for the State of Moot to issue a March 2020 executive order that citizens must remain at home. R. at 6. The Governor's order rendered the theater inoperable for nearly a year and the Debtor was forced to borrow $50,000 from Pink on an unsecured basis in September of 2020. R. at 6. Despite the theater reopening a few months later in February, business was not the same. R. at 6. In an effort to save the theater and increase cash

flows, the Debtor forfeited his modest salary and "was forced to incur significant credit card debt." R. at 6. Additionally, the Debtor fell behind on the home payments for his mortgage serviced by Another Brick in the Wall Financial Corporation (the "Servicer"). R. at 6. After months of missed payments, the Servicer initiated foreclosure proceedings. R. at 6.

With the goal of maintaining possession of his home, the Debtor filed for chapter 13 bankruptcy on December 8, 2021 (the "Petition Date"). R. at 6. The home had an appraised value of $350,000 just days before the Petition Date. R. at 6. Furthermore, the filing reflected $320,000 of "non-contingent, liquidated, and undisputed debt to the Servicer," and "a contingent and unliquidated unsecured debt in an unknown amount owed to Eclipse." R. at 6. The Debtor claimed the maximum homestead exemption permitted by state law and disclosed approximately $20,000 of payments that had been made to Pink less than a year before the Petition Date. R. at 6–7.

In his chapter 13 plan, the Debtor proposed to resolve his pre-petition debts "and make ongoing, continuing monthly payments to the Servicer" through the trustee. R. at 7. Additionally, the plan reflected that the Debtor "maintained no equity in his home as of the Petition Date" and payments would be made "solely through future earnings derived from Final Cut." R. at 7. To resolve an adversary proceeding between Eclipse and the chapter 13 trustee the parties agreed to an amended plan that increased payments in return for Eclipse dropping its avoidance action. R. at 7-8. The court officially confirmed the plan on February 12, 2022, and "expressly provided that all property of the estate vested in the Debtor." R. at 8.

After nearly a year of timely payments made in accordance with the plan, the Debtor contracted long-COVID and was unable to work. R. at 8. The theater closed a month later and Eclipse initiated foreclosure proceedings against Final Cut. R. at 8. Rather than allowing his

chapter 13 case to be dismissed due to his inability to make payments, the Debtor made the good faith decision to convert his case to chapter 7. R. at 8. The chapter 7 trustee ("Trustee") inherited much of the same information documented in the chapter 13 filing. R. at 9. Notably, the documents reflected that the Debtor owed Eclipse approximately $200,000 and intended to "reaffirm the mortgage debt that he owed to the Servicer and remain in his home." R. at 9.

During the chapter 7 creditors meeting, the Trustee ordered an appraisal of the Debtor's home which had increased in value by $100,000 since the initial appraisal. R. at 9. The Trustee proceeded to market the house for sale. R. at 9. Eclipse offered to purchase the home and the "alleged preference claim against Pink" for $470,000. R. at 9. The Trustee filed a motion (the "Sale Motion") reflecting her acceptance of Eclipse's offer. R. at 9.

In its objection to the Sale Motion, the Debtor argued: (1) that the Trustee could not sell the home because "any post-petition, pre-conversion increase in the equity of his home...inure[d] to his benefit" and, therefore, "there was no equity available for the estate as of the Petition Date;" and (2) "the Trustee's statutory ability to avoid and recover transfers under sections 547 and 550 [could not] be sold." R. at 10. The bankruptcy court ruled in favor of the Debtor on both issues and the Trustee timely appealed the ruling. R. at 10. The Thirteenth Circuit affirmed on both issues.

STANDARD OF REVIEW

The questions presented by this case are purely issues of statutory construction that require interpretation of the Bankruptcy Code. Thus, the appropriate standard of review is *de novo*. *See, e.g., Texas v. Soileau (In re Soileau)*, 488 F.3d 302, 305 (5th Cir. 2007).

SUMMARY OF THE ARGUMENT

This Court should affirm the decision of the Thirteenth Circuit Court of Appeals and rule in favor of the Respondent on both issues presented.

Section 348(f)(1)(A) of the Bankruptcy Code defines the bankruptcy estate of a converted case to include the property of the estate on the petition date that is still possessed or controlled by the debtor on the date of conversion. By proposing to recover and distribute assets that were never a part of the bankruptcy estate, the Trustee attempts to wrongfully interfere with property that rightfully belongs to Mr. Clegg.

The plain language and legislative history of section 348(f)(1)(A) strongly indicate that a post-petition, pre-conversion increase in home equity is not property of the estate. In this case, the Trustee is seeking to sell Mr. Clegg's home in an effort to distribute the realized gain and increase in equity to creditors. The Trustee's interpretation of section 348(f)(1)(A) fails to interpret the Code as a whole and does not give weight to other sections that impact a reading of section 348(f)(1)(A) such as sections 522 and 1327. The Thirteenth Circuit correctly places value on the legislative history of section 348(f) and Congress's statement that it intended for post-petition, pre-conversion increases in equity to inure to the debtor. This Court should affirm the Thirteenth Circuit's interpretation of section 348 because it comports with canons of construction and the foundational policy goals of the Bankruptcy Code.

The Thirteenth Circuit correctly held that the trustee cannot sell its power to avoid and recover preferential transfers under sections 547 and 550 of the Bankruptcy Code. Avoidance powers are a statutory right of the trustee in which the debtor does not have an interest. Neither are the avoidance powers after-acquired property because they are not sufficiently rooted in the pre-bankruptcy past or related to the estate's normal course of business.

The language of the Code dictates that only the recovered funds, not the trustee's avoidance powers are property of the estate. Because the Code only authorizes the trustee to exercise avoidance powers any attempt by a creditor, such as Eclipse, to recover avoidable transfers is futile. Circuits holding the trustee's avoidance powers to be property of the estate do not provide adequate justification. Only the funds recovered may be distributed for that purpose. This conclusion satisfies rules of statutory construction and pre-Code practices under the Bankruptcy Act. Holding the trustee's avoidance powers to be property of the estate renders provisions of the Code superfluous. Moreover, this Court interpreted similar language under the Bankruptcy Act to require that the debtor have an interest in property of the estate and that the trustee held an exclusive right to avoid preferential transfers.

Placing the avoidance powers in the hands of a biased creditor undermines the fiduciary duty of the trustee and gives the impression of impropriety. Given the lack of statutory authority and significant downsides in categorizing avoidance powers as property of the estate, this Court should affirm the Thirteenth Circuit.

ARGUMENT

I. POST-PETITION, PRE-CONVERSION INCREASES IN HOME EQUITY INURE TO THE BENEFIT OF THE DEBTOR BECAUSE SUCH AN INCREASE IS NOT PROPERTY OF THE ESTATE UNDER SECTIONS 348 AND 541.

A. When read in the context of the Code, the language of section 348(f)(1)(A) states that a post-petition, pre-conversion increase in home equity inures to the benefit of the debtor.

Section 348(f)(1)(A) of the Code states "property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion." 11. U.S.C. § 348(f)(1)(A). Courts must read the language of the Code within its broader context and

according to common understanding. *Southwest Airlines Co. v. Saxon,* 596 U.S. 450, 455 (2022); *see also 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."). The appreciation in home equity did not exist on the filing date and is an interest separate from the house itself, therefore the proceeds were not property of the estate "as of the date of filing of the petition" 11. U.S.C. § 348(f)(1)(A). Thus, the increase in home equity inures to the benefit of the debtor.

1. The "snapshot rule" and section 522(a)(2) apply to section 348(f)(1)(A).

When a case is converted from chapter 13 to chapter 7, the existing case continues without effecting a change in the date of the filing of the petition. *Harris v. Viegelahn*, 575 U.S. 510, 515 (2015). Therefore, this Court should determine property of the estate to include only the value of assets existing on December 8, 2021, when Mr. Clegg filed his original chapter 13 petition. R. at 6. The snapshot rule is an approach taken in bankruptcy cases that determines the extent of the bankruptcy estate and the scope of the debtor's exemptions as of the date of filing. *Zibman v. Tow (In re Zibman*), 268 F.3d 298, 302 (5th Cir. 2001). The snapshot rule freezes the debtor's financial situation, including the value of his assets, in time on the petition date. *Rockwell v. Hull (In re Rockwell*), 968 F.3d 12, 18 (1st Cir. 2020). Furthermore, section 522(a)(2) states that "value" means fair market value as of the date of the filing of the petition. 11 U.S.C. § 522(a)(2). Because section 522(a)(2) and the snapshot rule apply to section 348(f)(1)(A), Mr. Clegg's home value froze at its $350,000 appraisal value on the Petition Date.

Not applying the snapshot rule to section 348(f)(1)(A) leads to the absurd result of the same property being valued differently for different purposes during the life of the case. The

homestead could be valued at a certain amount for exemption purposes, but a different amount for property of the estate purposes. R. at. 14.

The Ninth Circuit held that post-petition, pre-conversion increases in equity inure to the benefit of the estate rather than the debtor because the language of section 348(f)(1) is plain. *Castleman v. Burman (In re Castleman)*, 75 F.4th 1052, 1058 (9th Cir. 2023). It stated that property of the estate includes any assets the debtor held on the petition date along with any increase in equity in those assets because the equity and the underlying asset are inseparable. *Id.* The Ninth Circuit's holding in *In re Castleman* is unpersuasive as it looks at solely at the language of section 348(f)(1)(A) without considering the impact of section 522. *Id.* As support for its holding, the Ninth Circuit cites lower court cases that also failed to consider the impact of section 522 on section 348(f)(1)(A). *In re Castleman*, 75 F. 4th at 1056 (citing *In re Peter*, 309 B.R. 792, 795 (Bankr. D. Or. 2004), and *In re Goins,* 539 B.R. 510, 516 (Bankr. E.D. Va. 2015)).

The court in *In re Peter* stated that section 348(f)(1)(A) does not limit the chapter 7 estate to "equity in" "property of the estate" as of the chapter 13 petition date. *In re Peter*, 309 B.R. at 795. Rather the chapter 7 estate upon conversion should consist of any property of the estate that remains in the possession of the debtor on the date of conversion. *Id.* The court in *In re Goins* further stated that the increase in equity is not separate after-acquired property because it is inseparable from the real estate, which was always property of the estate. *In re Goins,* 539 B.R. at 516.

However, this understanding of the language is simplistic and discounts other Code provisions. Section 348(f)(1)(A) must be read in the larger context of the Code which *In re Castleman* and the lower courts failed to do. When interpreting the language of section 348(f)(1)(A) this Court must consider the snapshot rule and section 522. Because the snapshot

rule freezes the valuation of an asset as of the petition filing date, the interest and value in the home itself is separate from the post-petition increase in equity. While the equity must be "newly acquired" during the chapter 13 bankruptcy, to inure to the debtor, the underlying asset need not be. *In re Hodges*, 518 B.R. 445, 451 (E.D. Tenn. 2014). Therefore, increases in equity that occur during a chapter 13 case, including in property that existed on the petition date, inure to the benefit of the debtor, not to the estate. *Id.*

2. The canon against superfluity conforms with the Thirteenth Circuit's holding that a post-petition, pre-conversion increase in equity inures to the benefit of the debtor upon conversion.

i. When the debtor converts in good faith, any post-petition increase in equity inures to the benefit of the debtor.

A statute should not be read in a way that renders its language "superfluous, void, or insignificant." *TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001). Here, reading section 348(f)(1)(A) to mean that a post-petition, pre-conversion increase in equity belongs to the estate upon conversion would render section 348(f)(2) superfluous. Section 348(f)(2) states that "if the debtor converts a case under chapter 13 … [to] 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*." 11 U.S.C. § 348(f)(2) (emphasis added).

The language in section 348(f)(2) makes clear that post-petition, pre-conversion increases in equity inure to the benefit of the estate if the debtor converts in bad faith. Congress intended this as a punitive measure for the bad faith conversion, as the debtor's otherwise immune post-petition property interests can be distributed to creditors. *Rodriguez v. Barrera* (*In re Barrera)*, 22 F.4th 1217, 1221 (10th Cir. 2022). When a debtor converts in good faith no penalty is exacted. *Harris,* 575 U.S. at 518. Post-petition increases in equity in a good faith conversion could not be property of the estate as such a reading would render section 348(f)(2)

superfluous. *In re Barrera,* 22 F.4th at 1222-1223. It is undisputed that Mr. Clegg converted his case from chapter 13 to chapter 7 in good faith. R. at 8. n.8. Therefore section 348(f)(1)(A) governs. Because Mr. Clegg converted in good faith, the chapter 7 estate only consists of the property of the estate as of the Petition Date and the post-petition, pre-conversion increase in equity should inure to the benefit of Mr. Clegg.

ii. Mr. Clegg's interest in the home is separate from his interest in the increase in equity.

The post-petition, pre-conversion increase in home equity is a separate interest from the home itself. Proceeds of the estate are distinct from a debtor's legal or equitable interest in the estate, as any other reading would render portions of section 541(a) superfluous. Section 541(a)(1) defines property of the estate as "all legal or equitable interest of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). Section 541(a)(6) further defines property of the estate to include all "proceeds, product, offspring, rents, or profits of or from property of the estate." 11 U.S.C. § 541(a)(6). The post-petition, pre-conversion increase in home equity would fall under section 541(a)(6) as it derives from the home which itself is property of the estate. Because the post-petition increase in equity falls under 541(a)(6), it must be separate from the legal or equitable interest of the debtor in the house itself because any other reading would conflict with the canon against superfluity. *In re Barerra,* 22 F.4th at 1222-1223.

In a traditional chapter 7 case, section 541(a)(6) requires that the post-petition increase in home equity inure to the benefit of the estate rather than the debtor. However, the Code must be read as a whole, and when read in conjunction with sections 348(f)(2), 541(a)(1), 522, and 1327[1], section 541(a)(6) does not support the conclusion that the increase in equity in Mr. Clegg's house inures to the benefit of the estate upon conversion.

[1] A section revesting Mr. Clegg's house in him upon confirmation of the chapter 13 plan

3. Section 1327(b) vested all property of the chapter 13 estate in Mr. Clegg upon confirmation, so any post-confirmation appreciation in equity belongs to him.

A debtor in a chapter 13 case is allowed to keep their assets in exchange for paying creditors all their disposable income for the next three to five years. *Bullard v. Blue Hills Bank*, 575 U.S. 496, 498 (2015). Section 1327(b) states that "except as otherwise provided in the plan… the confirmation of a plan vests all of the property of the estate in the debtor." 11 U.S.C. § 1327(b). This revesting provision gives the property to the debtor outright upon confirmation of a chapter 13 plan so any appreciation in that property belongs to the debtor, not the estate upon conversion. *Black v. Leavitt (In re Black)*, 609 B.R. 518, 529 (B.A.P. 9th Cir. 2019). Therefore, when Mr. Clegg confirmed his plan on February 12, 2022, he regained the rights to his house. R. at 8. Mr. Clegg owned the house when the post-petition equity accrued, thus the equity was his property, not the property of the estate.

Even if this Court holds that the home and the increase in equity in the home are not separate, section 541(a)(6) is operative only before confirmation of a chapter 13 plan, because confirmation of the plan vests property in the debtor. 11. U.S.C. § 1327. The Tenth Circuit stated, "only proceeds of or from property of the estate become property of the bankruptcy estate." *In re Barrera,* 22 F.4th at 1223. Therefore, proceeds from the home that accrued post-confirmation do not vest to the estate because the home was no longer property of the estate at the time the equity accrued.

Petitioner may argue that chapter 13 provisions should not govern after conversion and that section 1327 is moot since chapter 7 now governs the case. However, because chapter 13 governed at the time the post-petition equity accrued the applicable chapter post-conversion is immaterial. Applying section 1327 in its proper context, Mr. Clegg's house revested in him

upon confirmation of the plan. R. at 8. Chapter 13 still governed when the appreciation in the home equity accrued, and at the time that equity accrued, the house belonged entirely to Mr. Clegg.

The court in *In re Cofer* stated that the language of sections 1327 and 348(f)(1)(A) can be read harmoniously. 625 B.R. 194, 197 (Bankr. D. Idaho 2021). The court stated that because the debtor owned the home on the date she filed her chapter 13 petition, and the home remained in her possession upon conversion, it became property of the chapter 7 estate. *Id.* The court stated that upon conversion, property that vested in the debtor upon confirmation but was property of the estate as of the petition date is recaptured into the chapter 7 estate. *Id.*

However, following the holding in *In re Cofer* would run counter to a reasonable understanding of the text. Here, Mr. Clegg did own the home on the Petition Date, but the equity in the home accrued post-petition, when Mr. Clegg owned the home outright because it had revested in him. The appreciation therefore was never property of the estate, much less property of the estate as of the Petition Date.

When Mr. Clegg filed his chapter 13 petition on December 8, 2021, his home had a value of $350,000. R. at 6. When reading section 348(f)(1)(A) in the context of sections 522(a)(2), 348(f)(2), 541(a)(1) & (6) and 1327, the property of the estate upon conversion to chapter 7 only includes property of the estate as of the Petition Date. The property of the estate as of the Petition Date does not include the post-petition increase in equity. The home value froze on the Petition Date, the interest in proceeds from the home are separate from the home itself, and the proceeds accrued when the home was revested in Mr. Clegg. Therefore, the post-petition, pre-conversion increase in equity inures to Mr. Clegg's benefit.

B. The legislative history of section 348(f) reveals that congress intended for post-petition, pre-conversion increases in home equity to inure to the benefit of the debtor.

When read within the context of the Code, the language of section 348(f)(1)(A) dictates that a post-petition, pre-conversion increase in equity in a debtor's property inures to the benefit of the debtor. Though the language of section 348(f)(1)(A) is clear, "common sense suggests that inquiry benefits from reviewing additional information rather than ignoring it." *Wis. Pub. Intervenor v. Mortier,* 501 U.S. 597, 610 n.4 (1991). The legislative history behind section 348(f) supports the outcome to which the plain text already points; the post-petition, pre conversion increase in home equity inures to the benefit of Mr. Clegg and is not property of the estate.

Congress intended to address the issue of post-petition, pre-conversion interests in property when enacting section 348(f), and stated that post-petition, pre-conversion increases in equity should inure to the benefit of the debtor when the debtor converts in good faith. *In re Nichols*, 319 B.R. 854, 856 (Bankr. S.D. Ohio 2004). When Congress enacted section 348(f) in 1994, there was a circuit split regarding the issue of post-petition, pre-conversion assets. The Seventh Circuit in *Matter of Lybrook* held that property acquired post-petition, pre-conversion inured to the benefit of the chapter 7 estate while the Third Circuit in *In re Bobroff* held that upon conversion, the chapter 7 estate only acquired the property which the debtor held on the petition date. *Matter of Lybrook,* 951 F.2d 136, 139 (7th Cir. 1991); *In re Bobroff*, 766 F.2d 797, 804 (3d Cir. 1985). When enacting section 348(f), Congress intended to clarify the Code to resolve the circuit split regarding what property belonged to the estate upon conversion. *In re Pruneski*, 343 B.R. 714, 716 (Bankr. M.D. Fla. 2006). Congress specified that with section 348(f) it "overrul[ed] the holding in cases such as *Matter of Lybrook* and adopt[ed] the

reasoning of *In re Bobroff*." *See* H.R. REP. NO. 103-835, at 57 (1994), *as reprinted in* 1994 U.S.C.C.A.N. 3340, 3366.

The Third Circuit stated that the only properties of interest of the debtor that inured to the estate were those that existed upon the commencement of the case. *In re Bobroff*, 766 F.2d at 803. The court further stated that the Code sets the petition filing date as the "critical time" as of which property comprising the estate is to be determined. *Id.* The tort claim at issue in *In re Bobroff* occurred after the commencement of the case and therefore was not property of the estate upon conversion because it was not part of the estate's value as of the petition date. *Id.* at 803-804. In stating that it was adopting the reasoning of the Third Circuit, Congress indicated that it intended for property gained post-petition, pre-conversion to belong to the debtor rather than the new chapter 7 estate.

Petitioner may argue that *In re Bobroff* and *Matter of Lybrook* are distinguishable from cases like the one at hand because those cases addressed property that was not tied to existing property but instead was first acquired after the date of petition. However, this Court can still square *In re Bobroff* and *Matter of Lybrook* with the case at hand. Here, the home and the post-petition increase in home equity are separate interests. While Mr. Clegg did own his home on the Petition Date, unlike Mr. Bobroff whose torts claim did not come into being until after he had filed his petition for bankruptcy, the specific property at issue – the value of the appreciation in Mr. Clegg's home – did not exist as of the Petition Date. The appreciation in equity did not occur until after the Petition Date and is therefore separate from the value of the home itself.

The snapshot rule in section 522 further supports the notion that the increase in equity in the home is separate from the home itself. Therefore, the reasoning in *In re Bobroff* still stands. The only property of the debtor that becomes property of the estate upon conversion are those

interests that existed as of the commencement of the case, and the petition date is the "critical time" at which this property is determined. *Id.* at 803. Because Congress's explicit adoption of the reasoning in *In re Bobroff* is valid here, and because the appreciation in home equity did not exist at the commencement of the case, the appreciation is not included in property of the estate upon conversion.

The dissent also states that when Congress wanted to exclude assets from the estate it did so with specificity and its failure to exclude a post-petition increase in equity is compelling. R. at 29. However, this argument once again fails to read the Code as a whole. Though Congress did not explicitly exclude post-petition, pre-conversion equity from property of the estate in section 541(a), it did so in section 348(f). Section 348(f)(2) states that property of the estate shall consist of property as of the date of conversion when the debtor converts in bad faith. Therefore, when the debtor converts in good faith, the property of the estate is only that which existed as of the petition date. Any property acquired post-petition and pre-conversion is explicitly excluded from the estate when the debtor converts in good faith, as Mr. Clegg did
explicitly excluded from the estate when the debtor converts in good faith, as Mr. Clegg did
here.

C. Policy also supports the interpretation that post-petition, pre-conversion increases in home equity inure to the benefit of the debtor.

1. Affirming the Thirteenth Circuit supports Congress's goal of encouraging debtors to file chapter 13 cases.

Affirming the Thirteenth Circuit is the most equitable course as it furthers the goal of encouraging debtors to file under chapter 13. There is an interest in debtors filing chapter 13 as it benefits both debtors and creditors. *Kendall v. Lynch (In re Lynch),* 363 B.R. 101, 107 (B.A.P. 9th Cir. 2007). Congress designed chapter 13 to allow the debtor to retain his home, car, and

other property in exchange for regular payments to creditors. *Harris*, 575 U.S. at 514. Chapter 13 also benefits creditors because in a chapter 13 case, creditors often receive more from the debtor than they would in a chapter 7 liquidation. *Id*; 11 U.S.C. § 1325(a)(4). This interest has led to Congress enacting statutes to "incentivize debtors to opt for reorganization over liquidation." *In re Barrerra,* 22 F.4th at 1220.

Congress added section 348(f) to the Code to provide debtors with an incentive to reorganize under chapter 13 rather than liquidate under chapter 7. *Warren v. Peterson*, 298 B.R. 322, 325 (N.D. Ill. 2003). The Code elaborates on conversion in section 348(a) which specifies that conversion from one chapter to another does not start a new case but rather transforms the nature of the existing case. 11 U.S.C. § 348(a). Section 348(f)(1)(A) similarly aims to remove a disincentive to filing chapter 13 by allowing a good faith debtor to retain property acquired post-petition, pre conversion. Debtors should be able to keep the assets they acquire post-petition, pre-conversion because this property would not have belonged to the chapter 7 estate had the debtor filed under chapter 7 originally. *Harris,* 575 U.S. at 518. If the debtor's assets acquired after filing chapter 13 were property of the estate and available to creditors upon conversion to chapter 7, the debtor would be in a worse position than if he had initially filed under chapter 7 and would essentially be penalized for attempting a chapter 13 repayment plan. *In re Nichols,* 319 B.R. at 856. If debtors risked losing all post-petition assets upon conversion from chapter 13 to chapter 7, they might not attempt a chapter 13 plan to begin with. *Id*. This runs counter to Congress's goal of debtors filing chapter 13, as chapter 13 is more beneficial for both debtors and creditors. Therefore, this Court should read section 348(f)(1)(A) to mean that post-petition, pre-conversion assets inure to the benefit of the debtor. *See also*: *In re Lynch,* 363 B.R. at 107 ("Excluding equity resulting from debtors' payments on loans secured by their

residence and property appreciation subsequent to their chapter 13 filing in a case converted to chapter 7 serves the congressional purpose of encouraging chapter 13 reorganizations over chapter 7 liquidations, as reflected in the legislative history.")

This Court should not punish debtors for attempting chapter 13. Had Mr. Clegg filed in chapter 7 originally, he would have been able to retain his post-petition assets. Allowing Mr. Clegg to retain his post-petition assets upon conversion is consistent with the policy goal of encouraging debtors to file chapter 13. This retention of assets guarantees that the debtor will not be worse off for having tried a repayment plan so long as he converts in good faith. There is no clear reason why the debtor and creditors should not be in the same position they would have been had the debtor originally filed a chapter 7 case and never attempted to repay his debts.

Furthermore, if Mr. Clegg had filed chapter 7 to begin with, the trustee could not have sold his house because the secured indebtedness and homestead exemption left Mr. Clegg with no equity in the home. While the trustee could not have sold the house in a chapter 7 case, it is possible that the Servicer may have foreclosed on it, resulting in Mr. Clegg losing his home anyway. This is not a convincing reason to allow the post-petition, pre-conversion increase in equity to inure to the estate. Actions that the Servicer could possibly take outside of this bankruptcy case are not relevant to this Court's decision regarding the goals of the Code as they pertain to this case.

2. Freezing the home value on the Petition Date and valuing the home and the increase in equity as separate interests serves the Code's goal of providing a fresh start to the honest but unfortunate debtor.

Another fundamental goal of the Code is to give "a fresh financial start to the honest but unfortunate debtor." *In re Barrera,* 22 F.4th at 1219. Allowing the post-petition, pre-conversion equity in the home to inure to the estate would run counter to this goal as it would result in Mr.

Clegg losing his home. This Court should reward, not punish, Mr. Clegg for attempting to repay his creditors.

Concerns regarding bad faith conversions are not at issue. It is undisputed that Mr. Clegg converted in good faith when he realized he was no longer able to pay due to contracting long-COVID and the economic downturn caused by an unprecedented national pandemic. R. at 8. There is little concern that finding for Mr. Clegg will create a bad precedent because the existence of section 348(f)(2) mitigates the potential bad faith issue by including post-petition, pre-conversion interests into the estate when a debtor does convert a case in bad faith. 11 U.S.C. § 348(f)(2).

One of the ways the Code helps provide the debtor a fresh start is by ensuring stability and judicial efficiency within a bankruptcy case. Stability within a case allows the debtor and the creditors to make informed choices about how to proceed. Section 348(f) promotes stability and judicial efficiency "by preventing relitigation of valuation issues." *Warren v. Peterson*, 298 B.R. at 325. Establishing the value of property early on ensures stability and ensures that valuations do not have to be re-examined if the case is later converted. *Id.* at 326. If valuation of assets was subject to change throughout the course of a case, it could lead to unfair impacts to both the debtor and creditors.

For example, if a debtor had assets valued at exactly the exemption amount, resulting in a no asset case, an unsecured creditor might choose not to be involved because they would be unlikely to recover from the estate and it would not be worth it to invest in attorneys to represent them. However, if the assets experienced a significant increase during a case, because the value was subject to change, the unsecured creditor would have a greater chance of recovery but

would miss out on their pro rata distribution of estate property because they would not have filed a claim in time due to their reliance on the earlier asset valuation.

II. THE CODE DOES NOT PERMIT A CHAPTER 7 TRUSTEE TO SELL THE RIGHT TO AVOID AND RECOVER PREFERENTIAL TRANSFERS PURSUANT TO SECTIONS 547 AND 550.

Section 547 of the Code empowers the trustee[1] to avoid preferential transfers and recover funds that would have been property of the estate but for the transfer of the debtor's property. *Begier v. I.R.S.*, 496 U.S. 53, 58 (1990). Specifically, "the trustee may . . . avoid any transfer of an interest of the debtor in property" constituting a preference to a specific creditor. 11 U.S.C. § 547(b). Generally, the trustee may reshape the estate through avoiding, or "clawing back," several types of transfers under either federal bankruptcy law or through its position as a lien creditor via the strong-arm clause of the Code. 11 U.S.C. § 544 (strong-arm powers); 11 U.S.C. § 547 (avoidance of preferential transfers); 11 U.S.C. § 548 (avoidance of fraudulent transfers). The trustee may recover or "clawback" into the estate preferential transfers if, among other requirements, the transfer took place within ninety days of filing or one year if the transferee is an insider. 11 U.S.C. §§ 547(b), 550(a). Once recovered, the funds are reserved as property of the estate and may be distributed to creditors or for the benefit of the estate. *See* 11 U.S.C. §§ 541(a)(3), 551, and 550(a).

Once an estate is created by converting to chapter 7, the trustee must reduce the property of the estate in the best interest of creditors. 11 U.S.C. § 704(a)(1). The trustee is authorized to sell such property pursuant to section 363(b) to carry out this mandated liquidation. 11 U.S.C. § 363(b). The trustee's avoidance powers are not property of the estate because they are a claim held by the trustee, not the debtor. Section 547(b) allows for the recovery of the debtor's

[1] Reference to the trustee includes the debtor in possession. The debtor in possession is authorized to operate as a trustee when none has been appointed in a chapter 11 bankruptcy. 11 U.S.C. 1107(a).

property, a term interpreted as the pre-petition analogue to property of the estate. *Begier*, 496 U.S. at 59. Without a recovery of the debtor's interest, there is only the exclusive statutory power of the trustee, no property of the estate to sell.

A. The plain language of the Code does not permit the sale of a trustee's power to avoid a preferential transfer pursuant to section 547(b) because it is not property of the estate.

The language of the Code resolves the threshold question of whether the trustee's avoidance powers constitute property of the estate. The starting point in any statutory construction begins with the plain language of the text itself. *Artis v. D.C.*, 583 U.S. 71, 83 (2018). As the best indicator of congressional intent, unambiguous language ought to be the beginning and the end of the court's evaluation. *Id.* To accurately interpret plain language, the court must read the language within its broader context and according to common understanding. *Southwest Airlines Co.*, 596 U.S. at 455. Within the context of the Code's description of estate property in section 541—and distribution of funds recovered under section 547(b)—it defies plain meaning to permit the trustee to sell its avoidance powers. The trustee's statutory power to recover property on behalf of the estate is not an additional asset of the debtor which may be bought and sold. *See Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery (In re Cybergenics Corp.),* 226 F.3d 237, 244 (3d Cir. 2000) (discussing the lack of the debtor's property interest in a trustee's power to avoid a fraudulent transfer pursuant to section 548).

1. The trustee's avoidance power cannot be property of the estate because the debtor has no interest in the trustee's statutory power to recover funds.

Property of the estate includes all legal or equitable interests of the debtor in property as of the commencement of the case. 11 U.S.C. § 541(a)(1). Property of the estate is intentionally

broad in scope due to Congress's desire to encourage honesty on behalf of the debtor and maximize the pro rata distribution to creditors. *Smith v. State of Main Bureau of Revenue Servs. (In re Smith)*, 910 F.3d 576, 586 (1st Cir. 2018). The section's broad scope includes all potential or unliquidated claims held by the debtor and the debtor's contingent or inchoate interests at the time of filing. *Jackson v. Novak (In re Jackson)*, 593 F.3d 171, 176 (2d Cir. 2010). Regardless of where the property is located or who holds possession, it must be tied to a cognizable pre-petition interest of the debtor. *See In re TMT Procurement Corp. v. Vantage Drilling Co.*, (*In re TMT Procurement Corp.*), 764 F.3d 512, 524-525 (clarifying that even property that the estate acquires post-petition must be tied the debtor's interest).

The trustee's power to avoid preferential transfers (or pursue any avoidance action) is distinct from a debtor's interest. It is the trustee's statutory power to pursue funds in which the debtor no longer has a property interest. *In re Cybergenics Corp.*, 226 F.3d at 243. Consistent with the long-standing requirement that the debtor have a cognizable interest in property of the estate, the Third Circuit held that the sale of the debtor's assets did not include the trustee's avoidance powers. *Id.* Avoidance actions allow the trustee to pursue transferred funds for the general benefit of all unsecured creditors and are at no point a claim held by the debtor. *Id.* If the avoidance powers are not an asset of the debtor, the debtor does not have an interest sufficient to render them property of the estate. *Id.* at 247 n.16.

Provided the debtor itself has an interest at the commencement of the case, section 541(a)(1) includes property made available to the estate by provisions of the Bankruptcy Code. *U.S. v. Whiting Pools, Inc.*, 462 U.S. 198, 205 (1983). In *Whiting,* the debtor's interest in the surplus of a secured creditor's liquidation gave the debtor a sufficient interest for the trustee to recover possession through its turnover power of section 542. *Id.* at 206. The Code's turnover

provision authorized the trustee to bring the possessory interest, as well as the existing interest in the surplus of the secured creditor's sale, into the estate. *Id. Whiting* shows how broad the scope of property of the estate may be while reiterating that it is the debtor's interest that may be generously construed, not the interest of any party holding any claim having to do with the estate.

Here, Mr. Clegg did not retain any interest in the funds transferred in an allegedly preferential payment to Pink. R. at 4. The trustee's right to avoid preferential transfers are distinct from the debtor's interest in property because the debtor ceases to have an interest once the funds are transferred to the preferred creditor. *Upper Crust v. Tobins (In re Upper Crust, LLC)*, 554 B.R. 23, 32 (Bankr. D. Mass. 2016). Had the debtor retained any interest in the funds transferred, the trustee could recover the funds by use of its turnover power in section 542(a) rather than avoid the transfer as a preference. Any property of the estate that the trustee may use, sell, or lease under section 363 must be delivered to the trustee by any entity in custody, control, or possession of such property. 11 U.S.C. § 542(a). The very fact that the trustee alleged a preferential transfer and did not order turnover of the funds reinforces the fact that the debtor had no remaining interest in the funds or a claim to recover those funds.

Because a debtor's causes of action are included in the property of the estate, some courts have incorrectly held that the trustee's avoidance powers are as well. *Pitman Farms v. ARKK Food Co. (In re Simply Essentials, LLC)*, 78 F.4th 1006, 1008 (8th Cir. 2023); *Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec., LLC*, 460 B.R. 106, 114 (Bankr. S.D.N.Y. 2011), *aff'd,* 474 B.R. 76 (S.D.N.Y. 2012). However, avoidance powers belong solely to the trustee, not the debtor. *Titan Real Est. Ventures, LLC*, *v. MJCC Realty Ltd. P'ship (In re Flanagan)*, 415 B.R. 29, 48 (D. Conn. 2009). Both the *In re Simply Essentials* and *Bernard*

Madoff courts failed to provide an explanation for creating a debtor's interest in the avoidance powers where there is none. *Bernard L. Madoff*, 460 B.R. at 114; *In re Simply Essentials*, 78 F.4th at 1008. Including the avoidance power of a trustee available on the date of the petition in the property of the estate fails to account for the debtor's lack of interest in the trustee's avoidance powers.

2. The trustee's avoidance powers do not constitute after-acquired property under section 541(a)(7).

Property of the estate includes "any interest in property that the estate acquires after the commencement of the case." 11 U.S.C. § 541(a)(7). Section 541(a) is an "all-embracing definition" of the debtor's interest in property. 124 Cong. Rec. H11,096 (f. daily ed. Sept. 28, 1978). Congress clarified that after-acquired property may be property of the estate so long as it arises in the estate's enterprise which is necessarily constrained to the debtor's interest in property at the commencement of the case. *O'Dowd v. Trueger (In re O'Dowd*), 233 F.3d 197, 202 (3d Cir. 2000).

After-acquired estate property includes property interests acquired in the estate's normal course of business, as it would be conducted by the debtor pre-petition. *In re TMT Procurement*, 764 F.3d. at 525 n.52. Accordingly, after-acquired property is only property of the estate if it is rooted in a pre-petition interest included in the estate. *Id.* at 525. The underlying constraints on property of the estate still exist in the context of after-acquired property, meaning that the bankruptcy estate cannot hold anything more or less than the debtor did hold, or will hold, outside of bankruptcy. *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1663 (2019).

Categorizing avoidance powers as property of the estate under section 541(a)(7) misuses the statute to significantly expand the debtor's interests in property. Avoidance powers are

unrelated to the debtor's pre-petition activities or business interests and are instead a statutory power of the trustee to reshape the estate in bankruptcy. Still, some courts hold that the trustee's avoidance powers, which arise upon filing, constitute an after-acquired property interest under section 541(a)(7). *In re Simply Essentials,* 78 F4th at 1008; *Smith v. Greenhaw Oil and Gas (In re Greenhaw Energy, Inc.)*, 359 B.R. 636, 642 (Bankr. S.D. Tex. 2007). Preference actions constitute a claim under the Code's definition in section 101(5), which may be a property interest. 11 U.S.C. § 101(5) (defining "Claim", and including all legal, equitable, contingent, non-contingent, and contested matters in its broad definition).

This reading ignores the distinction between the debtor's and trustee's separate interests. Property of the estate only includes interests of the debtor, and section 541(a)(7) is no exception to that rule. A trustee may not include its own statutory power in the estate through section 541(a)(7). *Trinity Gas Corp. (Reorganized) v. I.R.S. (In re Trinity Gas Corp. (Reorganized))*, 242 B.R. 344, 350 (Bankr. N.D. Tex. 1999). Rather, section 541(a)(7) is intended to include property acquired through the estate's (formerly the debtor's) normal course of business. *Id.*

3. The funds recovered through the trustee's avoidance power are property of the estate, while the avoidance power itself is not.

The Code distinguishes between the recovered funds of an avoidable transfer and the power to avoid that transfer itself, with only the funds recovered being property of the estate. 11 U.S.C. § 541(a)(3). After the trustee successfully prosecutes an avoidance claim, the property recovered—or the value of the transfer—remains with the estate. 11 U.S.C. § 551. The trustee may then distribute the recovered property for the benefit of the estate; however, the trustee must first exercise its avoidance power and recover the transferred funds. 11 U.S.C. § 550(a).

The Code specifies that the *recovered* property is property of the estate. 11 U.S.C. § 541(a)(3) (emphasis added). Because "recovered" is defined as "to bring back by legal process,"

it is inconsistent with fundamental canons of statutory construction to read the term as including the legal process itself. *See Recovered,* MERRIAM-WEBSTER DICTIONARY (2022); *N.Y. & Presbyterian Hosp. v. U.S.,* 881 F.3d 877, 882 (Fed. Cir. 2018) (citing the common dictionary meaning of a statute's word as a fundamental canon of statutory construction). Sections 541(a)(3), 550(a), and 551 all refer to the recovered funds and not the avoidance power as the property of the estate to be distributed to creditors. *See* 11 U.S.C. §§ 541(a)(3), 550(a), and 551.

Congress knows how to refer to the trustee's avoidance powers when it means to. Regarding property of the estate and the trustee's avoidance power, Congress took great care to establish a set of provisions that control the recovery, reservation, and distribution of avoidable transfers, respectively. *Bank of Utah v. Hiawatha Coal Co. (In re C.W. Mining. Co.)*, 477 B.R. 176, 184 (B.A.P. 10th Cir. 2012), *aff'd*, 749 F.3d 895 (10th Cir. 2014). This distinction is especially pertinent here because the transfer of the debtor's property occurred pre-petition, leaving the debtor with no property interest in the funds at the time of filing. This Court stated in dicta that *post-petition* transfers were claims under section 101(5) and property of the estate under section 541(a)(3). *U.S. v. Nordic Vill. Inc.,* 503 U.S. 30, 37 (1992) (emphasis added). This does not inform the issue at hand because it references post-petition transfers which are transfers of property of the estate after the commencement of the case. 11 U.S.C. § 549(a). The Court's holding in *Nordic Village* focuses on the interpretation of section 106—not sections 547, 550, or 541—and its reference to property of the estate is dicta. Because the Court's statement is not binding and does not address this particular issue, the Code's plain language requires that the funds, not the power to recover them, are property of the estate.

4. The trustee's right to avoid preferential transfers is exclusive to the trustee and cannot be exercised by other parties.

The language of the Code and the trustee's function as a fiduciary for the benefit of the estate renders it impossible for anyone other than the trustee to prosecute an avoidance action. Avoiding a preferential transfer is a statutory power of the trustee to ensure that all funds available may be fairly distributed for the benefit of all creditors and is not derived from the debtor's own rights to a claim. *Bethlehem Steel Corp. v. Moran Towing Corp. (In re Bethlehem Steel Corp.)*, 390 B.R. 784, 790 (Bankr. S.D.N.Y. 2008) (denying arbitration of the trustee's avoidance claim because it belonged solely to the trustee and was separate from the debtor's claims). The Code specifies that a trustee may recover funds constituting a preferential transfer. 11 U.S.C. § 547(b).

By conferring the exclusive right to recover funds constituting a preference on the trustee, Congress meant for only the trustee to exercise that statutory power. Proper statutory construction assumes that Congress means what it says, especially when it authorizes a specific party to perform a specific function. *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 5 (2000). The phrase, "the trustee may" indicates that the trustee alone may exercise the statutory power referenced in the applicable section of the Code. *Id.* at 13. Courts assume that words carry the same meaning when they appear in different but related sections of a statute. *Kirtsaeng v. John Wiley & Sons, Inc.*, 568 U.S. 519, 536 (2013). In *Hartford,* the Court held that section 506(c) granted the trustee the exclusive right to exercise the power granted by the statute. *Hartford*, 530 U.S. at 7. The Court denied the creditor seeking to establish administrative priority under section 506(c) because the statute stated that the priority could be exercised by the trustee. *Id.* at 5. Because the Code specifically authorizes the trustee to recover

administrative expenses from a secured creditor's collateral the right does not extend to other parties. *Id.*

Both section 547(b) and 506(c) state "the trustee may recover" preferential funds and administrative expenses respectively. 11 U.S.C. §§ 547(b), 506(c). Given this Court's interpretation of identical language in section 506(c), the trustee's power to avoid preferential transfers is exclusive. *In re Bargdill*, 238 B.R. 711, 721 (Bankr. N.D. Ohio 1999). Proponents of the sale of avoidance powers oppose the exclusive right of the trustee under section 547(b) out of convenience to the trustee and saved cost of recovering the funds for the benefit of the estate. However, convenience and reduced cost do not justify actions that contradict the language of the Code. *Niz-Chavez v. Garland*, 593 U.S. 155, 160 (2021). Here, Eclipse cannot exercise the power under bankruptcy law because the Code only permits the trustee to exercise such power.

B. Circuits that have held the trustee's avoidance powers to be property of the estate have not provided an adequate justification.

The circuit courts are divided on the issue of whether section 541 includes the avoidance powers of the trustee as property of the estate. The Fifth, Seventh, Eight, and Ninth Circuit categorize the powers as property of the estate. *Cadle Co. v. Mims (In re Moore)*, 608 F.3d 253, 261 (5th Cir. 2010); *Mellon Bank, N.A. v. Dick Corp. (In re Qualitech Steel Corp.)*, 351 F.3d 290, 291 (7th Cir. 2003); *In re Simply Essentials, LLC*, 78 F.4th at 1010; *Simantob v. Mashian* (*In re Lahijani)*, 325 B.R. 282, 287 (B.A.P. 9th Cir. 2005). In contrast, the Third and Tenth Circuits have indicated—though not directly ruling on the issue—that avoidance powers are a statutory right distinct from property of the estate. *In re Cybergenics Corp.,* 226 F.3d at 243; *Rajala v. Spencer Fane LLP (In re Generation Res. Holding Co.)*, 964 F.3d 958, 968 (10th Cir. 2020) (holding that the Code's definition of property of the estate in section 541 does not

expand the trustee's powers under section 550(a) which ought to be plainly read to allow the trustee alone to recover from certain parties).

The Fifth Circuit permits the sale of a trustee's avoidance power in a narrow set of claims under section 544(a), the trustee's strong-arm power. *In re Moore*, 608 F.3d. at 261. The Fifth Circuit's precedent is narrow and acknowledges the general rule that it is the debtor's interest that matters for purposes of estate property. *Id.* This ruling applies only in the circumstance of a trustee pursuing a creditor's state law claim as lien creditor by function of the strong-arm clause. *Id.* The Fifth Circuit alternatively stated that the strong-arm clause itself creates property of the estate. *In re Moore*, 608 F.3d at 260. This interpretation impermissibly expands the debtor's property interests post-petition and conflates the trustee's power to pursue the claim with the recovered funds.

Here, the avoidance power sold to Eclipse is distinguishable from permissible sales in the Fifth Circuit. The trustee's avoidance power under state law via the strong-arm clause evokes a different property interest than a federally authorized preferential transfer. Preferential transfers avoided under section 547(b) are a function of federal bankruptcy law and ought to be analyzed differently than a state law claim pursued via section 544(a). Preferential transfers under the Code support equality among creditors by facilitating the pro rata distribution of estate property and preventing creditors from "dismembering the debtor." *Union Bank v. Wolas*, 502 U.S. 151, 160 (1991). The strong-arm clause in section 544(a) gives the trustee the rights and powers of a judgment lien creditor under relevant state law. 11 U.S.C. § 544(a). Fraudulent transfers under state law often carry a longer statute of limitations and include different requirements for recovery than avoidable transfers under the Code. *In re Moore*, 608 F.3d at 260. These distinct purposes and specifics of state laws and federal bankruptcy laws render

interpretations of the trustee's powers under section 544(a) unpersuasive in the context of the avoidable preferences.

The Seventh Circuit held that preference actions are an asset held by the estate that may be bought or sold to satisfy a creditor's claims against the estate. *In re Qualitech*, 351 F.3d at 293. Without delving into the language of the Code regarding property of the estate, the Seventh Circuit held that the broad meaning of "for the benefit of the estate" permits the sale of avoidance powers. *Id.* Without the inclusion of the avoidance actions, the debtor's business would have sold for less and the estate would have suffered accordingly. *Id.* By focusing exclusively on the benefit of the estate, the court in *In re Qualitech* overlooked the surrounding context of the Code's language. Rather than provide the trustee with carte blanche to go around the language of the Code, section 550(a) specifies that only the recovered funds may be distributed for the benefit of the estate. *In re Generation Res. Holding Co.*, 964 F.3d at 968.

The Eighth Circuit's reasoning conflates what is property of the estate and ignores the trustee's distinct interests in its avoidance powers. The Eight Circuit held that avoidance powers are property of the estate because the trustee's claim constitutes a legal interest in property arising at the commencement of the case or, in the alternative, acquired after the commencement of the case. *See Simply Essentials, LLC,* 78 F.4th at 1010 (discussing the claimed statutory support for the court's holding in sections 541(a)(3) and (7)). This holding, however, does not state what interest the debtor has in the avoidance powers themselves or address the language of section 541(a)(3) that states it is the recovered funds, not the avoidance powers, that the trustee may distribute for the benefit of the estate. 11 U.S.C. § 541(a)(3).

It is the interest of the debtor, not the trustee, that determines whether a claim is property of the estate. The purpose behind the sale does not render the avoidance power property of the

estate. *In re Upper Crust*, LLC, 554 B.R. at 32. In an avoidance action, the property interest at stake is the property that the trustee may "clawback" using its avoidance powers, not the avoidance power itself. *Begier v. I.R.S.,* 496 U.S. at 58. Without a clear explanation of why the interest is of the debtor, and not the trustee or a creditor, the Eight Circuit does not satisfy the Code's stipulation that only property of the estate may be sold pursuant to section 363.

The Ninth Circuit incorrectly holds the trustee's avoidance power to be sellable property of the estate based on the Code's reference to avoidance powers in section 541(a)(3). *In re Lahijani*, 325 B.R. at 287 (B.A.P. 9th Cir. 2005). Because the plain language of section 541(a)(3) does not include the avoidance powers themselves, this argument is unpersuasive. Alternatively, the Ninth Circuit held avoidance powers as property of the estate given the ability to assign the estate's claims in chapter 11. *See Spradling & Metzger (In re P.R.T.C., Inc.)*, 177 F.3d 774, 781 (9th Cir. 1999) (discussing the assignment of a claim to a representative of the estate in chapter 11).

However, the assignability of a claim is not automatically property of the estate. *Guttman v. Martin (In re Railworks Corp.)*, 325 B.R. 709, 722 (Bankr. D. Md. 2005). Moreover, the assignability of claims is closely monitored by the bankruptcy court to ensure that other provisions of the Code are satisfied, and no party is empowered to pursue a claim it would otherwise be unable to hold based on assignment under section 1123(b)(2). *Kroh Brothers Dev. Co. v. United Mo. Bank of Kansas City (In re Kroh Bros. Dev. Co.)*, 100 B.R. 487, 495 (Bankr. W.D. Mo. 1989). Accordingly, this precedent does not support the sale of avoidance powers here, where the issue is not the assignment of a claim but rather the property interests of the debtor in the trustee's right to bring a claim.

None of the circuits holding that avoidance powers are property of the estate provide an adequate justification. Conversely, the plain language conveys Congress's intent that the avoidance powers of the trustee are separate from the property of the estate. While the plain language is unambiguous, the context and policy of the Code reiterate that the trustee's avoidance power are not property of the estate.

C. Categorizing the trustee's avoidance power as property of the estate does not conform with established rules of statutory construction.

1. Treating the trustee's avoidance powers as property renders sections 541(a)(3) and 551 superfluous.

Courts construe Congress's words to ensure that each provision is given full effect, and no part is rendered superfluous by the court's interpretation. *TRW Inc.*, 534 U.S. at 31 (2001). The canon against surplusage is especially persuasive in this context where the surplus exists within the same chapter, provision, and section of the Code. *Chicago v. Fulton*, 141 S. Ct. 585, 591 (2021). The Code includes specific provisions to account for the avoidance, recovery, and preservation of transferred funds which in turn become property of the estate. *Rushton v. Bank of Utah (In re C.W. Min. Co.)*, 477 B.R. 176, 185 (B.A.P. 10th Cir. 2012), *aff'd*, 749 F.3d 895 (10th Cir. 2014).

Congress specifically included the proceeds of the estate's property to be property of the estate. 11 U.S.C. § 541(a)(6). Separately, Congress included the property that the trustee recovers pursuant to section 550(a) to be property of the estate. 11 U.S.C. § 541(a)(3). The trustee may recover property preferentially or fraudulently transferred for the benefit of the estate. 11 U.S.C. § 550(a). Upon recovery, that property is reserved to the estate. 11 U.S.C. § 551. Holding the avoidance power itself to be property of the state renders section 541(a)(3) and section 551 superfluous because recovered funds would then be proceeds of that avoidance

power. If avoidance powers were always property of the estate, it would be unnecessary for Congress to specify how the recovered funds ought to be categorized. Rather, Congress indicated that there are two distinct types of property considered in sections 541(a)(3) and 541(a)(6). Similarly, there would be no relevant function for section 551. Were avoidance powers property of the estate, there would be no need to clarify that avoided transfers were preserved for the benefit of the estate only with respect to property of the estate. 11 U.S.C. § 551.

The language of section 550(a) bolsters this interpretation. Section 550(a) authorizes the trustee to recover and distribute funds recovered from preferential transfers for the benefit of the estate. If both avoidance powers and the funds recovered were property of the estate, section 550(a) would also be superfluous. *In re Generation Res. Holding Co.,* 964 F.3d at 968. Congress chose to distinguish between the property recovered by a trustee's avoidance power and proceeds of estate property. *Id.* Conflating the two introduces ambiguity where there is none.

2. Permitting the sale of the trustee's avoidance powers is contrary to Congress's intent as informed by the history of the Code.

The plain language of the Code is consistent with pre-code practice that did not permit the sale of a trustee's avoidance power. Congress used similar language in both the Bankruptcy Act of 1898 ("the Act") and the current Code to describe the trustee's avoidance powers. Under the Act, "[a]ny such preference may be avoided by the trustee." 11 U.S.C.A. § 96(b) (repealed 1978). While not binding, it is a rule of statutory construction that previous renditions of a statue may inform the court's understanding of similar language in the present version. *Hartford Underwriters* 530 U.S. at 10. Courts construed similar language in the Act as granting the trustee the exclusive right to avoid preferential transfers. *See e.g., Glenny v. Langdon*, 98 U.S. 20, 30 (1878) (holding that only the trustee is vested with the power to pursue avoidance claims

and such claims cannot be pursued by creditors). Because the trustee represents all creditors and the language vested the right to pursue preferential transfers on behalf of those creditors, the avoidance power was neither an asset nor an assignable right. *U.S. v. Gen. Res., Ltd.*, 204 F.Supp. 872, 876 (D. Colo. 1962)

Under the Act, a debtor must have held an interest in the property before the bankruptcy, even if that interest were contingent or unmatured, to constitute property of the estate. *Segal v. Rochelle*, 382 U.S. 375, 379 (1966). In holding that a loss-carry back fund was property of the estate, the Court described the claim as being sufficiently rooted in the debtor's pre-bankruptcy past to constitute property of the estate. *Id.* at 380. Congress's use of similar language when drafting section 547(b) in the Code indicates its intent that the trustee's power to avoid preferential transfers be treated as an exclusive statutory right and not property of the estate.

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D. The sale of a trustee's avoidance power undermines bankruptcy policies and corrodes the structure of the Code.

Because the language of the Code is unambiguous, the policy concerns of bankruptcy do not override the application of the Code's plain language. *BFP v. Resolution Trust Corp*., 511 U.S. 531, 546 (1994). However, considering the important equitable concerns and policy of the bankruptcy system, it is imperative that avoidance powers not be categorized as property of the estate. A preference claim belongs solely to the estate and can only be exercise by the trustee to preserve the equal treatment of creditors. *Citicorp Acceptance Co. Inc. v. Robison (In re Sweetwater)*, 884 F.2d 1323, 1328 (10th Cir. 1989). Funds recovered through a preferential transfer action are to be recovered by the trustee for the benefit for the estate, not for a single creditor. *In re C.W. Min. Co.*, 477 B.R. at 189 (holding that even a broad understanding of the phrase "for the benefit of the estate" could not include recovered funds that inure to a single secured creditor).

The sale of the trustee's avoidance powers to a single creditor subjects the debtor to adversary proceedings that extend beyond the existence of the bankruptcy estate and frustrates

Congress's intended use for recovered funds. When purchased by a single creditor, avoidance powers cannot be recovered for the benefit of the estate and the creditor's prosecution of those funds takes away from the debtor's fresh start. *In re Bargdill*, 238 B.R. 711, 721 (Bankr. N.D. Ohio 1999). Here, Eclipse's prosecution of the preferential transfer to Pink would inure to the benefit of Eclipse as a single creditor and not to the benefit of the estate. R. at 9. This is problematic both as being antithetical to the Code's plain language and as being damaging to the integrity of the bankruptcy process.

The pursuit of preferential payments in bankruptcy is a unique process and expanding this practice outside of the estate and placing that power in the hands of a biased party corrodes the impartiality that justifies the trustee holding avoidance powers. *Mission Prod. Holdings, LLC*, 139 S. Ct. at 1663. When one creditor can purchase and prosecute a preferential transfer because it is able to make an appealing offer to the trustee, it raises the appearance of impropriety. *Miller v. Stone (In re Waterford Funding, LLC)*, 2017 WL 439308, at *3 (Bankr. D. Utah Feb. 1, 2017). Creditors may feel defrauded by a biased creditor, and not a neutral trustee, pursuing the avoidable funds. *In re Bargdill*, 238 B.R. at 721. While that concern is not especially pertinent here where there is only one creditor, the precedent is concerning for future cases in which one creditor can make an appealing offer to the trustee and thereby disenfranchise its fellow creditors.

Admittedly, selling the trustee's avoidance power without the trustee having to pursue the funds itself may enable the estate to benefit from the sale of the claim without having to pursue the claim itself. However, maximizing profit cannot come at the expense of other equally important policies such as equality amongst creditors and giving the debtor a fresh start. *See Republic Credit Corp. v. Boyer (In re Boyer)*, 372 B.R. 102, 106 (D. Conn. 2007) (discussing

the policy in support of the court's holding that preferential transfers could not be sold because they were held by the trustee for the benefit of all creditors).

The Code provides a mechanism to maximize value for distribution to creditors without incorrectly classifying avoidance powers as property of the estate. Creditors eager to pursue an avoidance claim that a trustee is unwilling or unable to pursue may do so using derivative standing. 11 U.S.C. § 503(b)(3)(B); *Hyundai Translead Inc. v. Truck & Trailer Repair, Inc. (In re Trailer Source, Inc.)*, 555 F.3d 231, 245 (6th Cir. 2009). The trustee may consent to creditors pursuing a derivative cause of action or the creditors may sue on behalf of the trustee if the trustee fails to fulfill its statutory obligations. *Pursuit Cap. Mgmt. LLC v. Pursuit Inv. Mgmt. LLC (In re Pursuit Cap. Mgmt., LLC)*, 595 B.R. 631, 663 (Bankr. D. Del. 2018).

While derivative standing essentially allows a party other than the trustee to pursue an avoidance claim, it avoids the statutory pitfalls that apply to the outright sale of avoidance powers. Section 503(b)(3)(B) expressly permits derivative standing for a creditor to pursue transfers on behalf of the estate under the court's supervision. *Off. Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery*, 330 F.3d 548, 559 (3d Cir. 2003). Because the Code already ensures a means of maximizing benefit for the estate without bending the language of the Code or sacrificing equally important goals, the sale of the trustee's avoidance power is unsupported and unjustified.

CONCLUSION

For the reasons listed above, this Court should find in favor of the Respondent, Mr. Eugene clegg, and affirm the decision of the Court of Appeals for the Thirteenth Circuit.