TEAM 37

No. 23-0115

IN THE

Supreme Court of the United States

OCTOBER TERM, 2023

IN RE EUGENE CLEGG, DEBTOR

VERA LYNN FLOYD, CHAPTER 7 TRUSTEE, PETITIONER

V.

EUGENE CLEGG, RESPONDENT.

ON WRIT OF CERTIORARI FROM THE

UNITED STATES COURT OF APPEALS

FOR THE THIRTEENTH CIRCUIT

BRIEF FOR PETITIONERS

TEAM 37

COUNSEL FOR PETITIONER,

VERA LYNN FLOYD

QUESTIONS PRESENTED

I. Whether the post-petition, pre-conversion increase in equity of a debtor's property rightfully becomes a part of the bankruptcy estate, aligning with the plain meaning of the text of 11 U.S.C. §§ 348(f)(1)(A) and 541(a), when a case is converted from Chapter 13 to Chapter 7, thereby enhancing the estate's capacity to equitably satisfy creditor claims.

II. Whether, for the best interest of the estate, the Chapter 7 trustee may sell property of the estate, in this case preference actions under 11 U.S.C. §§ 547 and 550, pursuant to her statutory duty to maximize the value of the estate, when such a sale is strongly supported by the text of the Bankruptcy Code, its policy, and standard bankruptcy practice.

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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 FACTS

FACTUAL BACKGROUND

Unwise Investments. Eugene Clegg ("Debtor") became the owner of a niche, historic single-screen movie theater ("Theater") after his mother, Emily Clegg ("Ms. Clegg"), gave him controlling interest in the Theater around late 2011. *See* R. at 5. Notably, Debtor, who is not an experienced businessperson, derived his entire income from the "modest salary" he made from operating the Theater. *See id.* After a few years of operation, Debtor made a financially risky decision by deciding to borrow $850,000 from Eclipse Credit Union ("Eclipse") to renovate the ceiling of the Theater. *Id.* Although also a risky investment for Eclipse, the "unconditional, unsecured personal guaranty in an unlimited amount" provided by Debtor and the granting of first priority liens to Eclipse seemed sufficient security for them to extend the loan. *See id.* However, after coming in under budget for the renovation, Debtor made an even more questionable decision by donating the substantial loan excess of $75,000 rather than reinvesting it into the business or using it to pay off any portion of the loan. *See id.* Worse yet, Debtor did this without informing Eclipse, using the money given to him for business purposes for unauthorized, personal reasons. *See id.* Further adding to his liabilities, Debtor stipulated he was making mortgage payments on a $350,000 house ("House") to a mortgage servicer ("Servicer") using his "modest salary" at the time of these events. R. at 6.

The Theater Goes Under. Things started to fall apart when the COVID-19 pandemic hit in 2020, and Debtor's business had to completely shut down for nearly a year, incurring disastrous losses. *Id.* In an attempt to plug the holes in this sinking ship, Debtor amassed a significant amount of credit card debt, and even borrowed $50,000 from his mother, Ms. Clegg, as a last-ditch effort to sustain the Theater. *See id.* Unfortunately, these efforts could not keep the Theater afloat, and disappointing post-pandemic revenues could not save the Theater from eventually going under. *Id.*

Chapter 13 Proceedings. With no options left, Debtor filed his original Chapter 13 petition on December 8, 2021, to attempt to keep the Theater, the House, and try to work out a payment plan with his creditors, of which there were three: Eclipse, the Servicer, and Ms. Clegg. *See* R. at 6–7. Interestingly, Debtor tried to pay Ms. Clegg back $20,000 under the table just before filing for bankruptcy despite Eclipse's first priority liens on his assets. *See* R. at 7. This is significant given that at the time of petition, the bankruptcy estate solely consisted of the Theater and the House, so his assets were very slim to satisfy his debt obligations. *See id.* The House was stipulated at a $350,000 value, with Debtor retaining a $30,000 homestead exemption of that value. *Id.* Pursuant to his plan, Debtor owed a contingent amount to Eclipse which was originally estimated at $150,000 for the Chapter 13 plan, $25,000 of which was non-dischargeable. R. at 8. In fact, this amount was agreed to as a compromise by Eclipse in lieu of it pursuing a preference action against Ms. Clegg for the $20,000 pre-petition transfer. *See id.*

Chapter 7 Conversion. Despite having several opportunities to pay back his debts, Debtor's situation fell out of his control when he contracted COVID in September of 2022 and had to stop working, shutting down the Theater permanently. *See id.* With no income to continue paying into his Chapter 13 plan, Debtor converted his case to Chapter 7. R. at 8. Thereafter, Vera Lynn Floyd ("Trustee"), the Petitioner in this case, was appointed to serve as the Chapter 7 trustee and she promptly began to carry out her duty to maximize the value of the estate. *See* R. at 8–9. In accordance with this duty, Trustee sought to sell the House because it had appreciated in value by $100,000. R. at 9. Trustee filed a motion to sell the House to Eclipse because it would not only buy the Servicer out of its interests in the estate, but the equity gain on the House would also pay the majority of the remaining amount owed to Eclipse. *See id.* Further, Trustee attempted to include in the sale motion the right to purse the preference action for the $20,000 transfer that Debtor made to Ms. Clegg on the eve of the bankruptcy. *See* R. at 10. The value of this amount ultimately furthering the best interests of the estate. *See id.* Debtor objected to Trustee's motion to sell in its entirety, resulting in the original suit. R. at 10.

PROCEDURAL HISTORY

Trustee brought a motion to sell the House and its associated preference claim under 11 U.S.C. § 363(b) and the bankruptcy court sustained Debtor's objection to the sale. R. at 10. Trustee timely filed for appeal under 28 U.S.C. § 158(d)(2)(A), and, applying a *de novo* standard of review, the United States Court of Appeals for the Thirteenth Circuit affirmed. *Id.*

SUMMARY OF THE ARGUMENT

This case is all about making the bankruptcy process simpler and more efficient in achieving its goals to ensure creditors receive payment while also giving debtors a fresh start. Petitioner's argument relies on a unified and time-honored theory of plain statutory interpretation and is well supported by the Code's overarching balancing for both debtor relief and fairness towards creditors. On the contrary, Respondent advanced two inconsistent arguments that ignore the supremacy of the text and cherry-picks policy positions. Thus, the Court stands on much firmer ground for ruling in favor of Petitioner for a multitude of reasons.

First, the plain reading of 11 U.S.C. §§ 541(a) and 348(f) decisively states that post-petition, pre-conversion appreciation in equity of a debtor's property is included in the Chapter 7 bankruptcy estate as an appurtenant interest in that property. In a game of smoke and mirrors, Respondent tries to read in ambiguity where none exists by using off-topic legislative history and scant support from the common law. However, because the actual language of the Code is unambiguous and makes sense when taken in context with the Code as a whole, this Court's analysis of the issue should stop there. In fact, even if the legislative history is entertained it only reinforces the fact that Congress intended the equity appreciation to inure to the estate. Finally, not only does the text and legislative history compel that the appreciation inure to the estate, but such an outcome advances the important policy goals of the Code in maximizing the value of the estate to the benefit of all parties involved in the bankruptcy.

Second, the right to avoid and recover preferential transfers under 11 U.S.C. §§ 547 and 550 is included as property of the bankruptcy estate and is therefore able to be sold under 11 U.S.C § 363(b). This is directly mandated by the text of 11 U.S.C. § 541(a)(1) as well as (7) and is further supported by the intent of Congress in drafting the Bankruptcy Code to promote maximization of estate value and equal distribution of that value to creditors.

Thus, to better serve the policy of the Code, this Court should **reverse** the Thirteenth Circuit on both issues and **grant** Trustee's motion to sell the House and its appurtenant right to avoid and recover under 11 U.S.C. § 363(b).

ARGUMENT

Bankruptcy can be an incredibly messy process for all parties involved, but this case presents a golden opportunity to help make things simpler. After all, the end goal of bankruptcy is intended to be simple: pay off the creditors and give the debtor a fresh start with their finances. *Loc. Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (pointing out that this "purpose of the act has been again and again emphasized by the courts as being of public as well as private interest."). This is especially prominent in Chapter 7 bankruptcy where speed and efficiency are integral to the bankruptcy process. *See Czyzewski v. Jevic Holding Corp.*, 580 U.S. 451, 455–56 (2017) (emphasizing that Chapter 7 trustee's main priority is to liquidate assets of the estate). The Court can further these goals by acknowledging that Chapter 7 trustees should be the ones to make the important financial decisions in the interest of the estate without being unduly restricted by either the creditors or debtor. *See In re Glob. Emergency Res., LLC*, 563 B.R. 76, 84 (Bankr. S.D. Ga.

2016) (noting how a Chapter 7 trustee "streamlines the process."). Specifically, Chapter 7 trustees should be allowed to capitalize on the post-petition, pre-conversion equity gains on property of the estate for the benefit of the estate as a whole. *Toibb v. Radloff*, 501 U.S. 157, 163 (1991) (restating that one of the main goals of the bankruptcy process is to maximize the value of the estate). Further, Chapter 7 trustees should be allowed to sell the abilities to avoid and recover, preference actions that are part of the property of the bankruptcy estate, pursuant to their statutory duty to maximize the value of the estate. *See* 11 U.S.C. § 704(a)(1).

Importantly, this Court has a great deal of discretion to consider the merits of these issues on appeal as they are pure questions of law and are reviewed *de novo*. *Razavi v. Comm'r of Internal Revenue*, 74 F.3d 125, 127 (6th Cir. 1996) (highlighting that under *de novo* review, the reviewing court decides questions of law as if it were the original trial court on the matter). Thus, the central policy of Chapter 7 in providing speedy maximization of the value of the estate, when taken in context with the overall goal of the Bankruptcy Code to settle debts for the benefit of all parties involved, should serve as a foundational guidepost for the analysis of these issues.

I. POST-PETITION, PRE-CONVERSION APPRECIATION IN THE EQUITY OF A DEBTOR'S PROPERTY IS INCLUDED IN THE CHAPTER 7 BANKRUPTCY ESTATE.

Bankruptcy, by all accounts, is the final opportunity for debtors to manage debt, and the Bankruptcy Code is drafted in a way to provide an emergency middle ground for them and their creditors to resolve that debt. *See Grogan v. Garner*, 498 U.S. 279, 286 (1991). However, this final opportunity is a privilege afforded by the Bankruptcy Code, one that is not absolute and can be lost with continued delinquency because there is nowhere to meet in the middle when a debtor simply cannot afford to satisfy his debts. Accordingly, there are consequences to losing this privilege, and a conversion from Chapter 13 to Chapter 7 is just one possible consequence of being unable to meet debt obligations to creditors consistently, even under a Chapter 13 plan. *See Toibb*, 501 U.S. at 162. As a part of that lost privilege, debtors lose access to the convenience of a more structured, gradual Chapter 13 repayment plan, and the newly appointed Chapter 7 trustee has a new interest: liquidate the estate as efficiently as possible to the benefit of the estate. *See id.* at 163–64. Thus, courts may consider equities of the case still upon conversion, but the key is that there is no blanket protection of assets because the case is now under Chapter 7, and its distinct liquidation policy predominates. *See Harris v. Viegelahn*, 575 U.S. 510, 520 (2015) ("[w]hen a debtor exercises his statutory right to convert, the case is placed under Chapter 7's governance, and no Chapter 13 provision holds sway"). Keeping those principles in mind, the question of whether a property's increase in value belongs to the Chapter 7 bankruptcy estate is a simple one that is directly answered by the text of the Bankruptcy Code. 11 U.S.C. § 541(a). Section 541(a) unambiguously includes in the estate "*all legal or equitable interests of the debtor in property* as of the commencement of the case," and according to section 348(f)(1)(A) that property "shall consist of *property of the estate*, as of the date of filing of the petition . . . ." *Id.*; 11 U.S.C. § 348(f)(1)(A) (emphasis added). Unfortunately, the lower court decided to disregard this text, venturing off into tangential musings where it carefully cherrypicked support to twist the text against its logical meaning. This Court should not allow itself to be fooled by the lower court or Respondent's attempts to distort what is actually important in this case and all bankruptcy cases: sound policy supporting all parties involved in the bankruptcy and respect for the text of the Code. Accordingly, this Court should reverse the Thirteenth Circuit.

A. <u>The Analysis Should Start and End with the Text.</u>

As outlined above, the answer to the inquiry derives naturally from the unambiguous language of the relevant sections of the Bankruptcy Code, 541(a) and 348(f)(1)(A). *See* § 541(a) (including "all legal or equitable interests of the debtor in property" as part of the estate); §

348(f)(1)(A) (affirming that debtor's "property" consists of "property of the estate"). "Where . . . the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'" *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989) (quoting *Caminetti v. United States*, 242 U.S. 470, 485 (1917)). Further, when interpreting provisions of the Bankruptcy Code, this Court "has been reluctant to declare its provisions ambiguous." *In re Price*, 370 F.3d 362, 369 (3d Cir. 2004) (citing *Kelly v. Robinson*, 479 U.S. 36, 43 (1986)).

i. ***The text of the Code plainly states that appreciation of real property is part and parcel with the property itself.***

What is property of the bankruptcy estate is a question plainly answered by section 541(a) of the Bankruptcy Code. § 541(a) ("[t]he commencement of a case . . . creates an estate . . . comprised of all the following property, wherever located and by whomever held . . ."). This includes "proceeds, product, offspring, rents, or profits of or from property of the estate" and "any interest in property that the estate acquires after the commencement of the case." 11 U.S.C. § 541(a)(6)–(7). Logically, this is interpreted to include any changes in equity and property valuation for property that is part of the bankruptcy estate, as "[n]othing in [s]ection 541 suggests that the estate's interest is anything less than the entire asset, including any changes in its value which might occur after the date of filing." *In re Goetz*, 651 B.R. 292, 198 (B.A.P. 8th Cir. 2023) (internal citation omitted); *see also, e.g.*, *Wilson v. Rigby*, 909 F.3d 306, 308–09 (9th Cir. 2018) (explaining that all changes in value inure to the estate); *In re Orton*, 687 F.3d 612, 619 (3d Cir. 2012) (interpreting § 541(a)(6) to include appreciation of value as part of the estate); *Hyman v. Plotkin,* 967 F.2d 1316, 1321 (9th Cir. 1992) (holding that both post-filing appreciation and depreciation inures to the bankruptcy estate). Applying this same reasoning, countless courts have found that value is an inseparable characteristic of that property in a variety of contexts. *See, e.g.*, *Crane v. Comm'r of Internal Rev*., 331 U.S. 1, 6 (1947) (finding that 'property' is inseparable from its gains and losses); *In re Adams*, 641 B.R. 147, 151 (Bankr. W.D. Mich. 2022) (finding that the *value* of estate property includes any appreciation to the property); *In re Larzelere*, 633 B.R. 677, 683 (Bankr. D.N.J. 2021) (stating that "appreciation cannot be separated from the underlying real estate."). Additionally, this Court has even acknowledged a construction of "property of the estate" identical to how many courts have interpreted section 541(a). *Rousey v. Jacoway*, 544 U.S. 320, 325 (2005) ("upon the filing of a petition for bankruptcy, 'all legal or equitable interests of the debtor in property' become the property of the bankruptcy estate . . . .") (quoting § 541(a)(1)).

Specifically, this interpretation has been applied to cases extremely similar to the one at bar. *See In re Goins*, 539 B.R. 510, 516 (Bankr. E.D. Va. 2015). The debtor first filed for relief under Chapter 13, and, at the time, the debtor's property was valued at $98,000. *Id.* However, the debtor later converted his case to one under Chapter 7. *Id.* In between the original petition and the conversion, his property had appreciated in value. *Id.* When inquiring to whom that appreciation would vest, the *Goins* court concluded that the trustee was entitled to the post-petition appreciation in the property because "the real estate was always the property of the estate under [s]ection 541(a) of the Code." *Id.* at 515. A similar result was reached in *Castleman* where the Ninth Circuit also was faced with a case of property appreciation in the process of a Chapter 13 to 7 conversion, and primarily relied on sections 541(a) and 348(f)(1)(A) in holding that it inures to the benefit of the estate. *In re Castleman*, 75 F.4th 1052, 1056–58 (9th Cir. 2023). Rooted in the direct text of the Bankruptcy Code, the overwhelming amount of authority supporting the specific point that equity appreciation inures to the estate demonstrates that this issue is simply answered by the Bankruptcy Code itself.

ii. The plain language interpretation is in harmony with the rest of the Bankruptcy Code.

Contrary to the lower court's insistence, the plain language treatment of equity gains on bankruptcy estate property is logical not only in isolation but especially when read in conjunction with other provisions of the Bankruptcy Code. *See Kelly*, 479 U.S. at 43 (holding it is important to "look to the provisions of the whole law, and to its object and policy."); *King v. St. Vincent Hosp.*, 502 U.S. 215, 221 (1991) (holding that a "cardinal rule" of statutory interpretation is reading the code as a whole).

For one, even though this case is a Chapter 7 issue first and foremost, the prior Chapter 13 provisions still support the notion that the appreciation of the property should inure to the estate. Section 1327(b) of the Code generally states that interests vest in the debtor upon confirmation of a Chapter 13 plan, but then several more specific provisions highlight the situations in which this is and is not the case. 11 U.S.C. § 1327(b); *see, e.g.*, § 348(f)(1)(A) (stating that property of the estate vests in the estate); 11 U.S.C. § 541(a)(6) (excluding post-petition earnings from estate); 11 U.S.C. § 541(b) (listing ten different types of assets excluded from the estate). It is a commonsense rule of statutory interpretation that the more specific provisions should govern over the more general ones, and since section 348(f)(1)(A) is more specific than section 1327(b), it should predominate. *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384–85 (1992); *see also RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645 (2012) ("To eliminate the contradiction, the specific provision is construed as an exception to the general one."). However, Respondent may attempt to make the argument that the interest vested in Debtor at the time of the Chapter 13 confirmation, but even if that were somehow true, it is at most a lazy rehashing of their atextual, already poorly-supported arguments and ultimately falls even further short because Chapter 13 policy lacks any mandatory force in a Chapter 7 case. 11 U.S.C. § 103(i) ("Chapter 13

... applies only in a case under [that] chapter."). Just for its guidance value alone, it is much more logical to adopt the reading of Chapter 13 which harmonizes the provisions of the Code and gives effect to the more specific provisions that follow section 1327(b). *See King*, 502 U.S. at 221 ("Words are not pebbles in alien juxtaposition; they have only a communal existence; and not only does the meaning of each interpenetrate the other, but all in their aggregate take their purport from the setting in which they are used . . . .") (internal citation omitted).

In a similar vein of fallacious arguments, the lower court attempted to push a reading of section 348 that makes it seem like the proper reading of (f)(1)(A) would render (f)(2) surplusage, but this is a misleading and false characterization of the law. R. at 13. Read properly, section 348(f)(2) punishes conversion in bad faith by including "property of the estate *as of conversion*." 11 U.S.C. § 348(f)(2). Thus, this goes much further than just including any increase in equity on property already in the bankruptcy estate and lumps in all sorts of post-petition earnings, assets, and income streams that are otherwise exempt from the bankruptcy estate. *See Viegelahn*, 575 U.S. at 518. The correct reading of the two provisions would recognize that the property already in the estate and its attached interests and values carry over with conversion from the original petition date, while any actual post-petition property or assets would only ever be included in the estate as punishment if the debtor converts in bad faith. *See City of Chicago v. Fulton*, 592 U.S. 154, 159 (2021) (as the lower court cites, "interpretation should not 'render superfluous another part of the same statutory scheme.'").

Another instance of the lower court's flawed argumentation is that it purports the "snapshot rule" of section 522 to contradict an interpretation of the Code that would include equity gains on estate property because the section 522 exemption valuation would be frozen, but the equity would not be. *See* 11 U.S.C. § 522; R. at 14. This argument completely misses the mark because that argument presupposes that the Code had identical intentions for exemptions and for property valuations, which is simply not the case. Property valuations have no equitable element to them and exist as a mechanical encapsulation of the property and its appurtenant value and/or interests which are used in sale decisions only when it would benefit the estate. *See Castleman*, 75 F.4th at 1058 (describing valuation as a "happenstance of market conditions"). Exemptions, however, are an equitable interest that is specifically meant to benefit the debtor. *See, e.g.*, Victor D. López, *State Homestead Exemptions and Bankruptcy Law: Is It Time for Congress to Close the Loop?* 7 RUTGERS BUS. L.J. 143, 146 (2010) (main purpose of exemptions in Code was to allow debtors to keep some property and/or assets after a bankruptcy judgment); *Law v. Siegel*, 571 U.S. 415, 422 (2014) (highlighting that exempted amounts are not required to satisfy administrative fees of estate).

To clarify the mechanics of this, take the example of the house in *Castleman* which is very analogous to the case at issue. *See Castleman*, 75 F.4th at 1054. In that case, the debtors were only benefitting from equity gains on their home because they were in a booming real estate market. *See id.* If the market were, however, to take a downturn, then the debtors would lose value on the house and be further indebted to their creditors in the event of a sale. *See id.* at 1058. In practice, the house would not be sold if it harmed the debtor because no one privy to the bankruptcy would benefit from that, it would only potentially be sold in a booming market to the benefit of the estate. *See id.* However, the same would not be true for an unfrozen exemption, which would, in fact, hurt the debtor in a down market as their assets would effectively decrease just by virtue of being in a decreasing real estate market. *See id.* Therefore, it is logical and better serves the policy of the Code to have the value of the property unfrozen because it could benefit but never hurt the debtor while keeping the exemption frozen to prevent it from ever tangibly harming the debtor.

In sum, the plain textual understanding that equity appreciation inures to the benefit of the estate is only made stronger by comparing the text to the whole Bankruptcy Code, and the alleged contradictions that the lower court mentioned are resolved by proper interpretation of the relevant statutory provisions.

B. Legislative History, if Analyzed, Leads Back to the Same Conclusion as the Textual Analysis.

Because the text of the Code is unambiguous, this Court should not even entertain a legislative history analysis. *See Edwards v. Valdez*, 789 F.2d 1477, 1482 (10th Cir. 1986) ("When the meaning of the statute is clear, it is both unnecessary and improper to resort to legislative history to divine congressional intent."); *see also Goetz*, 651 B.R. at 299 ("The plain meaning of the statute is conclusive, except in the 'rare cases [in which] the literal application of the statute will produce a result demonstrably at odds with the intention of its drafters.'"). The reason why this Court has been so hesitant and careful with legislative history is that it opens a dangerous door to judicial policymaking because almost any proposition on either side of the issue can be supported somehow by legislative history. *Exxon Mobil Corp. v. Allapattah Servs., Inc.*, 545 U.S. 546, 568 (2005) (reciting Leventhal's famous quote that judicial usage of legislative history is like "looking over a crowd and picking out your friends."). Moreover, relying heavily on legislative history in the face of clear statutory language and a large consensus of common law is a blatant form of judicial overreach. *See Comm. Nat'l Bank v. Germain*, 503 U.S. 249, 253–54 (1992) ("[C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there."). Further, another reason textually centered interpretation is preferred is that legislation stems from compromise, and likewise, the final product of the statute was carefully drafted and debated, a process which is severely undermined when courts surgically select specific lines from hearings, debates, or reports as representative of the will of Congress as a whole. *See*

Wyeth v. Levine, 555 U.S. 555, 601 (2009) (Thomas, J., Concurring). Therefore, the lower court's premature analysis of legislative history is inappropriate because it is prejudiced by the court's own preferences and ignores the holistic legislative process, including the debates, amendments, and compromises that shape the final text of the law.

However, even if this Court were to consider the legislative history for argument's sake, it only reinforces the interpretation derived from the statute's plain text. For its attempt at the legislative history argument, the lower court relies heavily on the 1994 House Report for its claim that "Congress clearly intended for any post-petition, pre-conversion interests in property to be retained by the Debtor." R. at 15. However, the lower court is frankly bluffing because there is zero support for such a proposition in that report, nor anywhere else in the legislative history. *See* H.R. REP. 103-835, at 57 (1994). What is particularly disingenuous is that this amendment was not even intended to address this issue—as the lower court claims—but focuses entirely on newly acquired property pre-conversion that could previously get lumped into the bankruptcy estate upon conversion. *See In re Castleman*, 631 B.R. 914, 919 (Bankr. W.D. Wash. 2021) (noting that both cases referenced in the proposed amendment "dealt with new assets acquired after the date of petition, not value changes to existing assets."). This goal was accomplished by section 348(f)(1)(A) because it only includes property in 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 . . ." which forecloses the possibility of pre-conversion assets getting included in the estate. § 348(f)(1)(A) (emphasis added).

As pointed out by the court in *Goins*:

> [T]he example in the legislative history to § 348 . . . arguably sheds light on the 'paydown cases,' [but] is not helpful, however, in determining which party, the Debtor or the Trustee, is entitled to the equity created by appreciation of the property while the Debtor is in Chapter 13.

See 539 B.R. at 516. Likewise, and completely contrary to the lower court's assertions, the 2005 amendments to the Bankruptcy Code fill in the gap by providing outright that valuations of the property under Chapter 13 do not apply to Chapter 7 cases in a conversion. 11 U.S.C. § 348(f)(1)(B) (providing, in relevant part, that "valuations of property [under Chapter 13] . . . shall apply . . . *but not in a case converted to a case under Chapter 7*.") (emphasis added). This strong, textually supported body of evidence stands in stark contrast to the lower court, which, in the judicial game of picking its friends out of the crowd, decided to make one up. Such tactics are as dishonest as they are dangerous to the integrity of the Bankruptcy Code and are an excellent case study of why legislative history should only be considered sparingly.

C. Policy Considerations Fall in Favor of Finding that Appreciation in Equity Belongs to the Bankruptcy Estate.

The entire point of bankruptcy is to provide for both the efficient repayment of creditors and the fresh start that debtors need. *See Lac du Flambeau Band of Lake Superior Chippewa Indians v. Coughlin*, 599 U.S. 382, 390 (2023). The different Chapters of the Bankruptcy Code all ultimately try to achieve that goal but through distinct means. *See Viegelahn*, 575 U.S. at 513–15. Chapter 13, for example, tries to give debtors a chance to meet a regular payment plan and satisfy their debts without losing any assets. *See id.* By contrast, Chapter 7 is narrowly concentrated on liquidation of the estate, prioritizing speed and value over structure. *See id.* ("Chapter 7 allows a debtor to make a clean break from his financial past, but at a steep price: prompt liquidation of the debtor's assets."). Speaking broadly, one of the main purposes of conversion between the Chapters is to give debtors a chance to try a payment plan and, should they fail to make their payments, convert to Chapter 7 without being any worse off. *See id.* (describing how easily conversion can take place); *see also* 11 U.S.C. § 1307(a) (allowing conversion "at any time" and making any waiver of the right to convert unenforceable). This policy is entirely consistent with the plain text of the relevant provisions of the Bankruptcy Code discussed above that would have the appreciation inure to the benefit of the estate, as none of them punish the debtor for trying a payment plan before converting to Chapter 7, and, in fact, may benefit the debtor by their design. *See, e.g.*, *Castleman*, 75 F.4th at 1058 (debtor benefits in a down real estate market from proper operation of §§ 348(f)(1)(A) and 522); § 348(f)(2) (debtor's post-petition assets are categorically excluded from the converted estate unless he converts in bad faith). Conversely, adopting the lower court's approach will only frustrate the goals of the Code, conflating Chapter 7 and 13 policies and bogging down the resolution of debts under the weight of unnecessary litigation. *See Castleman*, 75 F.4th at 1058. Therefore, this Court should accept the plain textual interpretation not only because it makes the most sense given the text of the Code and the legislative history behind it, but also because it produces the best policy outcomes for all parties involved.

i. In the realm of Chapter 7, allowing the trustee to maximize the estate makes sense to alleviate debts.

While Chapter 13 and similar Chapters provides a debtor with the opportunity for debt reorganization and financial management, Chapter 7's focus is primarily on the efficient liquidation and resolution of cases. *See Pioneer Inv. Servs. Co. v. Brunswick Assocs. Ltd. P'ship.*, 507 U.S. 380, 389 (1993). Because of its distinct liquidation focus, Chapter 7 can home in on maximizing value for the estate and efficiently satisfying its debts. *See Metro. Airports Comm'n v. Northwest Airlines, Inc.*, 6 F.3d 492, 494 (7th Cir. 1993) ("One of the Code's central purposes [is] the maximization of the value of the bankruptcy estate for the benefit of the creditors."). Thus, although it may be more mechanical in application, the Chapter 7 approach still aligns with the core objective of the Bankruptcy Code, which is to provide a fair and equitable settlement for creditors while offering a fresh start to debtors, albeit at a potentially steeper cost than under another Chapter. *See Viegelahn*, 575 U.S. at 513–14 (noting how under Chapter 7 debtor must give up most assets but is still able to retain income to get a fresh start). Importantly, Chapter 7 is extremely common, and a majority of personal bankruptcy proceedings end up under the Chapter either right away or via conversion, so making sure it is governed by sound policy is imperative. *See id.* at 514 (citing an empirical study that "only one in three cases filed under Chapter 13 ends in discharge."); *see also In re Eiland*, 170 B.R. 370, 372 (Bankr. N.D. Ill. 1994) (acknowledging the practical fact that "most Chapter 13 confirmed plans fail to complete.")

Therefore, to stay consistent with the thrust of Chapter 7, the trustee should decide which asset sales would be most beneficial to the estate, of course ultimately checked by the approval of bankruptcy courts. *See* 11 U.S.C. § 704(a)(1). In the increasingly common case of home equity appreciation, a sale decision may be decisive in resolving the entire bankruptcy and, under the careful supervision of the trustee and the bankruptcy court, may rightfully be chosen as the most prudent route for the wellbeing of the estate. *See* Christopher G. Bradley*, Rising Home Values and Chapter 13: Who Gets the Benefit?*, 43 NO. 6 BANKR. L. LETTER NL 1 (2023) (citing empirical metrics that some home values increased as much as 40% nationwide since 2020). While the lower court's approach of retaining the appreciated value of one's home may offer debtors temporary comfort, this approach attempts to graft Chapter 13 policy into Chapter 7, which ultimately frustrates the purpose of Chapter 7. *See Viegelahn*, 575 U.S. at 520 (noting how Chapter 13 policy has no "sway" upon conversion to Chapter 7). Such confusion not only practically frustrates the ultimate goals of timely resolving the bankruptcy and providing the debtor with a fresh start but also opens the floodgates of litigation that would undermine the purpose of Chapter 7. *See* Bradley *supra* (analyzing cases like *Barrera* as debtors try to argue for loopholes in the Code to allow them to keep their home equity gains). Thus, just coming from the perspective of this being a Chapter 7 case, the policy strongly supports having the appreciation inure to the benefit of the estate to set the right standard and allow the purposes of the Chapter to continue without unnecessary frustration.

ii. Including the appreciation of property in a Chapter 7 bankruptcy makes sense in a broad application to all debtors.

Following the 2005 amendments to the Bankruptcy Code, section 348(f)(1)(B) was amended to explicitly exclude Chapter 13 valuations from the Chapter 7 estate, giving the parties a "second bite at the valuation apple." *In re Airhart*, 473 B.R. 178, 185 (Bankr. S.D. Tex. 2012). With that in mind, holding that any change in equity belongs to the Chapter 7 bankruptcy estate is the only robust and timeless solution that protects the debtor while still ensuring efficient payment of debts. *See Castleman*, 75 F.4th at 1058. Further, by grounding this decision in the unambiguous language of the Code, this Court's precedent on the issue can remain consistent and reliable irrespective of future market dynamics. *See id.*

Contrary to the lower court's reasoning, including appreciation in the converted Chapter 7 estate does not lead to inequitable results because, ultimately, such an inclusion just becomes a part of the maximization exercise undertaken by an unbiased trustee. *See* 11 U.S.C. § 704 (it is the trustee's duty to decide how to dispose of the estate for the "best interests of parties in interest."). Although, at face value, the policy stance advocated for in the lower court's majority opinion may seem favorable to debtors, it can expose them to the risk of a market downturn and prevent the trustee from doing anything to help. *See id.* Under such a rule, if the debtor benefits from post-petition appreciation, the debtor would also be responsible to the Chapter 7 trustee for any depreciation in value. *See In re Lang*, 437 B.R. 70, 72 (Bankr. W.D.N.Y 2010) (discussing the depreciation of a debtor's vehicle that occurred between the debtor's initial filing of Chapter 13 and converting to Chapter 7). Understandably wanting to avoid that outcome, the court in *Lang* concluded that the debtor had no obligation to account for vehicle value lost to depreciation for the four years that the Chapter 13 case was pending. *Id.* at 73–74. Conversely, embracing the lower court's faulty reasoning may serve as a deterrent to debtors from even attempting repayment under Chapter 13. *See Castleman*, 75 F.4th at 1058. Therefore, the better approach would be to include any change in equity within the Chapter 7 bankruptcy estate because it is a balanced, equitable, and pragmatic solution that supports the overarching principles of the Code.

iii. Including the appreciation of property in a Chapter 7 bankruptcy estate makes sense in a narrow application in this case.

In the present case, allowing the equity appreciation on the House to inure to the estate would satisfy the remaining debts burdening the estate and give Debtor a clean slate. This increase in equity is the only realistic way that Debtor's estate can pay off even a portion of what is still owed to the creditors. *See* R. at 9. This is important because the estate is extremely encumbered while Debtor is still living in a half-million-dollar home. *See* R. *generally*.

Although Debtor may want to live above his means, it is much more sensible to use the money from the equity appreciation to pay off his lingering debts, as the total appreciation would add $100,000 to the value of the estate. R. at 9. Conveniently, this would completely pay off one of his creditors (Servicer) and cover the vast majority of his remaining debts while still providing him with a $30,000 retention via his homestead exemption to fall back on his feet after the resolution of the estate. Surely, this is a much more desirable outcome for all parties involved and sets up Debtor with a much more stable foundation for his fresh financial start. Accordingly, this Court should **reverse** the Thirteenth Circuit's holding.

II. AVOIDANCE AND RECOVERY ACTIONS ARISING UNDER SECTIONS 547 AND 550 OF THE BANKRUPTCY CODE CONSTITUTE PROPERTY OF THE ESTATE UNDER SECTION 541(A) AND THUS MAY BE SOLD BY THE CHAPTER 7 TRUSTEE PURSUANT TO SECTION 363(B).

Section 547(b) of the Bankruptcy Code provides that the trustee, subject to other elements and defenses not relevant here, may avoid preferential transfers of an interest of the debtor in property made to a creditor within one year before the bankruptcy filing if the creditor transferee was an insider at the time of the transfer. 11 U.S.C. § 547(b)(1)-(5). Section 550(a) enables the trustee to recover, for the benefit of the estate, the property or value thereof after the transfer has been avoided under section 547. 11 U.S.C. § 550(a). These provisions "facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor. Any creditor that received a greater payment than others of his class is required to disgorge so that all may share equally." *Union Bank v. Wolas*, 502 U.S. 151, 160–61 (1991) (citing H.R. REP. NO. 95-595, at 177-78 (1977), U.S.C.C.A.N. (1978), at 6137–38). Accordingly, the trustee, after notice and a hearing, may sell property of the estate. 11 U.S.C. § 363(b)(1). Thus, since the trustee's abilities to avoid and recover preferential transfers under sections 547 and 550 are property of the estate, the trustee may sell them.

Section 541(a) of the Code defines what is included as property of the estate. 11 U.S.C. § 541(a). Because creditors are paid from estate property, "it is necessary and desirable that the property included in the bankruptcy estate be as inclusive as possible." 11 U.S.C. § 726(a); *see also* 5 COLLIER ON BANKRUPTCY P 541.01 (16th ed. 2023). Indeed, it was Congress's express intention that section 541 be interpreted broadly, and this Court has in fact consistently done so. *See* H.R. REP. NO. 95–595, at 367 (1977); S. REP. NO. 95–989, at 82 (1978); *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204 (1983) ("Congress intended a broad range of property to be included in the estate"); *Segal v. Rochelle*, 382 U.S. 375, 86 (1966) ("the term 'property' has been construed most generously”). The trustee’s abilities to avoid and recover preferences under sections 547 and 550 are, therefore, property of the estate under section 541(a)(1) and (7). This interpretation is supported by standard bankruptcy practice and Congress’s intent for the value of the estate to be maximized and for creditors to receive equal distribution from the estate.

For these and the following reasons, this Court should reverse the Thirteenth Circuit and hold that a Chapter 7 trustee’s abilities to avoid and recover transfers under sections 547 and 550 of the Bankruptcy Code are property of the bankruptcy estate under section 541(a), and thus, may be sold under section 363(b).

A. A Chapter 7 Trustee’s Abilities to Avoid and Recover Preferential Transfers Under Sections 547 and 550 of the Bankruptcy Code are Property of the Estate Under Section 541(a)(1).

Section 541(a)(1) provides that the estate includes “all legal and equitable interests of the debtor in property as of the commencement of the case.” 11 U.S.C. § 541(a)(1). Thus, to be included as property of the estate under section 541(a)(1), the trustee’s abilities to avoid and recover preferential transfers must satisfy two distinct elements: (1) these abilities must be “property” and (2) if they are property, the debtor must have either a “legal or equitable interest” in them. *Id.*

i. A Chapter 7 trustee’s abilities to avoid and recover preferential transfers are property under section 541(a)(1).

As this Court has noted, Congress specifically intended the scope of section 541(a)(1) to be broad. *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204–05 (1983) (citing H.R. REP. No. 95–595, at 367 (1977); S. REP. No. 95–989, at 82 (1978)). Specifically, Congress intended property of the estate under section 541(a)(1) to include “all kinds of property, including tangible or intangible property, [and] *causes of action*.” H.R. REP. No. 95–595, at 367 (1977) (emphasis added). Consistent with the legislative history of section 541(a)(1), “[n]umerous courts have interpreted the definition set forth in the section to include causes of action.” *In re Murray*

Metallurgical Coal Holdings, LLC, 623 B.R. 444, 508 (Bankr. S.D. Ohio 2021); *In re Simply Essentials, LLC*, 78 F.4th 1006, 1008 (8th Cir. 2023) ("Causes of action are interests in property and are therefore included in the estate"). This Court has also supported that causes of action are included in estate property. *United States v. Nordic Vill. Inc.*, 503 U.S. 30, 37 (1992) ("§ 550 is clearly a 'claim' . . . and is 'property of the estate'"); *Claim*, BLACK'S LAW DICTIONARY (11th ed. 2019) (defining claim as a cause of action).

Moreover, avoidance actions, such as the trustee's right to avoid and recover pre-petition transfers, are "causes of action" under the plain language of the Code under sections 101(5)(A) and 926(a). *Compare* 11 U.S.C. §§ 547, 550 *with* 11 U.S.C. § 101(5)(A) ("The term 'claim' means a right to payment" whether or not such right is contingent, legal, or equitable); 11 U.S.C. § 926(a) (referring to sections 547 and 550 as causes of action). Consistent with the Code, courts have regularly described avoidance actions as "causes of action." *See Murray Metallurgical*, 623 B.R. at 508 (collecting cases). This Court too has acknowledged that the avoidance and recovery provisions—the specific provisions at issue—create "causes of action." *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 353 (1985) ("the trustee must investigate the conduct of prior management to uncover and assert *causes of action* against the debtor's officers and directors") (citing 11 U.S.C. §§ 704(4), *547*, 548) (emphasis added); *see Nordic Vill.*, 503 U.S. at 37 ("§ 550 is clearly a 'claim' . . . and is 'property of the estate'"). Thus, the avoidance and recovery actions created by sections 547 and 550 are "property" and are "property of the estate" if the debtor has any "legal or equitable" interest in these avoidance actions "as of the commencement of the case." § 541(a)(1).

ii. A debtor has an equitable interest in avoidance actions as of the commencement of the case.

Under section 541(a)(1), debtors have an equitable interest in "any property made available to the estate by other provisions of the Bankruptcy Code." *Whiting Pools*, 462 U.S. at 205. The debtor need not have a possessory interest in property as of the commencement of the case for such property to be included in the estate. *Id*. In fact, under section 541(a)(1), interests of the debtor that are contingent are also included as property of the estate. *See Segal v. Rochelle*, 382 U.S. 375, 379, 386 (1966); *see also* H.R. REP. NO. 95–595, at 367 (1977) (Congress intended all property that was previously included in the estate under the Bankruptcy Act of 1938 to continue to be included under the Bankruptcy Reform Act of 1978 and adopted this Court's analysis in *Segal*). These cases standing alone support that the Debtor in the present case had an equitable interest in the avoidance actions because they are "property" and "made available to the estate" by sections 547 and 550 of the Code. *See Whiting Pools*, 462 U.S. at 205. Likewise, debtors need not have a possessory interest in the avoidance actions prior to the commencement of the case. *Id*.

The Eighth Circuit's recent decision in *Simply Essentials* further supports that debtors have equitable interests in avoidance actions prior to the commencement of the case. *See* F.4th at 1009. In that case, the court considered whether avoidance actions are property of the estate under section 541(a)(1) and ultimately held that they are. *Id.* The court began by recognizing that avoidance actions are causes of action and, as such, are interests in property. *Id.* Next, the court considered whether the avoidance actions were "interests of the debtor in property" for them to be considered property of the estate under section 541(a)(1). *See id.*; § 541(a)(1). The court answered the question in the affirmative, holding that under this Court's precedent, "the estate includes inchoate or contingent interests held by the debtor prior to the filing of bankruptcy" and "any property made available to the estate by other provisions of the Bankruptcy Code." *Id.* (citing *Segal*, 382 U.S. at 379); *see also Whiting Pools*, 462 U.S. at 205. The court held:

> Avoidance actions are used to undo transfers made by the debtor prior to the commencement of bankruptcy that were made voidable by the Bankruptcy Code. Because debtors have the right to file for bankruptcy and the debtor in possession or the Trustee may file avoidance actions to recover property, the debtor has an inchoate interest in the avoidance actions prior to the commencement of the bankruptcy proceedings. Therefore, avoidance actions are property of the estate under § 541(a)(1).

Simply Essentials, 78 F.4th at 1009.

Similarly, a bankruptcy court recently held that actions to avoid preferential transfers are property of the estate under section 541(a)(1). *Murray Metallurgical*, 623 B.R. at 508-10. In its well-reasoned opinion, the court began with the principle that, under section 541(a)(1), property of the estate is broad in scope and "[n]numerous courts have interpreted the definition set forth in § 541(a)(1) to include causes of action." *Id.* (internal quotations omitted) (collecting cases). The court continued to explain that courts consistently describe avoidance actions, such as section 547, as "causes of action." *Id.* (collecting cases). Like the Eighth Circuit in *Simply Essentials*, the court cited to this Court's opinion in *Whiting Pools* for the proposition that estate property under section 541(a)(1) includes "any property made available to the estate by other provisions of the Bankruptcy Code," and reasoned that the avoidance provisions make available to the estate the avoidance causes of action. *See id.* (citing *Whiting Pools*, 462 U.S. at 204–05). The court concluded that causes of action to avoid pre-petition preferential transfers "exist 'as of the commencement of the case,'" and are property of the estate under 541(a)(1). *Id.*; § 541(a)(1).

Section 550 of the Code is a cause of action used to undo transfers made by the debtor before bankruptcy that were made voidable by, among other sections of the code, section 547. *See* 11 U.S.C. §§ 547 and 550. Actions arising under sections 547 and 550 of the code are "causes of action," and are therefore, property interests. *See Commodity Futures Trading Comm'n*, 471 U.S. at 353; *Nordic Vill.*, 503 U.S. at 37; H.R. REP. NO. 95–595, at 367 (1977); *Simply Essentials*, 78

F.4th at 1009; *Murray Metallurgical*, 623 B.R. at 508-10. Moreover, these property interests are included as property of the estate under section 541(a)(1) for two reasons: (1) because the causes of action arising under sections 547 and 550 of the Code are property interests that are "made available" by those sections, and (2) the debtor had a contingent equitable interest in the causes of action arising under those sections prior to his bankruptcy filing, and thus "as of the commencement of the case." § 541(a)(1); *Whiting Pools*, 462 U.S. at 204–05; *Segal*, 382 U.S. at 379; *Simply Essentials*, 78 F.4th at 1009. That the Debtor in this case had a contingent equitable interest in the causes of action is strengthened by the reasoning of the Eighth Circuit: the debtor at all times had a right to file for bankruptcy. *See Simply Essentials*, 78 F.4th at 1009. Therefore, because property of the estate under section 541(a)(1) includes causes of action, contingent interests, and "any property made available to the estate by other provisions of the Bankruptcy Code," the avoidance actions arising under sections 547 and 550 are property of the estate under section 541(a)(1) and may be sold under section 363(b). *See* § 541(a)(1); *Simply Essentials*, 78 F.4th at 1009; *Segal*, 382 U.S. at 386 (1966); *Whiting Pools*, 462 U.S. at 205; § 363(b).

B. <u>A Chapter 7 Trustee's Abilities to Avoid and Recover Preferential Transfers Under Sections 547 and 550 of the Bankruptcy Code are Property of the Estate under Section 541(a)(7).</u>

Section 541(a)(7) provides that the property of the estate includes "[a]ny interest in property that the estate acquires after the commencement of the case." 11 U.S.C. § 541(a)(7). In addition to being property of the estate under 541(a)(1), causes of action arising under sections 547 and 550 of the Bankruptcy Code are interests that the estate acquires "after the commencement of the case" pursuant to section 541(a)(7). 11 U.S.C. § 541(a)(1), (7).

Avoidance actions are "interest[s] in property" under section 541(a)(7) just as they are under section 541(a)(1). *Murray Metallurgical*, 623 B.R. at 508. Thus, the only question to be answered for the purposes of section 541(a)(7) is whether avoidance actions are acquired by the estate ***after*** the commencement of the case. § 541(a)(7). Under the plain language of the Code, the property rights that the avoidance provisions create accrue to the estate after the commencement of the case. *See, e.g.*, 11 U.S.C. §§ 301, 701, 547, 550. Specifically, section 301(a) provides that "[a] voluntary case under a chapter of this title *is commenced* by the filing with the bankruptcy court a petition under such chapter by . . . a debtor" and section 301(b) clarifies that "[t]he *commencement* of a voluntary case under a chapter of this title constitutes an order for relief under such chapter." 11 U.S.C. § 301 (emphasis added). Section 701(a)(1) plainly states that "[p]romptly ***after*** the order for relief under this chapter, the United States trustee shall appoint one disinterested person . . . to serve as interim trustee in the case." 11 U.S.C. § 701(a)(1) (emphasis added). Thus, in a Chapter 7 case, the estate acquires, by operation of law, the causes of action arising under sections 547 and 550 of the Code "after the commencement of the case" when the Chapter 7 trustee is appointed because only after the trustee is appointed may the trustee bring the causes of action or sell them as property of the estate under section 363(b). *See id.*; 11 U.S.C. §§ 547, 550, 363(b).

Applying similar logic in *Simply Essentials*, the Eighth Circuit held that "avoidance actions clearly qualify as property of the estate under subsection (7)." 78 F.4th at 1009. There, the court rejected the argument that property could be created in a third period of time, "a time that is equivalent to the moment the bankruptcy proceeding commences," because "[f]inding such a period of time existed would frustrate the bankruptcy policy of a broad inclusion of property in the estate[.]" *Id.* (internal quotation and citation omitted). Further, that avoidance actions are included in the estate under section 541(a)(7) is supported by several courts. *See, e.g.*, *Murray Metallurgical*, 623 B.R. at 512; *In re Greenhaw Energy, Inc.*, 359 B.R. 636, 642 (Bankr. S.D. Tex. 2007) ("causes of action that arise from the administration of the chapter 11 estate are property of the estate. This principle is codified in 11 U.S.C. § 541(a)(7)”); *In re Brown*, 2004 WL 5846460, at *2 (Bankr. N.D. Ga.) (once a case is commenced, “the estate automatically acquires a cause of action to seek avoidance of voidable transfers” under 541(a)(7)).

Giving effect to the plain text of the Code and the opinions of a myriad of courts, the property interests created by the avoidance and recovery actions arising under sections 547 and 550 vest in the estate after the commencement of the case. Therefore, these avoidance actions are property of the estate under section 541(a)(7) and may be sold under section 363(b). *See* §§ 541(a)(7), 363(b).

C. <u>The Code’s Inclusion of Avoidance Actions as Property of the Estate is Supported by Standard Bankruptcy Practice and Congress’s Intent for Creditors to Receive Equal Distribution.</u>

Providing even further support, the inclusion of avoidance actions as property of the estate is supported by numerous courts. *See Murray Metallurgical*, 623 B.R. at 509 (collecting cases). For example, the First, Fifth, and Seventh Circuits have all held that a claim for fraudulent conveyance is property of the estate. *In re Ontos, Inc.*, 478 F.3d 427, 431 (1st Cir. 2007) (“it is well established that a claim for fraudulent conveyance is included under § 541(a)(1)”); *In re Moore*, 608 F.3d 253, 262 (5th Cir. 2010); s*ee Nat'l Tax Credit Partners v. Havlik*, 20 F.3d 705, 708–09 (7th Cir. 1994) (“[T]he right to recoup a fraudulent conveyance . . . is the property of the estate”). Moreover, the Ninth and Seventh Circuits, along with a myriad of other courts, have permitted the sale of avoidance actions without considering whether avoidance actions constitute property of the estate. *See Mellon Bank N.A. v. Dick Corp.*, 351 F.3d 290, 292 (7th Cir. 2003); *In re Lahijani*, 325 B.R. 282, 288 (B.A.P. 9th Cir. 2005) (“trustee avoiding powers may be transferred for a sum certain.”); *see also Murray Metallurgical Coal*, 623 B.R. at 509 (“Courts in Chapter 11 cases regularly approve motions to sell assets that include requests to sell avoidance actions") (collecting cases).

Furthermore, including avoidance actions as property of the estate "facilitate[s] the prime bankruptcy policy of equality of distribution among creditors of the debtor." *See Wolas*, 502 U.S. at 160–61 (citing H.R. REP. NO. 95-595, at 177-78 (1977), U.S.C.C.A.N. (1978), at 6137, 6138). Cases like the present one, where the estate lacks the funds to pursue avoidance claims, are already common. R. at 9; *see In re Trailer Source, Inc.*, 555 F.3d 231, 244 (6th Cir. 2009) ("in contrast to Chapter 11 reorganization proceedings, in Chapter 7 liquidation proceedings there are often no funds remain[ing] to divide among creditors or to finance a suit to set aside a fraudulent conveyance.") (internal quotations omitted). It would surely be an absurd result, as well as against the clear intent of Congress, to allow a preferred creditor to receive a windfall and retain the transferred property for herself while other creditors get nothing. *See id.*; *In re Simply Essentials, LLC*, 640 B.R. 922, 930 (Bankr. N.D. Iowa 2022), *aff'd,* 78 F.4th 1006 (8th Cir. 2023). The Bankruptcy Court in *Simply Essentials* considered this potential for a windfall and reasoned that "Congress well knew that most estates would have no such funds to pursue claims and would not have created such robust causes of action that could not be pursued in most cases." *Simply Essentials*, 640 B.R. at 930. Thus, that court properly concluded that avoidance actions are property of the estate, and it would be the most harmonious with the text and policy of the Code for this Court to do the same. *See id.*

D. No Authority Supports a Holding that Avoidance Actions are not Property of the Estate.

The cases where courts have held the trustee's abilities to avoid and recover transfers to not be "assignable" are inapposite because they did so without considering whether they are property of the estate under section 541(a), and thus available for the trustee to sell under section

363(b). Rather than considering "whether a chapter 7 trustee may sell, as property of the bankruptcy estate, the ability to avoid and recover transfers"—the question raised on this appeal—these cases focus on whether creditors have standing to ***assert*** avoidance actions, a question not raised on this appeal. R. at 2; *see also In re Bargdill*, 238 B.R. 711, 721 (Bankr. N.D. Ohio 1999) (holding that only the trustee may pursue a preference action without considering whether the action was property of the estate); *In re Harrold*, 296 B.R. 868, 872-74 (Bankr. M.D. Fla. 2003) (same); *In re Sapolin Paints, Inc.*, 11 B.R. 930, 937 (Bankr. E.D.N.Y. 1981) (same); *In re Waterford Funding, LLC*, 2017 WL 439308, at *2 (Bankr. D. Utah) (holding that only the trustee may pursue a fraudulent transfer action without considering whether the action was property of the estate); *Parker v. Hand*, 132 N.E. 467, 469 (Ill. 1921) (same); *In re Clements Mfg. Liquidation Co.*, 558 B.R. 187, 189 (Bankr. E.D. Mich. 2016) (holding "the Chapter 7 Trustee in this case may not assign any of the avoidance actions as he seeks to do in the proposed settlement" without considering whether those actions were property of the estate).

Moreover, even if creditor standing was relevant to the sale of estate property, the majority of courts have affirmed that creditors can bring avoidance actions, including the Second, Third, Sixth, Seventh, Eighth, and Ninth Circuits. *See, e.g.*, *Glinka v. Murad (In re Housecraft Indus. USA, Inc.)*, 310 F.3d 64, 70–72 (2d Cir. 2002); *Off. Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery*, 330 F.3d 548, 580 (3d Cir. 2003) (en banc); *In re Trailer Source, Inc.*, 555 F.3d 231, 239 (6th Cir. 2009); *Fogel v. Zell*, 221 F.3d 955, 965–66 (7th Cir. 2000) (approving of derivative standing in dicta); *PW Enters., Inc. v. N.D. Racing Comm'n (In re Racing Servs., Inc.)*, 540 F.3d 892, 898 n. 7 (8th Cir. 2008).

This Court has consistently recognized that bankruptcy courts are courts of equity that apply equitable principles in the administration of bankruptcy proceedings. *Young v. United States*, 535 U.S. 43, 50 (2002). In this equitable role, bankruptcy courts are not chained to mechanical rules and are afforded flexibility to ensure that the purpose of the Code is given effect. *See Holmberg v. Armbrecht*, 327 U.S. 392, 396 (1946); *Mitchell v. Robert DeMario Jewelry, Inc.*, 361 U.S. 288, 292 (1960). Section 105(a) of the Code is consistent with these principles and provides that "the court may issue any order, process, or judgment that is necessary to carry out the provisions of this title." 11 U.S.C. § 105(a). When Congress enacted sections 547 and 550, it announced its clear intent that preferential transfers made on the eve of bankruptcy should be clawed back into the estate. 11 U.S.C. §§ 547(b), 550(a). When, in cases such as this one, the trustee lacks the funds to pursue preferential transfers, courts may exercise their equitable powers to give effect to the avoidance and recovery provisions by permitting a creditor to bring these actions. *See Cybergenics*, 330 F.3d at 569 ("the ability to confer derivative standing ... is a straightforward application of bankruptcy courts equitable powers.").

While the standards courts use to determine whether creditors may be given standing to bring avoidance actions differ, this Court should adopt the approach followed by the Ninth and Second Circuits: creditors may have standing to bring avoidance and recovery actions when the creditor has the permission of the trustee and approval of the court. *See In re Indus. Housecraft*, 310 F.3d 64, 71 (2d Cir. 2002); *Pro. Inv. Props. of Am.*, 955 F.2d 623, 626 (9th Cir. 1992). This approach aligns with the bankruptcy court's equitable powers to give effect to the Code. *See* 11 U.S.C. § 105(a); *DeMario Jewelry*, 361 U.S. at 292. Moreover, this approach allows the trustee to fulfill her duty to maximize the estate by selling avoidance actions in cases where the trustee lacks the funds to bring them herself while simultaneously ensuring that the sale is in the best interest of the estate by way of judicial oversight. *See* 11 U.S.C. § 704(a)(1); *see Housecraft*, 310 F.3d at 71. Likewise, under this standard, courts can ensure that the sale results in a "benefit of the estate" as required by section 550(a) for avoided transfers to be recovered. *See Housecraft*, 310 F.3d at 71; *see also Mellon Bank*, 351 F.3d at 293 ("§ 550(a) is satisfied by an indirect benefit to the estate, and the point hardly seems arguable even as an original matter").

Additionally, any argument relying on this Court's decision in *Hartford Underwriters* for the proposition that creditors may not be conferred standing to avoid and recover preference actions is misplaced. *See Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 13 n.5 (2000). This Court specifically noted that its holding was ***only*** that creditors do not have an "an independent right to use § 506(c)." *Id.* Moreover, "since *Hartford Underwriters* every court of appeals to address derivative standing to pursue avoidance claims has affirmed the practice's validity." *Trailer Source*, 555 F.3d at 239. Thus, under the overwhelming weight of authority, any standing issues potentially raised by Respondent are nothing short of a red herring and have no place in deciding the outcome of this case.

E. Allowing the Right to Avoid and Recover to Be Sold as Property of the Estate Would Produce the Best Policy Outcomes.

As applied here, holding that Trustee may sell the right to avoid and recover, as property of the estate, furthers the principle aims of the Bankruptcy Code by allowing her to maximize the value of the estate and ensure equal distribution among creditors. *See* § 704(a)(1). Debtor owes somewhere around $500,000 to all his creditors combined and the estate has no prospects of satisfying these debts because it is without assets. R. at 9 (Trustee found the estate "bereft of assets."). Allowing Trustee to include the right to avoid and recover in the motion to sell would generate further value for the estate, as Eclipse may be willing to pay a premium to have that right, driving up the total sale price. *See* R. at 9 (Eclipse offered to pay $120,000 when equity only increased by $100,000). Not only that, but Eclipse can cover the litigation and administrative fees associated with pursuing the action which would otherwise burden the estate. *See Matter of*

Taxman Clothing Co., 49 F.3d 310, 315 (7th Cir. 1995) (holding that a trustee has a duty to minimize the administrative expenses of the estate). Thus, even though the estate lacked the funds to pursue avoidance and recovery actions, Trustee would still fulfill her statutory duties, the estate would be maximized, and the creditors would be able to receive equal distribution all because Trustee could recover a sale price for the claims. *See* 11 U.S.C. §§ 704(a), 726(a), 547(b), 550(a), 363(b). A holding that includes the avoidance and recovery actions under sections 547 and 55 as property of the estate under 541(a) is the only way that these prime bankruptcy policies of the Code could conceivably be supported because it would allow for the sale of these property interests under section 363(b). *See* §§ 726(a), 704(a), 547(b), 550(a), 363(b).

To hold otherwise, by contrast, would fly in the face of the Code, these prime bankruptcy policies, and the opinions of countless courts. Estate value would not be maximized, especially in cases like the present one, because Chapter 7 trustees often do not have the resources to pursue avoidance and recovery under sections 547 and 550. *See id.*; *Trailer Source*, 555 F.3d at 239 (noting that the cost would otherwise fall on the estate); 726(a); 704(a). Furthermore, creditors would not receive equal distribution. *See Wolas*, 502 U.S. at 160–61; §§ 547(b), 550(a). To the contrary, in cases where the estate lacks the funds to bring the avoidance and recovery actions, any creditor that received a preferential transfer on the eve of bankruptcy could keep the property transferred—directly contravening Congress's intent that creditors receive equal distribution. *See Simply Essentials*, 640 B.R. at 930 ("Congress well knew that most estates would have no such funds to pursue claims and would not have created such robust causes of action that could not be pursued in most cases."). This would create a truly absurd result. *Id.* The Bankruptcy Court in *Simply Essentials* said it best: "The Code, case law, and common sense" require that avoidance and recovery actions be included as property of the estate. *See id.*

For all these reasons, this Court should **reverse** and hold that the causes of action arising under the avoidance and recovery provisions of sections 547 and 550 are property of the estate under 541(a), and, consequently, are available for the trustee to sell pursuant to 363(b).

CONCLUSION

In conclusion, the crux of this issue ultimately comes back to the central policy of the Code, which is to satisfy the debts owed to creditors and give debtors a new financial beginning. Allowing the Chapter 7 Trustee to fulfill her statutory duty will not only produce the best individual outcome here but also set lasting standards on highly relevant issues of law in the bankruptcy landscape today. Accordingly, this Court should hold that the post-petition, pre-conversion equity increase in the estate should inure to the benefit of the estate so that the Trustee can make the best financial decision for the wellbeing of the estate concerning the increase in value. Additionally, this Court should hold that the right to avoid and recover preferential transfers is property of the estate, and can be sold by the Chapter 7 Trustee when it is in the best interest of the estate, as in this case. Likewise, Petitioner respectfully requests that this Court **reverse** the judgment of the United States Court of Appeals for the 13th Circuit and **grant** the motion to sell the House and its associated preference claim under 11 U.S.C. § 363(b).

Dated: January 18, 2024

Respectfully Submitted,

/s/ Counsel for Team 37
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