Team R. 36

No. 23-0115

IN THE

Supreme Court of the United States

OCTOBER TERM, 2023

IN RE EUGENE CLEGG, DEBTOR

VERA LYNN FLOYD, CHAPTER 7 TRUSTEE, PETITIONER

V.

EUGENE CLEGG, RESPONDENT.

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

BRIEF FOR RESPONDENT

Team R. 36
Counsel for Respondent

Oral Argument Requested

QUESTIONS PRESENTED

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

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

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

STATEMENT OF JURISDICTION

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

STATEMENT OF CONSTITUTIONAL AND STATUTORY PROVISIONS

This action implicates statutory construction of certain provisions of Title 11 of the United States Code.

The relevant portions of U.S.C. § 348(a) provides:

(a) Conversion of a case from a case under one chapter of this title to a case under another chapter of this title constitutes an order for relief under the chapter to which the case is converted, but, except as provided in subsections (b) and (c) of this section, does not effect a change in the date of the filing of the petition, the commencement of the case, or the order for relief.

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

(f)(1) Except as provided in paragraph (2), when a case under chapter 13 of this title is converted to a case under another chapter under this title—

(a) property of the estate in the converted case shall consist of property of the estate, as of the date of filing the petition, that remains in the possession of or is under the control of the debtor on the date of conversion;

(b) valuations of property and of allowed secured claims in the chapter 13 case shall apply only in a case converted to a case under chapter 11 or 12, but not in a case converted under chapter 7, with allowed secured claims in cases under chapters 11 and 12 reduced to the extent that they have been paid in accordance with the chapter 13 plan; and

(c) with respect to cases converted from chapter 13—

(i) the claim of any creditor holding security as of the date of the filing of the petition shall continue to be secured by that security unless the full amount of such claim determined under applicable nonbankrutpcy law has been paid in full as of the date of conversion, notwithstanding any valuation or determination of the amount of an allowed secured claim made for the purposes of the case under chapter 13; and

(ii) unless a prebankruptcy default has been fully cured under the plan at the time of conversion, in any proceeding under this title or otherwise, the default shall have the effect given under applicable nonbankruptcy law.

(f)(2) If the debtor converts a case under chapter 13 of this title to a case under another chapter under this title in bad faith, the property of the estate in the converted case shall consist of the property of the estate as of the date of conversion.

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

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
   (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.
   (2) …
   (3) Any interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title.
   (4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title.
   (5) …
   (6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.
   (7) Any interest in property that the estate acquires after the commencement of the case.

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

(b) Except as provided in subsections (c) and (i) of this section, the trustee may, based on reasonable due diligence in the circumstances of the case and taking into account a party's known or reasonably knowable affirmative defenses under subsection (c), avoid any transfer of an interest of the debtor in property –
   (1) to or for the benefit of a creditor;
   (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
   (3) made while the debtor was insolvent;
   (4) made—
      a. on or within 90 days before the date of the filing of the petition; or
      b. between ninety days and one year before the date of filing of the petition if such creditor at the time of such transfer was an insider; and
   (5) that enables such creditor to receive more than such creditor would receive if—
      1. the case were a case under chapter 7 of this title;
      2. the transfer had not been made; and
      3. such creditor received payment of such debt to the extent provided by the provisions of this title.

The relevant portion of U.S.C. § 550(a) provides:

(a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 548, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
(2) any immediate or mediate transferee of such initial transferee.

STATEMENT OF THE CASE

Emily "Pink" Clegg ("Pink") transferred her 100% membership interest in The Final Cut, LLC ("Final Cut") to her son, Cpl. Eugene Clegg (ret.) (the "Debtor") following Debtor's retirement from the United States Army. R. at 5. Final Cut owned and operated a historic movie theater in the City of Moot. At the time of transfer, the theater consistently generated a net profit each year which Debtor relied on as his sole source of income. R. at 5.

Several years later, in 2016, Debtor caused Final Cut to borrow $850,000 (the "Loan") from Eclipse Credit Union ("Eclipse") to renovate the theater. R. at 5. Debtor performed much of the work himself, along with the assistance of other local veterans who donated their time. R. at 5. Consequently, the labor costs were reduced so that approximately $75,000 of the Loan remained. R. at 5. Out of gratitude and good will, Debtor donated the remaining proceeds to the Veterans of Foreign Wars (the "VFW") in 2017. R. at 5. Notably, even after the donation Final Cut remained solvent, fully capitalized, and capable of satisfying its debts as they became due, and the theater remained profitable upon reopening. R. at 5, footnote 3.

Debtor faithfully attended to the business and managed it successfully for three more years. R. at 6. However, in March of 2020 the Governor for the State of Moot entered an executive order quarantining all residents in response to COVID-19, a global pandemic which forced a society-wide lock-down. R. at 6. The theater – like countless businesses across the nation – was rendered inoperable for nearly a year. R. at 6. Such financial strain caused by the pandemic forced Debtor to look for other means of income for the theater, including receiving an unsecured $50,000 loan from his mother, Pink on September 8, 2020. R. at 6.

The effects of COVID had not yet faded in February 2021, when the theater was finally able to reopen. R. at 6. Debtor even went so far as to forfeit his own salary – and sole source of income – to lighten Final Cut's financial burden. R. at 6. Unfortunately, the lowered attendance and continuing pandemic forced Debtor to take on significant credit card debt, and he fell behind on his mortgage obligations to Another Brick in the Wall Financial Corporation (the "Servicer"), which then commenced foreclosure proceedings. R. at 6.

In a show of good faith to his creditors and to try to save his home, Debtor sought reorganization and filed for chapter 13 relief on December 8, 2021 (the "Petition Date"). R. at 6. In his schedules, Debtor stated that the value of the home was $350,000 based on an appraisal completed mere days before the Petition Date. R. at 6. Debtor further identified a non-contingent, liquidated and undisputed secured debt to Servicer for $320,000. R. at 6. Additionally, Debtor properly claimed the state $30,000 homestead exemption – thus, there was no equity available in the home for the estate. R. at 6. Debtor also listed payments he made to Pink within a year prior to the Petition Date aggregating $20,000 (the "Pink Transfers"). R. at 7.

Debtor filed a proposed plan, modeled after the national plan prescribed for use in District of Moot, that would pay creditors over a three-year period. R. at 7, footnote 6. The plan was to be funded through future earnings of Final Cut, which all parties in interest agreed would return to profitability to support the plan payments. With respect to Servicer, Debtor proposed to cure the prepetition arrears and make monthly payments (through the trustee) to pay down the mortgage. R. at 7.

During the initial proceedings, Eclipse became aware of the Debtor's repayments to Pink, as well as Debtor's donation of the remaining renovation loan to VFW. R. at 7. Both Eclipse and the chapter 13 trustee objected to the confirmation of the Debtor's plan in relation to these payments, arguing that the plan failed to satisfy section 1325(a)(4), which requires creditors to receive no less than they would under a chapter 7 liquidation. R. at 7. The chapter 13 trustee asserted that the alleged preferential transfers to Pink may have been recovered under chapter 7. R. at 7. However, Debtor, Eclipse, and the trustee agreed to a settlement (the "Agreement") to resolve this point – Eclipse would receive a claim in the amount of $150,000, with $25,000 deemed non-dischargeable. R. at 8. Importantly, the trustee also agreed under the plan that she would not seek to avoid and recover payments made to Pink prior to the Petition Date. R. at 8.

The bankruptcy court confirmed the Debtor's plan on February 12, 2022. R. at 8. The Debtor successfully made timely trustee's payments for eight months in accordance with the approved plan. R. at 8. Unfortunately, Debtor fell ill with long-COVID in September 2022. R. at 8. Unable to work, the theater was forced out of business in October 2022. R. at 8. In response, Eclipse commenced foreclosure proceedings against Final Cut. R. at 8. To avoid dismissal of his case, Debtor chose to convert his bankruptcy to a chapter 7 liquidation, which the bankruptcy court approved. R. at 8.

Following the conversion, Vera Lynn Floyd was appointed as the Debtor's chapter 7 trustee (the "Trustee"). R. at 9. Prior to conversion, the chapter 13 trustee confirmed that she distributed $10,000 to the Servicer in accordance with the plan. R. at 9. In Debtor's statement of intention, he highlighted that his intention to reaffirm the mortgage debt to remain in his home. R. at 9. However, Trustee decided to commission a second appraisal of the house, which reflected an increase in the home's non-exempt equity by $100,000 post-petition. R. at 9. Trustee then began marketing the home for sale, in defiance of Debtor's intention to reaffirm the debt. R. at 9. Eclipse, acting individually, offered to purchase both the home and the alleged preference claim against Pink, despite the chapter 13 trustee's stipulation against such recovery under the Agreement. R. at 9. Trustee then filed a motion (the "Sale Motion") to proceed with selling both the home and the alleged preference claim to Eclipse under section 363(b). R. at 9.

Debtor timely objected to Trustee's Sale Motion, arguing that the increase in equity should inure to his benefit, not the estate, and that Trustee's statutory ability to avoid and recover cannot be sold. R. at 10. The bankruptcy court held in favor of Debtor, denying Trustee's Sale Motion on the grounds that (1) any post-petition, pre-conversion increase in equity of the Debtor's home should inure to the Debtor's benefit, which would prevent the Trustee's sale of the home, and (2) second, the Trustee cannot sell her statutory avoidance ability under sections 547 and 550 to a creditor of the estate. R. at 10. The Trustee appealed the court's ruling pursuant to 28 U.S.C. § 158(d)(2)(A). R. at 10. The Thirteenth Circuit then affirmed the bankruptcy court's ruling in favor of the Debtor. Trustee then pursued an appeal to this Court.

STANDARD OF REVIEW

The issues addressed on appeal involve questions of law, thus, the standard of review is *de novo*. *See, e.g., Fox v. Hathaway (In re Chicago Mgmt. Consulting Grp.)*, 929 F.3d 804, 809 (7th Cir. 2019).

SUMMARY OF THE ARGUMENT

In the present case, the Debtor – a hard-working, U.S. veteran – sought reorganization under the Bankruptcy Code to not only save his home, but also to maximize what he was able to pay back to those he owed. Unfortunately, Debtor fell ill, another one of the countless individuals affected by COVID-19. Debtor then exercised his right to convert his chapter 13 case to a chapter 7 liquidation in good faith. In opposition to Debtor's intention to reaffirm his mortgage and his track record of timely payments, the Trustee not only started marketing Debtor's home for sale but also fostered a deal on the side with Eclipse, a single creditor, to sell to Eclipse Trustee's power to avoid and recover alleged preferential transfers Debtor made to Pink. Debtor objected to both of Trustee's requests. The bankruptcy court ruled in favor of Debtor on both issues, denying Trustee's Sale Motion regarding the home and the Trustee's attempt to sell her statutorily created avoidance powers under sections 547 and 550 of the Bankruptcy Code.

Trustee may not sell the home because the home was not property of the estate at the Petition Date, so any post-petition increase in value is not property of the estate. Even if the home was property of the estate, Congress enacted section 348(f) of the Bankruptcy Code to differentiate between good and bad faith conversions so that good faith debtors may use the Petition Date as the distinction for what is included as property of the chapter 7 estate, rather than the conversion date (reserved to penalize bad faith debtors). This excludes the post-petition increase in equity for good-faith Debtor. Further, the policies underlying the bankruptcy process do not support punishing debtors for attempting reorganization before commencing liquidation. By pulling the increased equity away from Debtor and into the estate, the Court would set a counterintuitive precedent that would disincentivize debtors from filing under chapter 13, which harms debtors and creditors alike since creditors usually receive more through chapter 13 than chapter 7.

Furthermore, the Trustee may not sell her avoidance and recovery powers to Eclipse, a creditor, because these powers are not property of the estate. Trustee's own actions indicate Trustee is aware of this, as the Trustee could have simply compelled turnover under section 542 if the funds at issue were properly property of the estate. However, Debtor does not have an interest in these funds, nor is the Trustee able to transfer the power to avoid or recover this alleged preferential transfer since these powers are explicitly granted to trustees under the Bankruptcy Code, no other parties, so that Eclipse cannot exercise these powers to claw back the funds from Pink under any circumstances.

For these reasons, this Court should AFFIRM the decision of the Thirteenth Circuit.

ARGUMENT

The overarching goal of the Bankruptcy Code is to provide debtors with a fresh start and allow the rehabilitation of these debtors back into the economy, benefitting society as a whole. The American bankruptcy system is a unique creature that grapples with particularly high-stress situations. As such, it is of the utmost importance to preserve and set precedent that favors the smooth, equitable treatment of all parties involved.

At issue in this case is whether (1) the Trustee may pull in the post-petition, pre-conversion appreciation in value of Debtor's home as property of the estate; and (2) whether Trustee may sell her statutorily granted avoidance and recovery powers to Eclipse, a creditor, for Eclipse to utilize for its own personal benefit. Under the statutory scheme of the Bankruptcy Code, the congressional intent behind the sections of the Code at issue, and truly at the heart of the purpose and policy of the bankruptcy process, the answer must be that (1) Debtor is entitled to the increase in equity in his home; and (2) the Trustee cannot sell her statutory power to avoid and recover preferential transfers to a single creditor to exercise for its personal gain to the detriment of other creditors and the estate.

I. DEBTOR IS ENTITLED TO THE POST-PETITION, PRE-CONVERSION INCREASE IN EQUITY IN DEBTOR'S HOME

The crux of this issue is whether a post-petition, pre-conversion shift in value in property inures to the benefit of the Debtor or to the chapter 7 estate. The circuits are split as to how section 348(f) should be applied to resolve this tension, with the minority arguing that appreciation in property is not separate, distinct property that can be acquired post-petition, and therefore must always come in as property of the estate. *See Goetz v. Weber (In re Goetz)*, 651 B.R. 292 (B.A.P. 8th Cir. 2023), *appeal docketed,* No. 23-2491 (8th Cir. June 23, 2023), *Potter v. Drewes (In re Potter)*, 228 B.R. 422 (B.A.P. 8th Cir. 1999), *and In re Goins*, 539 B.R. 510

(Bankr. E.D. Va. 2015). However, the majority supports Debtor's position – including precedent from this Court – in holding that the ambiguity of section 348(f) and the overwhelming support of the legislative history and policies surrounding this section, and the Bankruptcy Code as a whole, provide that the post-petition, pre-conversion increase in equity rightfully inures to the debtor. *Harris v. Viegelahn*, 575 U.S. 510, 511 (2015); *Rodriguez v. Barrera (In re Barrera)*, 22 F.4th 1217, 1226 (10th Cir. 2022); *In re Cofer*, 625 B.R. 194, 198 (B.R.D. Idaho 2021); *In re Lynch*, 363 B.R. 101, 107 (B.A.P. 9th Cir. 2007).

In the present case, it is uncontested that Debtor filed for conversion in good faith. R. at 8, footnote 8. Notably, Trustee does not – nor does any other party – contend that Debtor filed in bad faith. R. at 8. Debtor successfully and timely made the chapter 13 plan payments for eight full months before illness forced him to seek conversion. *Id*. Therefore, any post-petition, pre-conversion increase in equity of the Debtor's home rightfully inures to the benefit of Debtor because the home was no longer property of the estate after the confirmation of the chapter 13 plan; thus, the Trustee could not sell the home under chapter 7. Even if the Court were to find the home to be included as post-petition property of the estate, section 348(f) clearly distinguishes that the good faith Debtor's chapter 7 property of the estate is determined as a frozen snapshot in time of the Debtor's financial situation at the petition date, not the conversion date. *See* 11 U.S.C. § 348(f)(1)(A). Finally, the Debtor in all likelihood would have kept his home anyway if he had originally filed for chapter 7 and affirmed the mortgage debt; thus, it is against the very nature of the purpose and policies of the Bankruptcy Code to punish Debtor for striving to pay back his debts through a chapter 13 plan of reorganization. *See* Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106 (fewer debtors will opt to file for chapter 13 if they risk losing their homes to a forced sale upon conversion to a chapter 7); *see also In re Fobber*, 256

B.R. 268, 277-8 (Bankr. E.D. Tenn. 2000) (Congress intended to place debtors in the same economic position they would have occupied had they filed a chapter 7 originally, not penalize debtors for exercising their right of conversion).

a. Debtor's home was not property of the estate pre-conversion; thus, any appreciation in value to the home inured to Debtor, not the estate.

Because there was no equity in the home available for the estate at the Petition Date, the Trustee could not sell the home. R. at 6. At the Petition Date, the secured mortgage debt combined with the elected homestead exemption prevented the home from being pulled into the bankruptcy estate. *Id*. Further, Under section 1327(b), "the confirmation of a plan vests all of the property of the estate in the debtor." *See* 11 U.S.C. § 1327(b); *Bullard v. Blue Hills Bank*, 575 U.S. 496, 503 (2015). This provides that "equity increases from the time of the initial filing up until plan confirmation would inure to the estate, then from the time of confirmation until conversion would vest in the debtor." *Castleman v. Burman (In re Castleman)*, 75 F. 4th 1052, 1057 (9th Cir. July 28, 2023); *see also Harris*, 575 U.S. at 511; *In re Barrera*, 22 F.4th at 1226. This is bolstered by the fact that the plan explicitly stated that the property vested in Debtor at confirmation – so, even if the argument is made that the house had been considered property, it no longer was post-confirmation. However, the facts evidence that the home was not property of the estate from the very beginning.

Courts have addressed the ambiguity of whether the term "property" is "just the physical thing (i.e. the house) regardless of what has changed since the petition date – or [if] Congress intend[ed] to 'freeze' property to its attributes and status it held as of the Petition Date." *In re Harmon*, 2022 WL 20451952, at *8 (Bankr. E.D. La. June 9, 2022). *In re Barrera*, 22 F.4th at 1226. The court in Barrera distinguished that property of the estate as of the date of filing of the petition "meant property of the estate as it existed on the chapter 13 petition date, with all of its attributes including the amount of equity that existed on that date." *In re Harmon*, 2022 WL 20451952, at *8; *In re Barrera*, 22 F.4th at 1220.

A significant aspect of filing for bankruptcy is the freezing of the debtor's financial positions at the date of filing the petition, colloquially known as the "snapshot" rule. *Rockwell v. Hull (In re Rockwell)*, 968 F.3d 12, 18 (1st Cir. 2020); *see also Ritchie Special Credit Invs., Ltd. v. JPMorgan Chase & Co.*, 48 F.4th 896 (8th Cir. 2022), *and Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1656 (2019). This snapshot requires that assets "retain whatever status (i.e. exempt of part of the estate) [they] had when the debtor filed for bankruptcy," and this cannot be changed by shifting circumstances, focusing instead on "the facts and law as they exist on the petition date." *In re Rockwell*, 968 F.3d at 18. Congress specifically enumerated the circumstances when property that is properly exempt at the petition date can later be incorporated into the estate: "(1) debt from certain taxes and customs duties, (2) debt related to domestic support obligations, (3) liens that cannot be avoided or voided, including tax liens, and (4) debts for a breach of fiduciary duty to a federal depository institution." *Id.* at 20 (citing *In re Cunningham*, 513 F.3d at 323). In the present case, none of these exceptions apply, nor does the Trustee contend that one does. R. at 9. Therefore, the snapshot rule applies to Debtor's financial position at the time of filing the petition. Further, the facts, circumstances, and values attributed to Debtor's assets (other than under one of the specified situations under 522(c)) are frozen in time, so that any later market shifts that affected the value of Debtor's home are not relevant to this snapshot.

The minority of courts that have held that increases in equity do attach to the property of the estate rely on the reasoning that in *Barrera* (a leading case in this issue), the property at issue was post-petition wages, which may be viewed more straightforwardly as "proceeds" under

541(a). *Compare In re Barrera*, 22 F.4th at 1226*, with In re Goetz*, 651 B.R. at 416, *In re Potter*, 228 B.R. at 424, *and In re Goins*, 539 B.R. at 515. The catch is whether or not equity itself is inseparable from the item of property. *In re Goetz*, 651 B.R. at 416. In *Goetz*, the court argued that 348(f)(1)(A) "property of the estate" "captures the debtor's entire ownership interest in each asset that exists on the petition date without fixing the estate's interest to the precise characteristics the asset has on that date." *Id*. However, *Goetz* draws on *Potter* and *Goins* to support this conclusion. *See Id.*; *In re Potter*, 228 B.R. at 424; *In re Goins*, 539 B.R. at 516. *Potter* does not involve the same question at issue – instead, *Potter* concludes only that chapter 7 post-petition increases in equity are property of the estate, without any discussion of conversion from chapter 13. In *Goins*, the court based its conclusion on the premise that "the Trustee is entitled to the post-petition appreciation in the property because the real estate was *always* property of the estate under Section 541(a) of the Code." *In re Goins*, 539 B.R. at 515. However, under section 1327(b) of the Code, the home was vested in Debtor upon confirmation of the plan, and – as such – was not property of the estate. Additionally, the plan expressly provided that all property of the estate vested in Debtor. R. at 8; *See* 11 U.S.C. § 1327(b). Therefore, the argument in *Goetz* does not overwhelm the majority of courts which have affirmatively held that there is "no reason to distinguish between equity increased by payments to a secured lender from the Debtor's post-petition wages or by home appreciation." *In re Harmon*, 2022 WL 20451952, at *10; *see also In re Barrera*, 22 F.4th at 1226 *and In re Pearson*, 214 B.R. 156, 164 (Bankr. N.D. Ohio 1997). Debtor is entitled to this increase in equity in his home.

b. Even if the home was pre-conversion property of the estate, section 348(f) clearly differentiates which point in time courts must look to when determining property of the estate upon conversion to chapter 7.

Under section 348(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 of 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 possession or under control of the debtor on the date of conversion; … [and]
>
> (f)(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.

See 11 U.S.C. § 348(f)(1)(A)-(f)(2). As this Court has stated, section 348(f) was added through the Bankruptcy Reform Act of 1994 (the "1994 Act") to resolve the dispute as to whether property accrued under chapter 13 is part of a chapter 7 estate upon conversion. *See Harris*, 575 U.S. at 517 ("a debtor's post-petition earnings and acquisitions do not become part of the new Chapter 7 estate [with the] exception for debtors who convert in bad faith"); *In re Page*, 250 B.R. 465, 465 (Bankr. D. N.H. 2000) (absent a showing of bad faith, property of the estate of the converted case is property as of the date of filing, including valuations and allowed secured claims – there is no other reason for Congress to have distinguished between the petition date and conversion date); Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106.

Courts that argue otherwise focus on section 541(a)(6)'s definition of "property of the estate" which includes: "proceeds, product, offspring, rends, or profits of or from property of the estate." 11 U.S.C. § 541(a)(6); *In re Castleman*, 75 F.4th at 1056; *see also In re Niles*, 342 B.R. 72 (Bankr. D. Ariz. 2006); *In re Slack*, 290 B.R. 282 (Bankr. D.N.J. 2003); *In re Wegner*, 243 B.R. 731 (Bankr. D. Neb. 2000). While some could argue that appreciation in home value could be viewed as 'proceeds' if the debtor sells the property, this argument is not solid. The increase in equity alone – without sale of the home – is not necessarily "proceeds" of the property of the estate. *See In re Barrera*, 620 B.R. at 653 ("'Property' in 348(f)(1)(A) means property that existed on the petition date, with all its attributes, including the amount of equity that existed on that date"); *see also In re Niles*, 342 B.R. 72 (Even if one argued proceeds were property, post-petition proceeds belong to the debtor after confirmation of the chapter 13 plan revests estate property in the debtor). Further, this relies on the assumption that the property in question is in fact property of the estate. In the present case, the plan expressly provided that all property of the estate vest in the Debtor at confirmation. R. at 8. As such, even if the Court disregards the difference between good and bad faith and chooses to determine property of the estate as being at the time of conversion to chapter 7, the home was not property of the estate at conversion under not only section 1327(b), but also the plan itself. R. at 8; 11 U.S.C. § 1327(b); *see also In re Cofer*, 625 B.R. at 194 (section 1327(b) prevented the home in *Cofer* from becoming property of the chapter 7 estate under section 348(f)(1)(A) because section 1327(b) vested property of the estate back to the debtor at confirmation).

Trustee relies heavily on *Castleman* to support the argument that section 348(f) requires that post-petition, pre-conversion increases in equity are property of the estate, and thus do not inure to the debtor. The court in *Castleman* asserts that 348(f) is unambiguous, and thus does not look to legislative history, arguing instead that the plain language of the Code absolutely supports that the equity inures to the estate. *In re Castleman*, 75 F.4th at 1058. Yet, even if this Court finds section 348(f) to be unambiguous, the plain language of section 348(f) clearly differentiates between what date courts look to when determining what is included in property of the estate, hinging on whether the case was converted in good faith.

Castleman's sticking point is centered on 541(a), arguing that the definition of property under 541(a) does not change from chapter 13 to a chapter 7 upon conversion. *See* 11 U.S.C. § 541(a) ("all legal and equitable interests of the debtor in property as of the commencement of the case."). However, *Castleman* fails to acknowledge a key point – even if the Court finds that the appreciation in value is "property" under section 541(a), section 348(f) clearly differentiates "property of the estate" as including such property either at the date of the filing of the petition *or* at the date of conversion, depending on whether the case was converted in good or bad faith. *Id.*; 11 U.S.C. § 348(f)(1)-(2). Further, upon confirmation of Debtor's plan under chapter 13, "the home was no longer 'property of the estate' and therefore any appreciation in its value is not 'proceeds…of or from property of the estate.'" *In re Castleman*, 75 F.4th at 1061; *In re Niles*, 342 B.R. at 71. Therefore, the increase in value of the home post-confirmation of the plan does not constitute property of the estate. Even if the Court were to find that the home, and thus the increase in equity, *was* property of the estate post-petition, this still does not undermine the plain meaning of section 348(f) – because Debtor converted in good faith, any increase in equity in the property post-petition inures to Debtor under section 348(f)(1)(A). Reading the Code to mean otherwise would render Congress' addition of section 348(f)(2) nonsensical. *See* 3 Collier on Bankruptcy ¶ 348.02[1], at 348-28 (Alan N. Resnick & Henry J. Sommer, 16th ed. Rev. 2017) (Regarding the 1994 Act, the House Report Committee was concerned a contrary rule would disincentive chapter 13 filings because debtors would fear losing property attained after filing, including equity created by payment of secured debts if their case converted).

Castleman relies on faulty support in *Schwaber* and *Wilson* in reaching the court's conclusion. *See In re Castleman*, 75 F.4th at 1056; *Schwaber v. Reed*, 940 F.2d 1317, 1323 (9th Cir. 1991); *Wilson v. Rigby*, 909 F.3d 306, 309 (9th Cir. 2018). *Schwaber* predates section 348(f)'s addition to the Bankruptcy Code, which was added through the Bankruptcy Reform Act of 1994 to resolve the dispute between whether property accrued during chapter 13 proceedings was part of the chapter 7 estate upon conversion was resolved through the addition of section 348(f). *In re Castleman*, 75 F.4th at 1056; *Harris*, 575 U.S. at 517 Because The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") did not amend section

348(f)(1)(A), the legislative history surrounding the 1994 Act is relevant when determining the purpose of section 348(f). *See In re Hodges*, 518 B.R. 445, 448 (Bankr. E.D. Tenn. 2014). As such, the "legislative history [of the 1994 amendments to section 348(f)] states that Congress intended to 'clarify' the fractured case law, in favor of the view that consumer debtors should not be penalized at conversion for attempting and failing in a Chapter 13 case." Hon. Keith M. Lundin, CHAPTER 13 BANKRUPTCY, 3D EDITION § 316.1, at 316-1 (2000 & Supp. 2004) (quoting 140 Cong. Rec. H10, 752). 752 ("The *spirit* of § 348(f)(1)(A) is best captured by the rule that property acquired by the Chapter 13 estate or by the debtor after the chapter 13 petition does *not* become property of the estate at a good-faith conversion") (emphasis added); *see also In re Fobber*, 256 B.R. at 277-8. Thus, *Schwaber* is not applicable support for the intent behind section 348(f); rather, the Court should look to cases examining the 1994 Act to delve into the actual congressional intent of section 348(f) and what role this addition to the Code is meant to play in the American bankruptcy system.

Castleman also relies on *Wilson*, a case where the chapter 7 debtor sought to amend her schedules post-petition to reflect the appreciation in her home value. *Wilson*, 909 F.3d at 309. The *Wilson* court held that "the value of the homestead must be fixed as of the date of the bankruptcy petition." *Id.* While this case differs in that the debtor was trying to attain a larger homestead exemption – unlike good-faith Debtor working to pay back all his creditors – the Court may still follow this logic that the value of the estate is frozen at the petition date, and may not be altered to add post-petition appreciation in value when determining what constitutes property of the estate. *Id.*

Besides, regardless of what the court held in *Castleman*, this Court has already held that absent a bad-faith conversion, section 348(f) limits a converted chapter 7 estate to the date of the original chapter 13 petition. *Harris*, 575 U.S. at 510. As such, Trustee's reliance on Castleman is ill-founded, as section 348(f)(1)(A) requires courts to look to the petition date when determining property of the estate. Additionally, interpretation of a Code section should not render superfluous another part of the same statutory scheme. *City of Chicago v. Fulton*, 141 S. Ct. 585, 159 (2021); *Roberts v. Sea-Land Servs., Inc.*, 566 U.S. 93, 101 (2012). Trustee's argument would render meaningless the distinction between good and bad faith conversion under 348(f)(1)(A) and 348(f)(2) because if the Court finds that 348(f)(1)(A) is not subject to the snapshot rule, the Code would be nonsensical. *See* Keith M. Lundin & William Brown, Chapter 13 Bankruptcy, § 316.1 (4th ed. 2004) (The legislative history of section 348(f)(1)(A) shows Congress' intent to take a 'snapshot' of the estate at the filing of the original chapter 13). If Congress intended such property to inure to the estate rather than the debtor, it would not have enacted section 348(f)(2). *In re Lynch*, 363 B.R. at 107. (9th Circuit BAP recognized that property appreciation after the chapter 13 petition should be excluded from property of the estate because allowing the debtor to retain equity arising during the chapter 13 case reflected the legislative purpose behind section 348(f) and buttressed section 348(f)(2)). Because the increase in value of the home was not property of the estate at the petition date, such an increase in equity is not included in the converted chapter 7 estate.

c. Debtor likely would have been permitted to keep the home if he filed under chapter 7 in the first place; thus, holding to penalize Debtor for attempting reorganization flies in the face of the purpose and policies underlying the Bankruptcy Code.

This Court has supported that there is "nothing in this Code denying debtors funds that would have been theirs had the case proceeded under Chapter 7 from the start." *Harris*, 575 U.S.

at 518.[1] In the present case, Debtor likely would have been able to keep the home even if he filed under chapter 7 from the start. Debtor disclosed to the Trustee that he intended to reaffirm his mortgage debt owed to Servicer, as is allowed under section 524 and which would remove this debt from the bankruptcy proceedings. R. at 9; 11 U.S.C. § 524 ("An agreement between a holder of a claim and the debtor" is enforceable if the "consideration for which…is based on a debt that is dischargeable in a case under this title" to the extent "such agreement was made before the granting of the discharge…"). If Debtor had elected to file under chapter 7 from the get-go, the reaffirmation of the mortgage debt combined with the homestead exemption would allow Debtor to keep the home, while preventing the home from being pulled in as property of the estate. R. at 6, 9. Under the chapter 13 plan, Debtor successfully and timely paid not only towards the mortgage debt, but also to unsecured creditors and arrears for eight full months before falling victim to a global pandemic. This emphasizes that Debtor is committed to following through and paying the mortgage in order to save his home, and likely could have paid for longer if he was working to pay back Servicer's debt alone. However, Debtor in good faith chose a path that would provide the most parties the best outcome, even if he later needed to convert after contracting long-Covid. R. at 8. It is not logical, nor in line with overarching public policy, to punish Debtor for pursuing reorganization in good faith for the betterment of all interested parties.

It is against the purpose and policy of the Code to support a position that debtors will be worse off for having tried a plan of reorganization in good faith. *See* 3 Collier on Bankruptcy ¶

[1] In *Harris*, this Court held that "Chapter 13 is a voluntary proceeding in which debtors endeavor to discharge their obligations using postpetition earnings that are off-limits to creditors in a Chapter 7 proceeding. We do not regard as a 'windfall' a debtor's receipt of a fraction of the wages he earned and would have kept had he filed under Chapter 7 in the first place." *Harris*, 575 U.S. at 521. While the property at issue here is not wages, the same principle still holds – Debtor keeping the house with its appreciated value is what he would have kept even if he filed under Chapter 7 originally. *See also In re Barrera*, 22 F.4th at 1226.

348.02[1], at 348-28 (Alan n. Resnick & Henry J. Sommer, 16th ed. rev. 2017); H.R. Rep. No. 835, 103d Cong., 2d Sess. 57 (1994); *see also In re Hodges*, 518 B.R. at 445. By penalizing debtors this way, future debtors will be disincentivized from filing chapter 13. Such a reaction harms all parties involved, since creditors usually collect more under chapter 13 than chapter 7. *Harris*, 575 U.S. at 514. Although some may argue that occasionally debtors may be prioritized above the debt owed creditors, it is a core tenet of the Bankruptcy Code to prioritize a fresh start for debtors where they may rehabilitate and integrate back into society after making peace with their creditors. *In re Rockwell*, 968 F.3d at 20. When creating and amending the Code, Congress balanced the difficult choices that exemption limits can place on debtors with the economic harm faced by creditors – and yet, Congress still acknowledged through the statutory scheme that the purpose behind bankruptcy is to allow relief for the honest but unfortunate debtor. *Id.*

Based on the plain language of the Code – interpreted in light of the context of the statutory scheme as a whole – the increase in equity in Debtor's home inures to Debtor, not the property of the estate. Such a holding finds support under section 1327(b), which provides that the home vested in Debtor upon confirmation of the chapter 13 plan, and thus was not property of the estate moving forward. In fact, the Debtor's plan expressly provided that all property of the estate vested in the Debtor. R. at 8 ("…the bankruptcy court confirmed the Debtor's plan which incorporated by reference the settlement with the chapter 13 trustee and expressly provided that all property of the estate vested in the Debtor."; *see also Harris*, 575 U.S. at 519; *Bullard* 575 U.S. at 503. Even if this Court does not agree that the home is exempt from post-petition property of the estate, section 348(f), in conjunction with the snapshot rule, requires that debtors who convert in good faith fall under section 348(f)(1)(A) so that the property of the chapter 7 estate is determined as of the petition date, not the conversion date. If Congress did not intend to separate post-petition, pre-conversion additions to property, they would not have enacted section 348(f)(2), clearly marking a different snapshot in time to determine property of the estate when a debtor converts in bad faith. *See* 11 U.S.C. § 348(f)(2). In contrast, section 348(f)(1)(A) requires the property of the estate to be determined as of the petition date, not the conversion date, when a debtor acts in good faith. Interpreting the Code to mean otherwise goes against the United States Supreme Court rules of interpretation, as this would render section 348(f)(2)'s distinction for bad faith debtors superfluous. *See Roberts*, 566 U.S. at 101. Because Debtor did convert in good faith, the Court must look to the existing facts and circumstances of the property as of the time of the petition, which does not include the appreciation in value of Debtor's home. Therefore, the post-petition, pre-conversion increase in equity inures to Debtor, not the estate.

II. TRUSTEE MAY NOT TRANSFER AVOIDANCE AND RECOVERY POWERS TO ECLIPSE BECAUSE THESE POWERS ARE NOT PROPERTY OF THE ESTATE.

A "fundamental tenant of bankruptcy law is to provide an orderly and equitable distribution of a debtor's bankruptcy estate." *In re Bargdill*, 238 B.R. 711, 716 (Bankr. N.D. Ohio 1999). Such emphasis on fairness and efficiency permeates all aspects of a bankruptcy case. The trustee must act as an impartial guide who manages the bankruptcy proceedings and ensures the equitable treatment of all parties involved. *Id*. The Code instituting and prescribing certain powers to the trustee is evidence of Congress' intention to preserve the balance among all parties in interest.

The concept at issue here is whether a trustee may transfer avoidance powers as property of the estate. In response to this query, the circuits are split over what constitutes property of the estate in relation to section 547 and section 550 avoidance and recovery of preferential transfers. *Pitman Farms v. Arkk Food Co., LLC (In re Simply Essentials, LLC)*, 78 F.4th 1006, 1008 (8th

Cir. 2023); *In re Bargdill*, 238 B.R. at 721; *In re Sapolin Paints, Inc.*, 11 B.R. 930, 937 (Bankr. E.D.N.Y. 1981). However, the precise dilemma in the present case is whether the trustee's ability to avoid and recover alleged preferential transfers in and of itself constitutes property of the estate that may be sold to another party. When honing in on this particular question, the answer must be that Trustee's proposed sale of the alleged Pink Transfers is impossible: the funds in question are not property of the estate that may be transferred, as Debtor has no interest in them; and – even if the Court considered Debtor to retain an inchoate interest – only the Trustee may exercise section 547 and section 550 avoidance and recovery powers under the Code, not any other parties; thus, these powers cannot be sold to Eclipse.

a. The funds transferred to Pink by Debtor are not property of the estate.

Regardless of the circuit split on avoidance actions, the funds in question are not property of the estate in the first place because Debtor disposed of the funds prior to the petition date, which is the point in time at which the estate comes into existence. R. at 7; *see Beiger v. IRS*, 496 U.S. 53, 58-59 (1990); *In re Lindbergh Boulevard Corp.*, 128 B.R. 53, 56-59 (Bankr. E.D.N.Y. 1991); *see also* 11 U.S.C. § 101(54). Additionally, even if there was an interest previously, through the chapter 13 plan the trustee agreed to not pursue the funds. R. 7-8 ("The settlement was memorialized in a stipulation, wherein the chapter 13 trustee agreed that she would not seek to avoid and recover the payments made to Pink prior to the Petition Date."). Moreover, it is against the policy and purpose of the Bankruptcy Code to allow Eclipse to benefit from the funds to the detriment of other parties in interest. *See* 11 U.S.C. § 101 et. seq.; *In re Trailer Source, Inc.*, 555 F.3d 231, 238-45 (6th Cir. 2009); *In re Boyer*, 372 B.R. 102, 106 (D. Conn. 2007); *see also Union Bank v. Wolas*, 502 U.S. 151, 161 (1999).

Congress granted trustees the power in "exceptional cases" to "unwind" certain types of payments – deemed preferential to certain creditors – when necessary for the benefit of the estate as a whole. *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1663 (2019); 11 U.S. § 547(b), (c). Under section 547, the trustee may "avoid any transfer of an interest of the debtor in property." 11 U.S.C. § 547(b). Section 550 allows "the trustee [to] recover, for the benefit of the estate, the property transferred." 11 U.S.C § 550(a). This power to avoid a transfer is a condition precedent to the actual recovery of the funds. *Id.*; *see Wolas*, 502 U.S. at 160. In essence, this allows trustees to invoke these powers to claw back funds within the "narrow circumstances" when otherwise these funds would have been properly included in the bankruptcy estate. *Mission Prod. Holdings*, 139 S. Ct. at 1663.

Preference actions "are designed to accomplish two public policy goals." *In re Bargdill*, 238 B.R. at 721; *In re Wolas*, 502 U.S. at 160-161. First, to "ensur[e] that all creditors within the same class receive the same pro-rata share of a debtor's limited assets." *In re Bargdill*, 238 B.R. at 721. Secondly, "to reduce the incentive of creditors to rush and dismember a financially unstable debtor by allowing a bankruptcy trustee to recoup last-minute payments made to creditors." *Id*. Trustees may pursue these actions for the benefit of the estate. 11 U.S.C. §§ 547, 550. However, an initial hurdle the trustee must clear when pursuing a preference action is establishing that the funds in question are properly considered property of the estate. While this can be shown through the debtor retaining some interest in the funds, in the present case there is no such interest for the Trustee to pursue. 11 U.S.C. § 547.

Because Debtor disposed of these funds at issue, Debtor no longer had an interest in them – thus, the estate cannot have an interest in them. *See* 11 U.S.C. § 541(a)(1) (property of the estate is "all legal or equitable interests of the debtor *in property as of the commencement of the* case.") (emphasis added); *In re 100 Lindbergh Boulevard Corp.*, 128 B.R. at 56-59 (Duberstein, C.J.). Even if the Trustee argues the estate could claw back these payments as preferential, the funds were transferred to Pink before the petition date, which is when the actual bankruptcy estate comes into existence. *Mission Prod. Holdings, Inc.*, 139 S. Ct. at 1652. This Court has expressed the general bankruptcy rule that "the estate cannot possess anything more than the debtor did outside bankruptcy." *Id.* This is a staunch reason to keep avoidance powers "cabined – so they do not threaten the rule that the estate can take only what the debtor possessed before filing." *Id.*

Further, under the confirmed chapter 13 plan, the trustee agreed to not pursue the Pink Transfers. R. at 8. The prevailing counterargument is that upon conversion to chapter 7, the chapter 13 provisions no longer apply. *Harris*, 575 U.S. at 520. Thus, Trustee's view is that vesting of the property in the debtor via the chapter 13 plan no longer would count, and the Trustee could claw back funds that trustee claims the estate is now entitled to. However, this is a broad statement that does not necessarily apply to the present facts – while chapter 7 provisions would govern the bankruptcy proceedings moving forward, that does not mean that all traces of the chapter 13 proceedings disappear. For example, the petition date does not change. *Harris*, 575 U.S. at 517. The chapter 7 proceedings still respect the financial condition of the Debtor in relation to the chapter 13 proceedings. At the petition date, Debtor did not have an interest in these funds. Therefore, conversion to chapter 7 does not alter the facts, regardless of which Code sections govern future proceedings specifically relating to the liquidation process.

Particularly damning is the fact that Trustee did not merely compel turnover under section 542(a), which provides that an entity "in possession of property of the debtor that the trustee in bankruptcy can use, sell, or lease…deliver that property to the trustee." *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 202 (1983). In essence, 542(a) "grants to the estate a possessory interest in certain property of the debtor that was not held by the debtor at the commencement of reorganization proceedings." *Id*. If, in line with Trustee's contentions, Debtor retained an interest in the funds so that they qualified as property of the estate, Trustee could have simply ordered these funds to be turned over. However, Trustee chose not to follow this straightforward, widely-accepted course of action. R. at 8; *Whiting Pools*, 462 U.S. at 202. The Trustee not attempting to avoid or recover the Pink Transfers indicates that Trustee understood that the estate did not have a valid interest in these funds. R. at 9. It would render section 542(a) nonsensical to find that avoidance powers are property under section 541(a), but may not be turned over under section 542(a).

Debtor does not have an interest in the funds. If he did, the Trustee would have compelled turnover under section 542(a). Further, the chapter 13 trustee already agreed to not pursue these transfers. It is not fair to other parties in interest that the chapter 13 trustee did not pursue these transfers – so that these parties did not reap a benefit from these funds under the eight months of the plan – yet upon conversion and post-sale Eclipse would be able to collect the entire amount. R. at 9. Allowing such a result "impair[s] the ability of the bankruptcy court to coordinate proceedings, as well as the ability of the trustee to manage the estate" *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6-7 (2000) (*"Hen House"*). As expressed by this Court "equality of distribution among creditors is a central policy of the Bankruptcy Code." *Beiger*, 496 U.S. at 54. In this vein, "the power to avoid a preference is one which is to be exercised in the interest of securing equality of distribution among creditors." *In re Sapolin Paints, Inc.*, 11 B.R. at 937. Refusing to include the funds under the chapter 13 plan then selling the alleged interest to one specific creditor for its own personal benefit does not align with this goal. Truly, allowing the sale of the avoidance claim to Eclipse is not even fair to

Eclipse, as it would be improper for Eclipse to exercise this power due to the Code allowing only the Trustee to pursue preference actions this way. *See, e.g., In re Boyer*, 372 B.R. at 106.

b. Only a trustee is authorized to exercise avoidance and recovery powers under sections 547 and 550 of the Bankruptcy Code; thus, these powers cannot be transferred by sale to Eclipse.

A "close examination of this statutory section [reveals] that the only person explicitly authorized by the Bankruptcy Code to pursue a preference action is the bankruptcy trustee." *In re Bargdill*, 238 B.R. at 721. Although section 541(a) is generally thought of as rather broad in scope, its reach is not without limits, evidenced by Congress carving out avoidance powers in sections 544-553. *Mission Prod. Holdings, Inc.*, 139 S. Ct. at 1663. In fact, section 541(a)(3) plainly states that the "interest in property that the trustee recovers" is what becomes property of the estate, supporting that the power to recover itself does not constitute property. 11 U.S.C. § 541(a)(3). By singling out these avoidance actions and granting them specifically to trustees, Congress highlights the limitation on who may exercise avoidance powers. This textual, statutory grant of authority to the Trustee under sections 547 and 550 to avoid and recover on these actions therefore must exclude Eclipse.

Any perceived ambiguity in the word "trustee" under the Bankruptcy Code has already been resolved by this Court. *Hartford Underwriters Ins.*, 530 U.S. at 6-7. Sections 547 and 550 explicitly state "the trustee" may avoid and recover, without mention of additional parties. 11 U.S.C. §§ 547, 550. This Court has already clarified through *Hen House* that grants of power under the Code to the "trustee" do not include other parties. *Hartford Underwriters Ins.*, 530 U.S. at 6-7. If Congress had intended to broaden a power under a provision, "it could simply have said so, as it did in describing the parties who could act under other sections of the Code. Section 502(a), for example, provides that a claim is allowed unless a 'party in interest' objects, and [section] 503(b)(4) allows 'an entity' to file a request for payment of an administrative expense." *Id*. at 2.

Although *Hen House* dealt with this in the context of section 506(c), this Court explained that "provisions of the Bankruptcy Code that do not contain an express exclusion cannot sensibly be read to extend to all parties in interest." *Id*. According to the rules of statutory interpretation, this clarification of "trustee" meaning only the trustee applies throughout the Code, as it must be read in the context of the entire statutory scheme. *Roberts*, 566 U.S. at 101; *see also RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645 (2012) ("Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions."); *King v. St. Vincent's Hosp.*, 502 U.S. 215, 221 (1991).

The lack of any cross-reference between section 541 and section 547 avoidance powers further supports the conclusion that Congress meant solely the trustee when drafting "the trustee." 11 U.S.C. §§ 541, 547. If Congress intended otherwise, it could have included language such as "parties in interest" as it did in other sections of the Code. *Hartford Underwriters Ins.*, 530 U.S. at 7. By choosing not to, Congress made clear that "trustee" does not encompass other parties. Interpreting the Code otherwise goes against the canon against surplusage, because if Congress meant for "trustee" to extend to other parties, there would be no need to specify under other provision what parties have the provided powers. *Roberts*, 566 U.S. at 101. Such a view would also create an absurdity in other sections of the Code; for example, if a trustee's avoidance powers are property of the estate, these powers would vest in the debtor upon abandonment, which would be absurd. Combined with precedent from this very Court, it is evident that section 547 and section 550's explicit grant of power to the "trustee" means just that - only the trustee.

c. Even if the alleged interest in the transferred funds is considered property of the estate, the trustee's power to avoid the transfer is not.

The rules of statutory interpretation and United States Supreme Court precedent provide that the right of avoidance and recovery vested in the trustee by the bankruptcy code is not assignable. *In re Sapolin Paints, Inc.*, 11 B.R. at 937 (citing Collier on Bankruptcy, ¶ 60.57); *In re Bargdill*, 238 B.R. at 721; *Hartford Underwriters Ins.*, 530 U.S. at 7. This conclusion is further supported by the fact that even a debtor in possession is limited when exercising such powers, as "a debtor-in-possession may not exercise the avoidance powers of a trustee" when "no benefit to the estate will result." *In re Sapolin Paints Inc.*, 11 B.R. at 937. If a debtor in possession is restricted in this power, logically it follows that a creditor would not have more leeway in taking over powers rightfully belonging only to the trustee. In fact, "even where a contract explicitly purports to assign the right to set aside a preference, the court will give it no effect. *Id.*

Outside of the statutory allocation of these powers, bankruptcy policy – and public policy as a whole – supports bestowing the ability to avoid and recover preferential transfers solely on the trustee. As a neutral party "specifically designated by law to act impartially on behalf of a debtor's estate," the trustee is in the best position to ensure and enforce fairness in distribution of such property. *In re Bargdill*, 238 B.R. at 721. In this capacity, the trustee is inherently more neutral than a creditor pursuing an alleged preferential transfer, as the creditor may "have ulterior motives for pursuing the preference action," among them bolstering their own recovery at the detriment of other equally-situated creditors. *Id*. The trustee is in this position to act with a fiduciary duty to protect all interested parties. In contrast, creditors have no such duty, and thus must not be allowed to exercise trustee powers to harm the estate in pursuit of their own gain.

Trustee's argument rests on a rather creative interpretation of *Simply Essentials*, where the court argued that avoidance actions, as claims, must therefore be property of the estate, whether or not the debtor has a possessory interest. *In re Simply Essentials*, *LLC*, 78 F.4th at 1008. However, *Simply Essentials* is not focused on the same situation as the present case - there, the court states that "whether the avoidance action is brought by the trustee or by a creditor, the action is brought for the benefit of the estate and therefore belongs to the estate." *Id*. Here, that is not the case. Even if this Court assigns any weight to *Simply Essentials*' argument that some "inchoate or contingent interest held by the debtor prior to filing" may be looped in as property of the estate, *Simply Essentials* relies on the assumption that the action is brought for the benefit of the estate. *Id*. In the present case, Eclipse bringing this action would be to its own personal benefit, not the benefit of other creditors, since the entirety of the recovery benefit from the avoidance action would go solely to Eclipse.

In fact, the *Simply Essentials* court relies on pre-Code cases to bolster this argument, admitting in the opinion that this definition of property is "interpreting a previous version of the Bankruptcy Code." *In re Simply Essentials, LLC*, 78 F.4th at 1009. When faced with the indisputable argument that reading avoidance powers into section 541(a) creates surplusage in sections 544-553, the court glosses over this in a single short paragraph, tossing out the argument that Congress just may have "repeat[ed] itself" to create a "redundancy," and that "the possibility of our interpretation creating surplusage does not alter our conclusion." *Id.*; *see, e.g., Hibbs v. Winn*, 542 U.S. 88, 101 (2004) (The canon against surplusage). This flies in the face of widely accepted, general rules of statutory interpretation. *Roberts*, 566 U.S. at 101.

Yet another stanchion of support for Debtor's argument is the fact that the trustee's powers arise at the commencement of a bankruptcy case, not at random intervals throughout the proceedings. Section 541(a)(7) provides that the bankruptcy estate may include property accumulated "after commencement of the case." In contrast, a trustee's powers are granted under the Code at the creation of the estate, which is when the petition is filed. 11 U.S.C. § 541(a) ("The commencement of a case…creates an estate."). Further, trustee powers are not "acquired" as property may be– they are granted under the Code. 11 U.S.C. § 541(a)(7) ("Any interest in property that the estate acquires *after* the commencement of the case"). Trustee finds no support for her argument under section 541(a)(1), as this provision allows "interests of the debtor in property as of the *commencement of the case*." 11 U.S.C. § 541(a)(1) (emphasis added). The Trustee's power to avoid and recover transfers is not property of the debtor. Therefore, section 541(a)(7) would apply to resolve this query; however, section 541(a)(7) explicitly differentiates property "acquire[d] after the commencement" of the bankruptcy case. 11 U.S.C. § 541(a)(7). As such, the plain language of the Code provides that the Trustee's power to avoid and recover transfers is not property of the estate.

Allowing Eclipse to pursue the Pink Transfers would set a harmful precedent for creditors to pursue their own personal gain at the expense of other interested parties. This may encourage underhanded or unsavory behavior by parties seeking to grab more than their fair share, the very essence of which the Bankruptcy Code seeks to prevent by instituting a trustee. *In re Boyer*, 372 B.R. at 106. Even if other parties could exercise avoidance and recovery powers, because Eclipse would be recovering the funds for its own benefit, not the benefit of the estate, this cannot be allowed. Sections 547 and 550 vest avoidance and recovery powers solely in the trustee. *See Hartford Underwriters Ins.*, 530 U.S. at 6. Arguing that the proceeds of the sale would go back to the estate is a moot point, as the actual recovery of the avoided transfer would benefit Eclipse, not the estate. Therefore, Eclipse may not exercise section 547 or 550 powers – only the Trustee may avoid and recover preferential transfers.

Whether or not the Court finds that the Debtor maintains an interest in the funds, and even if the Court holds this is an avoidance action that can be considered property of the estate, the Trustee's actual power to avoid and recover these transfers is not property of the estate that may be assigned. Rather, these powers are a statutory grant of authority to the trustee alone. Congressional intent, the policies of the Bankruptcy Code, precedent from this Court, and the explicit language of the Code itself provide that avoidance and recovery powers belong only to the trustee. As such, these powers may not be sold to Eclipse - not only are they not property of the estate, but Eclipse is not authorized to exercise avoidance or recovery.

CONCLUSION

This Court should hold that the post-petition, pre-conversion increase in equity in Debtor's home belongs to the Debtor, not the estate; further, the Court should also find that the Trustee's power to avoid and recover preferential transfers may not be assigned to Eclipse.

Debtor is entitled to the appreciation in value in his home because (1) the home was not property of the estate after confirmation of the chapter 13 plan; (2) even if the home was considered property pre-conversion, the language, legislative history, and policies surrounding section 348(f) marks a clear line between when the courts must look to the petition date or the conversion date to determine property of the converted, chapter 7 estate. Debtor – converting in good faith – falls under section 348(f)(1)(A), so that the Court must look to the Petition Date to determine what is pulled into the estate. Because the increase in equity did not exist on the Petition Date, this equity is not included as property of the estate. Finally, (3) due to Debtor's intention to reaffirm his mortgage debt with Servicer and his allowed homestead exemption, Debtor likely would have kept the home if he filed under chapter 7 originally; therefore, holding that the appreciation in value inures to the estate would not only penalize a good faith debtor for attempting reorganization, but will serve to deter future debtors from filing under chapter 13.

Trustee's position is not only in the minority but also relies on tenuous case law and presents troubling implications for future bankruptcy proceedings. Trustee particularly looks to *Castleman*, where the court held that the definition of property under section 541(a) does not change from chapter 13 to chapter 7. However, that is not quite the argument at issue. In the present case, the issue is when such property would become and remain property of the estate. This question is answered by section 348(f) – good-faith Debtor's property of the chapter 7 estate is calculated as of the Petition Date, which the attributes, valuations, and characteristics of the property on that date frozen in time.

Additionally, the court in *Castleman* refused to acknowledge the legislative history behind section 348(f). The very purpose of adding section 348(f) to the Bankruptcy Code was to settle this debate about who gets post-petition appreciation in favor of the debtor. The congressional intent behind the 1994 Act has been analyzed and accepted as a way to distinguish between good and bad faith conversions, penalizing the bad faith debtors by moving the "snapshot" to the conversion date so that any appreciation in value would be lost to them. Any logical review of this section – especially when combined with the purpose and policy behind this section – reveal that Congress intended these increases in equity to inure to debtors, with the possibility of losing this value for bad faith as a deterrent to fraudulent behavior. The American legal system has widely accepted that Chapter 13 is the better path for debtors and creditors alike. The Bankruptcy Code affirmatively protects debtors' right to exercise conversion to a chapter 7 to encourage debtors to at least attempt to reorganize their debts before going through with liquidation proceedings. Holding that the home's appreciation in value inures to the estate, rather than to the Debtor, sets a precedent that directly opposes the purpose and policies underlying the Bankruptcy Code.

The Trustee may not sell the alleged preferential Pink Transfers to Eclipse because (1) the funds Debtor transferred to Pink before the Petition Date are not property of the estate, which comes into existence at the Petition Date; (2) only a trustee may exercise avoidance and recovery powers under the Bankruptcy Code pursuant to sections 547 and 550, so that (3) even if the Court found an interest in the transferred funds to be considered property of the estate, the Trustee's power to avoid and recover the transfer is not property of the estate – thus, Eclipse may not exercise these powers.

Congress purposely cabined the trustee's powers to avoid and recover in sections 544-553 of the Bankruptcy Code to support the general rule that the estate cannot possess more than the debtor did outside of the bankruptcy. Because Debtor did not possess these funds at the Petition Date, they are not inherently included in the property of the estate. If they were, Trustee would have simply compelled turnover of the funds under section 542(a). By choosing to not pursue the funds this way, Trustee's actions admit that this money was not considered part of the estate.

The plain language of sections 547, 550, and 541 – especially when viewed within the overall statutory scheme of the Bankruptcy Code – supports that the "trustee" specifically referred to in sections 547 and 550 means only the trustee. The lack of cross-references to section 541 (which could have possibly supported an argument that these sections involved property of the estate) is particularly telling, and bolsters the conclusion that Congress never intended to include these trustee-specific powers as property of the estate.

Trustee relies heavily on *Simply Essentials*, where the court argued that avoidance actions are property of the estate because they are claims, which may fall under section 541 property of the estate. However, this argument is not as solid as it may seem. *Simply Essentials* rests on the conclusion that the action is brought for the benefit of the estate, which is impossible at present because Eclipse would be recovering the funds for its own personal benefit, not the estate's. Additionally, this is premised on the idea that the claim would be pursued after the commencement of the case so that section 541(a)(7) would consider the pursuit of these funds through avoidance and recovery property. The fatal flaw in this argument is that the real issue lies in whether or not the *trustee's powers* – not just the funds – are property of the estate. The trustee's power to avoid and recover arises at commencement of the case, not at some indeterminate point afterwards. Further, these powers are statutorily granted, not accumulated, as the Code is written. Therefore, Trustee's argument that Simply Essential's must support a finding for Trustee is inherently flawed.

Perhaps most concerning is the added complications for the bankruptcy system if the Court supports the Trustee's view. Not only future debtors, but also creditors, trustees, bankruptcy practitioners, and judges will feel the effects of this Court's ruling on this issue. The trustee is under a fiduciary duty to protect the estate and act as a watchdog for any foul play. Creditors are under no such duty, and creating precedent that allows creditors to essentially create claims or causes of action against each other – to be fought about through the bankruptcy process without the oversight of the trustee – is in direct opposition to the purpose of the Bankruptcy Code. By allowing Eclipse to buy the alleged Pink Transfers, the Court would be granting a creditor preferential treatment for their own personal gain via a preferential transfer to the detriment of other similarly-situated creditors. This cannot be the result under not only the statutory language and congressional intent, but regarding the overarching goals of the American bankruptcy system. The first priority of the Code is to provide good faith debtors with a fresh start and to create harmony in society by rehabilitating these debtors back into the economy. Thus, finding that the trustee's explicitly awarded statutory power can be bartered and sold to a self-interested creditor to then attack another creditor – with a power that the creditor cannot properly exercise anyway – cannot be in line with the purpose and policy of the Bankruptcy Code.

WHEREFORE, **PREMISES CONSIDERED**, Respondent respectfully prays that this Court **AFFIRM** the decision of the United States Court of Appeals for the Thirteenth Circuit.

Respectfully Submitted,

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Team R. 36
Counsel for Respondent