No. 23-0115

IN THE

SUPREME COURT OF THE UNITED STATES

IN 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 OF RESPONDENT

Team Number 34

January 18nd, 2024

Counsel for
Respondent

QUESTIONS PRESENTED

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

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

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STATEMENT OF JURISDICTION

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

STATEMENT OF THE CASE

In 2011, Cpl. Eugene Clegg (the "Debtor") retired from the United States Army as a decorated veteran after a distinguished career. R. 4–5. Upon returning home, Clegg's mother, Emily "Pink" Clegg ("Pink") handed Clegg the reins and ownership of the family business: The Final Cut, LLC ("Final Cut"), a historic, single-screen movie theater in the City of Moot. R. 5. For years, the Debtor lived modestly off the profit generated from Final Cut. *Id*. In 2016, Final Cut borrowed $850,000 ("Loan") from Eclipse Credit Union ("Eclipse") for renovations, secured against the theater. *Id*. The Debtor personally guaranteed the loan. *Id*. The Debtor then personally renovated a substantial portion of the theater with assistance from local veterans who volunteered their time and services. *Id.* In gratitude for the cost-saving generosity of his fellow veterans, a fully solvent Final Cut made a charitable donation of its $75,000 savings to the Veterans of Foreign Wars. *Id.*

After three years of profitability for the renovated Final Cut, the theater was forced to close its doors in March of 2020 after the Governor of the State of Moot issued a stay-at-home order due to the Covid-19 pandemic. R.5-6. The Debtor, now living with no income, borrowed $50,000 (unsecured) from his mother to make ends meet. *Id.* The Debtor was able to reopen Final Cut in early 2021 and repaid Pink in the amount of $20,000 during the year. R. 6, 7. Unfortunately, Final Cut failed to reach pre-pandemic levels of customers. R. 6. Forgoing his own salary, the Debtor incurred substantial credit card debt and fell behind on his mortgage payments. *Id*. After several months of missed payments, the mortgage lender commenced foreclosure proceedings. *Id.*

In an effort to save his home, the Debtor filed for Chapter 13 bankruptcy protection on December 8th, 2021 (the "Petition Date"). *Id.* His home was valued at $350,000 just days pre-petition. *Id*. At filing, the debtor owed $320,000 to his mortgage lender secured on the house, and properly claimed Moot's $30,000 homestead exemption. *Id*. Eclipse was owed an unknown amount of unliquidated unsecured debt but agreed to a claim amount of $150,000 which included a $20,000 adjustment to account for the transfer to Pink that the Trustee agreed not to avoid. R. 6–7. The payment plan called for the Debtor to repay both the Servicer and Eclipse over three years from his Final Cut income which all parties believed was on the cusp of returning to profitability. R. 7–8. In February 2022, the court confirmed the plan and thereby all property of the estate vested with the Debtor. R. 8.

For the subsequent eight months, the Debtor made timely payments according to the plan, during which time the trustee distributed $10,000 to the Servicer. *Id*. Unfortunately, in September of 2022, the Debtor contracted long-COVID which prevented him from continuing to work at the still suffering Final Cut. *Id*. In October 2022, Final Cut closed permanently and Eclipse commenced foreclosure proceedings against the theater. *Id*. Now without an income, the Debtor could no longer make payments under the Chapter 13 plan and chose to convert to Chapter 7. *Id*.

On conversion, the Debtor's schedules ascribed a value of $350,000 to the home and the Debtor indicated he intended to reaffirm the mortgage to remain in his house. R. 9. After foreclosing on the theater, Final Cut owed Eclipse $200,000, which was personally guaranteed by the debtor. *Id*. Initially the trustee concluded the estate was bereft of assets, however, after re-appraising the Debtor's home, realized that non-exempt equity had increased by $100,000 since the petition date. *Id*. The Trustee began marketing the house for sale and Eclipse offered to buy the house and the alleged preference claim against Pink for $470,000. *Id.* The Trustee filed a motion to accept Eclipse's offer. *Id*. However, the Debtor objected to the sale of his house and the preference action. R. 10. First, he argued that post-petition, pre-conversion increases in equity should inure to his benefit and therefore the Trustee could not sell the house since there was no equity to sell. Id. Second, the Debtor argued that the Trustee could not sell the ability to avoid and recover transfers under sections 547 and 550. R. 10. The bankruptcy court and the United States Court of Appeals for the Thirteenth Circuit held for the debtor on both counts. R. 10; R. 24.

SUMMARY OF THE ARGUMENT

This Court should affirm the decision of the Thirteenth Circuit Court of Appeals because post-petition, pre-conversion increases in equity and avoidance actions are not property of the estate. The plain language of the relevant statutes make clear that property value is calculated on the petition date—like the "snapshot rule"—so any post-petition increases in value do not belong to the estate. The Code also explicitly penalizes debtors who convert in bad faith by assigning appreciation to the estate; good faith conversions should not be similarly penalized. Lending further support, Chapter 13's revestment provision, whereby plan confirmation revests the debtor's property back with them, shows post-petition increases in equity accrue to the debtor.

The principles and policy behind the Code and and of the specific conversion section also support a finding that post-petition, pre-conversion increases in equity inure to the debtor. Historically, bankruptcy proceedings have always cut-off claims on the debtor and their property which enables the bankruptcy system to provide the honest but unfortunate debtor a fresh start. Furthermore, due to the benefits of completing Chapter 13 plans, Congress has worked to incentivize debtors to attempt reorganizations instead of directly liquidating under Chapter 7. Were this Court to assign post-petition appreciation to the estate, debtors would be disincentivized from Chapter 13 filings, contradicting the goals of the Code. Therefore, post-petition, pre-conversion increases in equity should accrue to the debtor.

The trustee's powers to avoid and recover transfers pursuant to 11 U.S.C. §§ 547 and 550 cannot be sold because they are not property of the estate under the plain meaning of section 541(a). The trustee's section 547 avoidance powers are not property of the estate under section 541(a)(1) because the debtor has no interest in the actions before the commencement under the case, rather the powers vest in the *trustee* upon the commencement of the case. The trustee's avoidance powers are not property of the estate under sections 541(a)(3) or 541(a)(4) because these sections only bring in the recovery from avoidance actions into the estate under section 550. Because section 547 avoidance is intentionally divided from section 550 recovery, the clear meaning of the statute does not include avoidance powers into property of the estate under sections 541(a)(3) and 541(a)(4). Avoidance powers do not become property of the estate under section 547(a)(7) because this section only includes interests that arise "after the commencement of the case" while avoidance powers are statutorily created *upon* commencement of the case.

The plain meaning of section 547 and 550 make clear that Congress intended for the trustee's avoidance powers to be non-transferable and for the benefit of the estate. Under the common law, rights of action are not assignable. Absent a designation by statute declaring avoidance powers to be transferable, common law principles should control. The Supreme Court held that where a statute only names the trustee in granting a right then only the trustee has the power to invoke the provision. Because Congress only makes reference to the trustee in section 547, only the trustee is designated with the right to invoke avoidance powers under the section. This result is also consistent with the idea that Congress created the trustee as a neutral fiduciary of the estate with unique qualifications whose powers and duties should not be transferable to third parties. As a matter of policy, disallowing the transfer of avoidance actions protects the equitable treatment of creditors by keeping the power vested in the neutral trustee, as Congress intended.

ARGUMENT

I. The Text of the Code and Policy Behind 11 U.S.C. § 348(f)(1)(A) Shows Post-Petition, Pre-Conversion Increases in Equity Accrues to the Debtor

A. The Plain Language of 11 U.S.C. § 348(f)(1)(A) Given the Context of the Bankruptcy Code Shows Post-Petition, Pre-Conversion Appreciation in Value Accrues to the Debtor

Section 348 controls what is included in the estate upon conversion from a Chapter 7 to a Chapter 13 proceeding. In relevant part, section 348(f)(1)(A) holds "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). At first glance—and as the Trustee argues— section 348(f)(1)(A) could be interpreted in isolation to say that the appreciation in value of the equity in the Debtor's home is part of the converted Chapter 7 estate. R. 12. However, that interpretation is incomplete because "statutory construction…is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme-because the same terminology is used elsewhere in a context that makes its meaning clear." *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988); *see also*, *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (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."). Indeed, a "cardinal rule" of statutory interpretation requires the Bankruptcy code "be read as a whole…since the meaning of statutory language, plain or not, depends on context." *King v. St. Vincent's Hosp.*, 502 U.S. 215, 221-22

(1991) (citations omitted). When read in context of sections 522, 541, and 348(f)(2) the plain meaning of section 348(f)(1)(A) becomes clear; that pre-petition appreciation of home equity inures to the debtor.

i. The Snapshot Rule Dictates Home Equity is Valued on the Petition Date for Homestead Exemptions, Valuation Under 11 U.S.C. § 348(f)(1)(A) Should be the Same

To assign post-petition, pre-conversion increases in home equity to the estate would require inconsistent valuations to be used for the same property. Section 522(b)(3)(A) enables a debtor to exempt certain property from the bankruptcy estate. *See* 11 U.S.C. § 522(b)(3)(A). A common exemption is the "homestead exemption" which protects a debtor's interest in their home. *In re Rockwell*, 968 F.3d 12, 18 (1st Cir. 2020). The value of an exemption is determined when the petition is filed. *White v. Stump*, 266 U.S. 310, 313 (1924). This has become known as the "snapshot" rule where the debtor's financial situation is frozen at the time of petition. *In re Rockwell*, 968 F.3d at 18 (quoting *In re Awayda*, 574 B.R. 692, 697 (Bankr. C.D. Ill. 2017)). If property were to be valued on the petition date for purposes of determining the homestead exemption but the date of conversion for purposes of liquidation in Chapter 7, then the same piece of property could be subject to two differing valuations under the Chapter 7 proceeding. In this case, the Debtor's property would be valued at $350,000 for determining the homestead exemption under the snapshot rule and $450,000 for inclusion in the estate. These two differing valuations would be necessary even though section 348(f)(1)(A) and section 522(a)(2) both reference "the petition date." 11 U.S.C. §§ 348(f)(1)(A), 522(a)(2). The Bankruptcy Code should be read as a symmetric and coherent whole, and property of the estate under section 348(f)(1)(A) should also be determined by the snapshot rule, with post-petition, pre-conversion increases in equity accruing to the debtor. *Food and Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000) ("A court must therefore interpret the statute "as a symmetrical and coherent regulatory scheme").

ii. 11 U.S.C. § 541(a)'s Distinction Between Interests In and Proceeds From Property Shows Post-Petition Proceeds Are Not Part of the Estate

The 10th Circuit in *In re Barrera* determined that post-petition appreciation in equity should be categorized as "proceeds from" property under section 541(a)(6), rather than an "interest in" property under section 541(a)(1). *In re Barrera,* 22 F.4th 1217, 1223 (10th Cir. 2022); 11 U.S.C. §§ 541(a)(1); 541(a)(6). In that case, a debtor in a Chapter 7 proceeding sold their home before converting to Chapter 13. The court held that the sale proceeds realized from post-petition appreciation in equity were classified under section 541(a)(6) and accrued to the debtor. This interpretation is consistent with the snapshot rule, as section 348(f)(1)(A) mandates measuring the value of property "as of the date of filing of the petition." *In re Barrera,* 22 F.4th at 1222. Failure to adhere to this principle would render section 541(a)(6) redundant alongside section 541(a)(1), violating the canon of surplusage. *See City of Chicago, Illinois v. Fulton*, 592 U.S. 154, 159 (2021) ("an interpretation" should not "render superfluous another part of the same statutory scheme."). While the Debtor in this case did not liquidate his house pre-conversion, the Debtor should not be treated differently in this case for not having realized his post-petition appreciation in value. When read in the context of section 541(a), section 348(f)(1)(A)'s "property of the estate" only includes the value of equity as it exists on the petition date, any subsequent increases in equity is "proceeds" under section 541(a)(6) and should inure to the debtor.

iii. Appreciation in Value Inures to the Debtor to Not Render 11 U.S.C. § 348(f)(2) Superfluous

Section 348(f)(2) penalizes debtors who convert cases from Chapter 13 in bad faith by recategorizing what's included in the estate from the date of petition to the date of conversion.

"In essence, 'those debtors who convert…in bad faith are punished because their otherwise immune post-petition interests are available for liquidation and distribution to creditors.'"[1] *In re Harmon*, 2022 WL 20451952, at *6 (Bankr. E.D. La. June 9, 2022) (quoting *In re Barrera*, 22 F.4th 1217, 1220–21 (10th Cir. 2022)). The inclusion of section 348(f)(2) implies that in cases of good faith conversion, increases in equity go to the debtor, otherwise there would be no need to include a penalty for bad faith conversions. *Harris v. Viegelahn*, 575 U.S. 510, 519 (2015) (Finding that under the most sensible reading of section 348, nothing denies debtors funds that would have been there's had the case proceeded under Chapter 7 from the start).Therefore, "when the conversion to Chapter 7 is made in *good* faith, no penalty is exacted." *Id*. at 518; *see also King v. St. Vincent's Hosp.*, 502 U.S. 215, 221-22 (1991) (holding the absence of provisions in one section, when included in neighboring sections, showed that the absence was intentional); *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 646 (2012) (finding the broad and general language of one provision did not apply to a matter covered by a narrower and more specific provision of the same act).

Here, Clegg was an especially good faith debtor. He is a war hero who has donated to support veterans. R. 5. In a good faith effort to repay his creditors, he opted to attempt a Chapter 13 Bankruptcy when he did not stand to gain financially. R. 6-8. Through no fault of his own, he became sick and was unable to make payments under his plan. R. 8. Only then was he forced into liquidation under Chapter 7. *Id*. Indeed, no party contends the Debtor lacked good faith on conversion. *Id*. Therefore, Clegg should not be penalized. Context again shows post-petition, pre-conversion increases in equity should accrue to the debtor so as not to render section 348(f)(2) superfluous and penalize good faith debtors.

[1] Creditors are still appropriately protected because "the power of bankruptcy courts to make bad-faith determinations is broad." *In re Barrera*, 22 F.4th 1217, 1226 (10th Cir. 2022).

iv. The Automatic Vesting Provision of 11 U.S.C. § 1327(b) Also Shows Post-Petition, Pre-Conversion Increase in Equity Accrues to the Debtor

Court confirmation of a Chapter 13 plan vests all of the property of the estate in the debtor, making the debtor once again the owner of the property. 11 U.S.C. § 1327(b). *Matter of Castleman*, 75 F.4th 1052, 1061 (9th Cir. 2023). "It follows that when a Chapter 13 plan has been confirmed, appreciation accrues to the debtor." *Matter of Castleman*, 75 F.4th at 1061; *see also Warren v. Peterson*, 298 B.R. 322 (N.D. Ill. 2003); *In re Slack*, 290 B.R. 282 (Bankr. D.N.J. 2003); *In re Page*, 250 B.R. 465 (Bankr. D.N.H. 2000). Since under a Chapter 13 Bankruptcy the debtor is the vested property owner, proceeds from that property in the form of post-petition, pre-conversion increases in equity, should not accrue to the estate .

B. The Principles of the Bankruptcy Code Support Post-Petition, Pre-Conversion Increases in Equity Accruing to the Debtor

i. The Bankruptcy System Has Historically Fixed the Rights of Creditors on the Petition Date and Not Permitted Post-Petition Interest to go to Creditors

More than a century ago, this Court incorporated in the American Bankruptcy system the theory of English Bankruptcy law that "everything stops at a certain date." *Sexton,* 219 U.S. at 344-45 (the English system itself being a continuation of pie-powder courts which required security to be "valued on the spot"). In *Sexton*, secured creditors sought to obtain the interest that accrued on their claims after the debtor filed for bankruptcy. *Id.* at 343. This Court denied creditors post-petition interest and fixed the valuation of claims at the time of the petition. *Id*. at 345; *see also Parks v. City of Boston*, 15 Pick. 198, 208 (Mass. 1834). While this rule to choose a single time when affairs were to be valued for the bankruptcy decreased the ultimate payout to secured creditors, this Court declared this "the necessarily possible result of bankruptcy." *Sexton,* 219 U.S. at 345.

If, “everything stops at a certain date,” then, quite simply, everything must indeed stop at that date, including the value of debtor’s equity. *Id*. Additionally, in the same way that secured creditors were “cut off” from receiving the additional benefit of accrued interest in *Sexton*, so too will some creditors be disadvantaged here by no longer receiving post-petition appreciation of equity. That one group is benefitted over another does not invalidate or undermine the result. The Bankruptcy system balances considerations of fairness, efficiency, and a desire to encourage Chapter 13 filings. *In re Cardelucci,* 285 F.3d 1231, 1236 (9th Cir. 2002) (Courts seek to promote “efficiency, fairness, predictability, and uniformity within the bankruptcy system”); *In re Barrera,* 22 F.4th at 1220 (“Because of the benefits to debtors and creditors stemming from Chapter 13 bankruptcies, Congress has enacted statutes to incentivize debtors to opt for reorganization over liquidation”). Accordingly, the principle that creditor’s claims do not grow past the petition date favors post-petition appreciation inuring to the debtor.

ii. Bankruptcy Provides the Honest but Unfortunate Debtor a "Fresh Start" so Post-Petition Increases in Equity Should Accrue to the Debtor

In fixing the creditor’s claims on the petition date, the Bankruptcy Code protects the debtor from additional losses to creditors and thereby provides the “honest but unfortunate debtor” a “fresh start.” *Grogan v. Garner,* 498 U.S. 279, 286-87 (1991); *Marrama v. Citizens Bank of Mass*., 549 U.S. 365, 367 (2007). In *Harris v. Viegelahn,* this Court considered whether a debtor’s wages, set aside for creditors but left undistributed, inured to the estate upon conversion or back to the debtor. *Harris*, 575 U.S. at 512. This Court held that undistributed post-petition wages are excluded from the converted Chapter 7 estate because “the Bankruptcy Code aims to facilitate” a “fresh start” for the honest debtor. *Id.* at 518. Since Chapter 7 “allows a debtor to make a clean break from his financial past” and conversion from Chapter 13 neither creates a new case nor changes the date the petition was filed, any post-petition "accumulated wages go to the debtor." *Id*. at 513-19.

Like in *Harris* where post-petition undistributed wages were deemed to go to the debtor, here post-petition increases in equity should also accrue to the debtor. In the same way this Court in Harris found the "fresh start" policy means a debtor gets to keep their undistributed post-petition wages, a debtor should also benefit from the post-petition increase in equity of their home. "Thus, while a Chapter 7 debtor must forfeit virtually all his prepetition property, he is able to make a 'fresh start' by shielding from creditors his postpetition earnings and acquisitions." Id. at 514. The "fresh start" policy of Chapter 7 cases weighs in favor of post-petition, pre-conversion increases in equity accruing to the debtor.

iii. To Incentivize Chapter 13 Filings, Increases in Post-Petition, Pre-Conversion Equity Should Inure to the Debtor

Congress explicitly stated section 348(f) is meant to eliminate the disincentive to Chapter 13 cases created when property acquired post-petition and pre-conversion is included in the Chapter 7 estate, and thereby encourage Chapter 13 filings. *In re Barrera,* 620 B.R. 645, 652 (Bankr. D.Co. 2020). Proceedings under Chapter 13 can be preferable to Chapter 7 as debtors are allowed to retain their assets and creditors typically collect more under a completed Chapter 13 plan. *Harris v. Viegelahn*, 575 U.S. at 514; *In re Barrera,* 620 B.R. at 652.

Unfortunately, however, many debtors fail to successfully complete a Chapter 13 plan. *Harris v. Viegelahn*, 575 U.S. at 514. Therefore, Congress permits debtors to convert to a Chapter 7 case "at any time." § 1307(a). Congress wants to incentivize debtors to attempt a Chapter 13 plan by not punishing those who fail when they convert to a Chapter 7 bankruptcy. By limiting the converted estate to the property a debtor had at the time of the initial petition, section 348(f) is meant to leave the debtor no worse off for having attempted a Chapter 13 case.

In re Barrera, 620 B.R. at 648; *In re Brown,* 953 F.3d 617, 620 (9th Cir. 2020). As the Third Circuit put it in *In re Bobroff,* when a debtor fails to satisfy their chapter 13 repayment plan, "no reason of policy suggests itself why the creditors should not be put back in precisely the same position as they would have been had the debtor never sought to repay his debts." *In re Bobroff,* 766 F.2d 797, 803 (3rd Cir. 1985). In passing section 348, Congress provided an illustration of a situation—where a debtor would be made worse off for attempting a Chapter 13 filing—which they wanted to avoid:

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

In re Barrera, 620 B.R. at 652 (quoting the House Report). In the same way that Chapter 13 filings would be disincentivized by permitting the estate to gain equity created by a debtor, as Congress's example makes clear, Chapter 13 filings would also be disincentivized were post-petition appreciation in equity to go to the estate. Congress did not make a distinction between equity created through the debtor's paydowns on secured debt and equity created through market forces. *In re Barrera,* 620 B.R. at 653. Were new equity or appreciated equity to go to the estate, the debtor would be made worse off for having attempted a Chapter 13 filing. In either case, a debtor would jeopardize their property by attempting a Chapter 13 repayment plan instead of opting for Chapter 7 liquidation directly—a disincentivizing result Congress aims to avoid.

Under the Trustee's interpretation of section 348(f), where the debtor's property has entirely exempted equity on the petition date, the debtor could keep their home by initially filing for Chapter 7 liquidation but would risk losing their home by proceeding first under Chapter 13. The facts of this case illustrate this injustice as Clegg had fully exempted property upon filing for Chapter 13 but now risks losing his home upon conversion to Chapter 7. Under such a rule, a rational and risk averse debtor would file a Chapter 7 Bankruptcy first out of fear that a Chapter 13 Bankruptcy will cause their home to be lost when subsequently—and most probably—they convert to Chapter 7. Again, denying the converting debtor the future appreciation they would have realized under Chapter 7, penalizes those who first attempt a Chapter 13 reorganization, and is thus inconsistent with the policy goals articulated by Congress. Moreover, a rule whereby post-petition appreciation in value accrues to a converted Chapter 7 estate disincentivizes Chapter 13 plans because the debtor risks incurring additional losses of future earning power while also risking the loss of their property. Conversely, a debtor is encouraged to file a Chapter 13 case if they have the possibility of gaining equity through their repayments on secured debt or post-petition appreciation in property value. Accordingly, reading section 348(f) in light of its purpose to incentivize Chapter 13 cases plainly leads to the result that appreciation in value should not accrue to a converted Chapter 7 estate and risk an honest debtor's property.

II. The Trustee's Powers to Avoid and Recover Preferential Transfers Pursuant to 11 U.S.C. §§ 547 and 550 Cannot be Sold as Property of the Estate

Under section 363 of the Bankruptcy Code, the Trustee may, after notice and a hearing, "use, sell, or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b)(1). The trustee is empowered only to sell that which is "property of the estate." *Id*. As a threshold issue in this case, the power to avoid and recover prepetition transfers under sections 547 and 550 must be property of the estate pursuant to section 541 in order to be sold by the trustee. *See* 11 U.S.C. 541, *In re Popp*, 323 B.R. 260, 266 (B.A.P. 9th Cir. 2005) (noting that section 363(b) requires that the estate demonstrate that the property it proposes to sell is "property of the estate"). Section 547 grants the trustee the ability to avoid preferential transfers made by the debtor- that is payments from the debtor to a creditor made in a certain period before the filing of bankruptcy while the debtor was insolvent which would result in an unfair preferential distribution to that creditor. *See* 11 U.S.C § 547(b). This power vested to the trustee protects creditors from a pre-petition "race to the courthouse." *See Union Bank v. Wolas*, 502 U.S. 151, 161 (1991). Section 550 allows the trustee to recover the property from avoided preferential transfer. *See* 11 U.S.C. § 550. Because the trustee's ability to avoid and recover preferential transfers is not property of the estate, but rather a power vested to the trustee to ensure equitable distribution of the estate, the trustee in this case cannot sell the avoidance action to Eclipse.

A. The Plain Language of Section 541 Establish That The Trustee's Avoidance Powers were not Intended to be Property of the Estate

i. Avoidance Powers are not Property of the Estate Under Section 541(a)(1) Because the Debtor has no Interest Upon Commencement

Section 541(a)(1) of the Bankruptcy Code sets forth that 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). The Supreme Court has determined that as a general rule of bankruptcy, the estate cannot possess anything more than the debtor itself did outside bankruptcy. *See Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1663 (2019) (finding that § 365 of the Bankruptcy Code reflects this general principle). Section 541(a)(1) brings into the estate the interests in property that the *debtor* had at the filing of the case (emphasis added*) Id*. The estate can only succeed to "no more or greater causes of action against third parties than those held by the debtor." *U.S. v. Whiting Pools, Inc.*, 462 U.S. 198, 204 n.8 (1983). The debtor has no interest in causes of action under section 547 at the commencement of the case because they are powers that vest to the *trustee* upon commencement of the proceeding. Therefore, the avoidance action against Pink does not become property of the estate under section 541(a)(1) and cannot be sold by the trustee.

The dissenting opinion of the lower court relies heavily on the Eighth Circuit decision in *In re Simply Essentials*, which overlooks the plain language of the statute in holding that Chapter 5 avoidance actions are property of the estate. The Eighth Circuit found avoidance actions to be property of the estate under section 541(a)(1) through the attenuated reasoning that the debtor has an "inchoate interest in the avoidance actions prior to the commencement of the bankruptcy proceedings" by nature of the debtor's pre existing right to file for bankruptcy and the Trustee's subsequent power to file avoidance actions and recover property. *See Pitman Farms v. ARKK Food Co.* (*In re Simply Essentials, LLC*), 78 F.4th 1006, 1009 (8th Cir. 2023). The majority in *In re Simply Essentials* offer no legal support for this proposition. *Id*.

State property law defines property rights in bankruptcy. *See Butner v. U.S.*, 440 U.S. 48, 55 (1979) ("Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding."). Bankruptcy law, in general, should not substantively alter entitlements created by otherwise applicable nonbankruptcy law. *See* Keith Sharfman, *Derivative Suits in Bankruptcy*, 10 Stan. J.L. Bus. & Fin. *1, 14.* The mere existence of bankruptcy does not expand a debtor's property rights at state law to include all the powers available to a trustee in a potential future bankruptcy. Therefore, the estate cannot claim the powers of bankruptcy under 541(a)(1).

The Third Circuit held *In re Cybergenics* that certain fraudulent transfer avoidance actions available to the debtor in possession under section 544(b) were not saleable assets of the estate. *See In re Cybergenics Corp.*, 226 F.3d 237, 244 (3rd Cir. 2000). In holding that section

544(a) creates a legal fiction in which the trustee is empowered to step into the shoes of a creditor and bring an action otherwise available to that creditor at state law, the court found ownership of that claim did not transfer to the debtor. *Id.* at 245. Thus, it could not be sold as an asset. *Id*. *Cybergenics* makes clear that powers of the trustee do not create legal property interests for the debtor outside of bankruptcy. As such, the power to avoid preferential transfers cannot enter into the estate pursuant to section 541(a)(1), as the debtor has no interest at the commencement of the proceeding.

The Supreme Court's decision in *U.S. v. Whiting Pools* relied on by the lower court's dissent similarly does not support a case that the power to avoid preferential transfers is property of the estate under section 541(a)(1). In that case, the IRS had legally seized possession of the debtor's physical property pre-petition pursuant to a tax lien. *Whiting Pools, Inc*., 462 U.S. at 204- 206. Though the debtor lacked possessory interest at the time of commencement, he maintained certain rights to the property possessed by the IRS.[2] *Id.* at 211. The Court held that the property reentered the estate pursuant to section 541(a) because the debtor had rights at the time of commencement. These facts are clearly distinguishable from the case at issue. The Debtor here maintained no form of property rights to the funds transferred to Pink, possessory or otherwise. There is no connection between the Debtor and the funds outside of bankruptcy.

Other courts that have found certain avoidance actions to be property of the estate have expressly limited their holdings to state law claims that exist outside of bankruptcy, thus not including the power to avoid preferential transfers. *See; In re Ontos, Inc*., 478 F.3d 427 (1st Cir. 2007); *In re Moore*, 608 F.3d 253 (5th Cir. 2010); *National Tax Credit Partners, L.P. v. Havlik*, 20 F.3d 705, 708-709 (7th Cir. 1994) ("the right to recoup a fraudulent conveyance, *which*

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[2] The tax sale provision referred to the debtor as the owner of the property after the seizure and prior to the sale. The IRS also would have to return to the debtor any surplus from a potential sale in excess of what was necessary to satisfy the lean.

outside of bankruptcy may be invoked by a creditor, is property of the estate") (emphasis added). The Fifth Circuit, for example, has held that the trustee can sell avoidance actions that exist under section 544, it has carefully noted that this constitutes nothing more than a sale of the trustee's right to bring state law claims that exist outside of bankruptcy. *In re Moore*, 608 F.3d at 261 ("We focus narrowly on the trustee's ability to sell causes of action that he has inherited from creditors under § 544(b)—causes of action that exist independent of the bankruptcy proceeding"). The court acknowledged that it is a "broader question" whether a trustee can sell the power to avoid transfers under section 547, where no right exists at state law. *Id.* at 261 n.13. Avoidance and recovery of preferential transfers are unique among avoidance actions in that they do not exist at state law, but rather are created by the Bankruptcy Code to allow the *trustee* to effectively manage the bankruptcy proceeding. Thus even under a more expansive view that allows for some avoidance actions to be considered as property of the estate under section 541(a), the trustee's powers pursuant to sections 547 and 550 would not be regarded as saleable property.

ii. Avoidance Powers are not Property of the Estate Under Section 541(a)(3) or (4) Because of the Intentional Divide Between Substantive and Remedial Portions of Causes of Action

The Bankruptcy Code makes a sharp distinction between the remedial and the substantive portion of causes of action. Section 547 of the Code grants the trustee the power to avoid certain transfers made by the debtor, while section 550 allows the trustee to actually recover the transferred property. In splitting the avoidance and recovery powers, the Code clearly envisioned different treatment for the underlying cause of action and eventual proceeds from that cause of action.

Further, while section 541(a)(3) expressly references section 550, bringing the proceeds into estate, section 541 makes no reference to section 547. Congress clearly knew how to cross-reference to section 547, as the statute does so in at least fifteen other sections. See 11 U.S.C. §§ 303, 349, 362, 502, 521, 522, 546, 550-552, 749, 764, 901, 926, 1521, 1523. It is fundamental to statutory interpretation that where Congress has failed to include language in statutes, it is presumed to be intentional. *In re Grigas*, 252 B.R. 866, 872 (Bankr. D.N.H., 2000), citing *Bates v. U.S.*, 522 U.S. 23, 25 (1997). Congress clearly intended that avoidance actions would not enter into property of the estate until the remedial portion of a claim comes to fruition. *See In re Feringa*, 376 B.R. 614, 624 (Bankr. W.D. Mich. 2007) (relying on § 541(a)(3) in concluding that "[s]ection 541 is quite clear that it is only the property that is actually recovered or preserved as a consequence of a successful avoidance action that in fact becomes property of the estate"); *Wagner v. Christiana Bank & Tr. Co. (In re Wagner)*, 353 B.R. 106, 112 (Bankr. W.D. Pa. 2006).

Congress used a parallel construction in section 541(a)(4), which brings into the estate the remedial portion of a preserved lien by including reference to Section 551, while excluding the action itself under section 548. *See* 11 U.S.C. § 541(a)(4). This further evidences that the Code intentionally separated the substantive portion of the trustees powers to avoid from the remedial portion. In this case, while any property recovered from an avoidance action against Pink comes into the estate under section 541(a)(3), Congress expressly left the action itself out of the definition of property of the estate. Because the action itself to avoid the preferential transfer is not property of the estate, it cannot be sold by the trustee.

iii. Avoidance Powers are not Property of the Estate Under Section 541(a)(7) Because of the Temporal Requirement in the Plain Language of the Subsection

Section 547(a)(7) brings into the estate "[a]ny interest in property that the estate acquires after the commencement of the case." 11 U.S.C. § 541(a)(7). The plain language of the subsection creates a temporal restriction on property entered into the estate under this subsection. The alleged property must have been acquired by the estate *after* the commencement of the case. Avoidance actions are created contemporaneously, not after, with the commencement of the case by virtue of the statute. Therefore, these causes of action cannot enter the property of the estate pursuant to section 547. *In re Raynor*, 406 B.R. 375, 381 (B.A.P. 8th Cir. 2009).

Congress enacted § 541(a)(7) to clarify its intention that § 541 include as property of the estate any property interests created with or by property of the estate. *TMT Procurement Corp. v. Vantage Drilling Co. (In re TMT Procurement Corp.)*, 764 F.3d 512, 524-525 (5th Circ. 2014). The trustee's power to avoid preferential transfers differs fundamentally from the kind of post-petition claims Congress intended to include with section 541(a)(7). *E.g.; In re Robotic Vision Sys.,* Inc., 343 B.R. 393, 398 (Bankr. D.N.H. 2006) (relying on § 541(a)(7) to find that "[c]claims of malpractice and fraud that arise during the performance of services for a debtor or a debtor in possession in a chapter 11 proceeding are property of the bankruptcy estate").

Section 541(a)(7) does not serve as an independent basis for the creation of property of the estate. *See In re Patterson*, 2008 WL 2276961 1, 6 (Bankr. N.D.Ohio,2008); *In re Doemling*, 116 B.R. 48, 50 (Bankr. W.D.Pa., 1990) (finding that interests in property qualify as property of the estate only if said property interest is "traceable to (or arises out of) some prepetition property interest which already is included in the bankruptcy estate."). Property acquired by the estate after commencement of the bankruptcy case is included in the estate under § 541(a)(7) if it was created with or by property of the estate; acquired in the estate's normal course of business; or is otherwise traceable to, or arises out of, any prepetition interest included in the bankruptcy estate. *See*; *Id. In re Neidorf*, 534 B.R. 369, 374 (B.A.P. 9th Cir. 2015). The cause of action to avoid preferential transfers is not traceable to some prepetition property interest. In this case, the debtor transferred these funds to Pink, and only post-petition does the *trustee* have the power to recover them pursuant to the Code.

B. The Plain Language of Section 547 and 550 Makes Clear that Congress Intended These Powers to be Available Only to the Trustee for the Benefit of the Estate

i. Where the Statute is Silent, Principles of Common Law Dictate That Causes of Action are not Assignable

Historically at common law, no right of action was assignable. *Tiernan v. Jackson*, 30 U.S. 580, 597 (U.S.,1831) (stating that the general principle of law is that choses in action are not assignable). In modern times, many states have reversed the default common law rule by statute. Teal E. Luthy, *Assigning Common Law Claims For Fraud*. 65 U. Chi. L. Rev. 1001, 1003 (1998). Unless the statute specifically designated avoidance actions as assignable, principles of common law should control. *Norfolk Redevelopment and Housing Authority v. Chesapeake and Potomac Telephone Co. of Virginia*, 464 U.S. 30, 35 (1983) (quoting *Fairfax's Devisee v. Hunter's Lessee*, 11 U.S. 603, 623, 3 L.Ed. 453 (1812). ("[t]he common law ... ought not to be deemed repealed, unless the language of a statute be clear and explicit for this purpose."). Section 547 creates a cause of action for the *trustee* to avoid certain prepetition transfers made by the debtor on behalf of the estate. The language of the statute does not provide for assignment of that cause of action. Therefore, the common law principle that causes of action are not assignable should govern. The trustee cannot assign this right to avoid the preferential transfer to Pink to a creditor, and it should not be regarded as saleable property of the estate.

ii. Congress's Choice to Designate the Trustee Implies an Exclusive Power

In writing a statute, Congress "says in a statute what it means and means in a statute what it says there." *Connecticut Nat. Bank v. Germain*, 503 U.S. 249, 254 (1992). In *Hartford Underwriters*, this Court held that an insurer could not recover from secured property for administrative expenses that benefited that property under § 506(c) because that power lay solely with the trustee. *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000). Section 506(c) states that "the *trustee* may recover from property securing an allowed secured claim." (emphasis added), 11 U.S.C. § 506(b). This Court held that under the plain language of the text, only the trustee was empowered to take that action, reasoning that "[w]here a statute names the parties granted [the] right to invoke its provisions such parties only may act." *Hartford Underwriters Ins. Co.* 530 U.S. at 6 (quoting 2A N. Singer, Sutherland on Statutory Construction § 47.23 p. 217 (5th ed. 1992)). When Congress specifically designates the trustee as the party empowered to take an action created by the Bankruptcy Code, the "proper inference" is that the trustee is the *only* party empowered to invoke the provision. *Hartford Underwriters Ins. Co.* 530 U.S. at 6. The Supreme Court noted that the burden of persuading the court otherwise would be "exceptionally heavy." *Id* at 9.

If Congress intended for the action to be broadly available, they would have authorized the provision by using general language, as they have elsewhere in the Code. *Hartford Underwriters Ins. Co.*, 530 U.S. at 7. For example, section 502(a) allows a claim unless "a party in interest objects" and section 503(b)(4) allows for "an entity" to file a request for payment. *Id*. Congress does not need to expressly state that the action is available to "*only* the trustee" in order to grant an exclusive power to the trustee as the sole named party. *Id* at 8. Consistent with this Court's interpretation of the plain language of the statute, the power to avoid and recover preferential transfers under section 547 and 550 are bestowed only upon the trustee and cannot be sold to Eclipse as property of the estate.

iii. The Trustee Serves a Unique and Important Function in the Bankruptcy Process

This Court noted in *Hartford Underwriters* that the fact that the sole named party in the statute is the trustee, who serves a "unique role in the bankruptcy proceeding," makes it entirely plausible that Congress intended to provide the power to the trustee at the exclusion of others. *Hartford Underwriters Ins. Co.* 530 U.S. at 7. The Bankruptcy Code gives trustees special powers to fulfill their primary duty of assembling the debtor's assets for the benefit of the estate. *See* 11 U.S.C. §704; *In re McGuirk*, 414 B.R. 878, 879 (Bankr. N.D.Ga., 2009). A Chapter 7 Trustee is appointed and trained by the United States Trustee pursuant to certain qualifications and is charged with broad ranging fiduciary duties to both creditors and the debtor. *See* 11 U.S.C. § 704(a)(1). A creditor does not have the qualifications, training or corresponding duties of a trustee and thus is not afforded the same powers. *See In re McGuirk*, 414 B.R. at 879. It follows that Congress would grant an exclusive power to the trustee as a neutral and independent party to bring actions that exist exclusively under the Bankruptcy Code.[3] Elizabeth Warren & Jay L. Westerbrook, *Selling the Trustee's Powers*, AM. BANKR.INST. J., September 2004 at 2 ("The trustee is visibly the court-appointed representative of creditors, but a buyer is just another self-interested party.") These independent powers of the trustee are analogous to "the power of a public official to carry out various responsibilities in a representative capacity." *In re Cybergenics Corp.,* 226 F.3d at 244. Just as the trustee could not contractually grant the right to investigate the debtors financials to an outside party-- even if it were to materially benefit the estate- the trustee cannot contractually grant Eclipse the authority to independently pursue a preference action against Pink. *In re Feringa,* 376 B.R. at 624 (Bankr. W.D.Mich., 2007) ("The avoiding powers are not 'property' but a statutorily created power to recover property").

[3] Congress has specifically granted a Debtor-in-possession in the Chapter 11 context all of the powers and duties of the Trustee, with limited exceptions. *See* 11 U.S.C. § 1107(a). This fact does not support an argument that the trustee can expand his own power to other parties through contract where Congress has granted an exclusive power to the trustee as fiduciary of the estate.

C. Policy Reinforces the Interpretation that Avoidance Powers Under Section 547 Should Not be Saleable Property of the Estate

The bankruptcy system still promotes meritorious preference actions to be brought for the benefit of the estate, without allowing the sale of the right to bring that action to outside parties. The trustee, as a neutral fiduciary, has the discretion to bring preference actions to benefit the estate. If the trustee were to violate his fiduciary duties, or find himself otherwise unable to bring the action, the Supreme Court in *Hen House* specifically left open the possibility of derivative standing for others to bring actions on behalf of the estate even where the Code mentions only the trustee.[4] As the Court noted, there is no analogy between seeking permission from bankruptcy court to pursue a particular claim *on behalf of the estate*, and asserting that that right can be sold and brought independently by an outside party. "[T]he bankruptcy court plays a vital gatekeeper role in determining whether derivative standing is appropriate in a given case, granting standing only where certain conditions exist and prerequisites are met." *In re Baltimore Emergency Services II, Corp.*, 432 F.3d 557, 562 (4th Cir. 2005), *In re Gibson Group, Inc.*, 66 F.3d 1436 (6th Cir. 1995). To offer control of preference actions to the highest bidder undermines the system set in place for maximizing the estate.

The sale of avoidance actions to outside bidders delegitimizes the bankruptcy system by opening up the potential for retaliatory claims. Avoidance actions exist under the bankruptcy code to benefit the estate and are brought by the trustee as a neutral representative of the bankruptcy system. The trustee serves as a neutral and independent party, charged with broad

[4] *Hartford Underwriters*, 530 U.S. at 13, n. 5. "We do not address whether a bankruptcy court can allow other interested parties to act in the trustee's stead in pursuing recovery under § 506(c). Amici American Insurance Association and National Union Fire Insurance Co. draw our attention to the practice of some courts of allowing creditors or creditors' committees a derivative right to bring avoidance actions when the trustee refuses to do so, even though the applicable Code provisions, see 11 U.S.C. §§ 544, 545, 547(b), 548(a), 549(a), mention only the trustee. See, e.g., In re Gibson Group, Inc., 66 F.3d 1436, 1438 (C.A.6 1995). Whatever the validity of that practice, it has no analogous application here, since petitioner did not ask the trustee to pursue payment under § 506(c) and did not seek permission from the Bankruptcy Court to take such action in the trustee's stead. Petitioner asserted an independent right to use § 506(c), which is what we reject today."

ranging fiduciary duties to both creditors and the debtor. *See* 11 U.S.C. § 704(a)(1). To allow the highest bidder the privilege to bring avoidance actions undermines the discretion of the neutral fiduciary in bringing such claims and harms the legitimacy of the system by opening up the possibility of abuse. *See* Kristina M.Stanger, et. al., Estate Avoidance Actions: Stand in the Trustee's Shoes or Buy Them? 42-NOV Am. Bankr. Inst. J. 20, 56 (2023).

The facts presented here illustrate the dangers that arise from allowing the trustee to sell avoidance actions to vengeful third parties. Eclipse is proposing to buy the preferential claim against Pink for $20,000, the maximum value of the claim. It is unclear if recovery of the funds transferred to Pink is even possible, as the record does not indicate that the Debtor was insolvent at the time of the transfer. *See* 11 U.S.C. § 547(b)(3). Eclipse's offer of the maximum potential value of the claim is economically unsound. This irrational decision implies that Eclipse is likely motivated to bring this claim against the Debtor's mother in retaliation against the Debtor. Eclipse was livid at the Debtor when it learned of his charitable donation of borrowed funds to the Veterans of Foreign Wars (R. 7). If Eclipse was allowed to "buy" the avoidance action from the trustee, it would allow them to seek revenge on the Debtor by litigiously pursuing a claim against his mother. *See In re Metropolitan Electric Manu. Co*., 295 B.R. 7 (Bankr. E.D.N.Y. 2003) (denying a sale of avoidance actions where the sale would profit the estate but the buyers likely only intended to harass the targets of the claims.) Selling preference actions to creditors contradicts the intent of section 547, which aims to empower the trustee to ensure equitable treatment of creditors in bankruptcy.

CONCLUSION

This Court should affirm the decision of the Thirteenth Circuit Court of Appeals and hold that (1) post-petition, pre-conversion increases in home equity inure to the benefit of the debtor and (2) preference actions pursuant to section 547 and 550 cannot be sold by the trustee as property of the estate under the plain language of the Bankruptcy Code.