No. 23-0115

In the

Supreme Court of the United States

IN RE EUGENE CLEGG, DEBTOR

VERA LYNN FLOYD,

Petitioner,

v.

EUGENE CLEGG,

Respondent.

ON APPEAL FROM THE
UNITED STATES COURT OF APPEALS
FOR THE THIRTEENTH CIRCUIT

BRIEF FOR THE RESPONDENT

TEAM NUMBER 38
COUNSEL FOR RESPONDENT

JANUARY 18, 2024

QUESTIONS PRESENTED

I. Does an increase in equity of a home inure to the benefit of the debtor, who has filed for Chapter 13, but later converted to Chapter 7, when the increase in equity occurred after the date of the original Chapter 13 was filed but before the case was converted?

II. May a trustee sell the power to avoid and recover preferences under sections 547 and 550?

TABLE OF CONTENTS

TABLE OF AUTHORITIES

United States Supreme Court Cases

Federal Court of Appeals Cases

Bankruptcy Appellate Panel Cases

Federal District Court Cases

Statutes

Other Authorities

OPINIONS BELOW

The United States Court of Appeals for the Thirteenth Circuit's decision is available at No. 22-0359 and reprinted at Record 3. The bankruptcy court decided in favor of Corporal Eugene Clegg, the debtor. On appeal, the United States Court of Appeal affirmed the bankruptcy court's holding.

STATEMENT OF JURISDICTION

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

RELEVANT STATUTORY PROVISIONS

The case at bar involves interpretation of certain provisions of Title 11 of the United States Code and are as follows:

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

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

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

> **(a)**The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
>
> > **(1)**Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.
> > **(7)** Any interest in property that the estate acquires after the commencement of the case.

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

> **(b)** Except as provided in subsections (c) and (i) of this section, the trustee may, 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 the filing of the petition, if such creditor at the time of such transfer was an insider; and
>
> **(5)** that enables such creditor to receive more than such creditor would receive if-
>
> **(A)** the case were a case under chapter 7 of this title;
>
> **(B)** the transfer had not been made; and
>
> **(C)** such creditor received payment of such debt to the extent provided by the provisions of this title.

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

> **(a)** Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from--
>
> **(1)** the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
>
> **(2)** any immediate or mediate transferee of such initial transferee.

STATEMENT OF THE CASE

I. FACTUAL HISTORY

The seeds of this controversy were sown in 2012, when Corporal Eugene Clegg ("Cpl. Clegg"), a retired veteran, acquired a 100% membership interest in Final Cut, LLC ("Final Cut") from his mother, Emily Clegg ("Pink"). R. at 5. Final Cut, which owned and operated a single-screen movie theater in the City of Moot, provided Cpl. Clegg's sole source of income for years. R. at 5. In 2016, Cpl. Clegg caused Final Cut to borrow $850,000 from Eclipse Credit Union ("Eclipse") for the purpose of renovating the theater. R. at 5. Eclipse retained and perfected a priority lien on Final Cut's real and personal property, and Cpl. Clegg also executed an unsecured personal guaranty in an unlimited amount. R. at 5.

Final Cut completed the renovations without exhausting the proceeds of the loan from Eclipse, due in large part to the generosity of local veterans who volunteered to assist Cpl. Clegg. R. at 5. To demonstrate his gratitude, Cpl. Clegg caused Final Cut to donate the remaining proceeds, approximately $75,000, to Veterans of Foreign Wars ("VFW") in early 2017. R. at 5. Final Cut was solvent at that time and continued to be profitable for 3 years after the renovation. R. at 5-6.

Sadly, that profitability was interrupted in March 2020, when the Governor of the State of Moot issued a public health emergency due to the COVID-19 pandemic, rendering the theater inoperable for nearly a year. R. at 6. Cpl. Clegg was forced to borrow, on an unsecured basis, $50,000 from Pink in September 2020. R. at 6. The theater reopened in February 2021, but attendance failed to rebound to pre-pandemic levels. R. at 6. To remedy the Final Cut's cash flow problems, Cpl. Clegg elected to forego his salary, leaving him without a reliable source of income. R. at 6. As a result, Cpl. Clegg incurred significant credit card debt and fell months behind on his home mortgage. R. at 6. Another Brick in the Wall Financial Corporation (the "Servicer"), the servicer of the home mortgage, then commenced foreclosure proceedings. R. at 6.

Hanging onto his home in quiet desperation, Cpl. Clegg filed for Chapter 13 bankruptcy on December 8, 2021 (the "Petition date"). R. at 6. The value of Cpl. Clegg's home at that time was $350,000, and Cpl. Clegg claimed a state law homestead exemption of $30,000 pursuant to 11 U.S.C. § 522(b). R. at 6-7. Cpl. Clegg owed the Servicer a non-contingent, liquidated and undisputed secured debt of $320,000, and owed Eclipse a non-contingent, unliquidated and unsecured debt of an unknown amount. R. at 6. Cpl. Clegg also disclosed on the Statement of Financial Affairs that he had made $20,000 in payments to Pink within one year of filing for bankruptcy. R. at 7.

Cpl. Clegg filed a Chapter 13 plan in which he proposed to make payments over a 3-year period, cure the pre-petition arrears, and make ongoing monthly payments to the Servicer. R. at 7; *see also* 11 U.S.C. §§ 1322(b)(5), 1326(c). The plan also stated that Cpl. Clegg maintained no equity in his home as of when he filed for bankruptcy and proposed to fund the plan through Cpl. Clegg's future earnings derived from Final Cut, which the parties expected to return to profitability. R. at 7; *see also* 11 U.S.C. § 1325(a)(6).

The Chapter 13 trustee objected to the Chapter 13 plan for failing to meet the requirement that each creditor receives under the plan no less than it would receive in a Chapter 7 liquidation. R. at 7; *see also* 11 U.S.C. § 1325(a)(4). The trustee based this objection on the allegedly preferential transfers Cpl. Clegg made to Pink in the year before the Petition date. R. at 7. To resolve the objection, Cpl. Clegg agreed to increase the aggregate payments to creditors by $20,000 over the period of the plan, and the trustee agreed that she would not seek to avoid or recover the allegedly preferential transfers. R. at 7-8. At the meeting of the creditors, Eclipse learned of Cpl.

Clegg's donation of $75,000 to VFW and commenced a proceeding seeking to have Cpl. Clegg's debt related to the loan declared non-dischargeable under 11 U.S.C. § 523(a)(2)(A). R. at 7. Eclipse then objected to Cpl. Clegg's Chapter 13 plan as not being proposed in good faith. R. at 8; *see also* 11 U.S.C. § 1325(a)(3). However, Eclipse agreed to withdraw this objection in exchange for a claim of $150,000, of which $25,000 was deemed non-dischargeable even in the event of conversion. R. at 8. The bankruptcy court confirmed Cpl. Clegg's Chapter 13 plan, which incorporated by reference his agreement with the trustee, and separately approved the agreement between Cpl. Clegg and Eclipse. R. at 8.

Cpl. Clegg operated Final Cut and made timely payments under the Chapter 13 plan for eight months. R. at 8. Unfortunately, Cpl. Clegg contracted COVID in September 2022, which forced him to stop working at Final Cut. R. at 8. The theater permanently closed in October 2022, and Eclipse commenced foreclosure proceedings against Final Cut. R. at 8. Cpl. Clegg, left without a way to make payments under his Chapter 13 plan, desperately decided to convert the case to Chapter 7, and all interested parties agreed that Cpl. Clegg converted the case in good faith. R. at 8. In her final report, the Chapter 13 trustee reported that she had distributed $10,000 to the Servicer under the plan, and that she returned to Cpl. Clegg the funds held in reserve for Eclipse. R. at 8-9. The bankruptcy court appointed Vera Lynn Floyd ("Floyd") to administer Cpl. Clegg's Chapter 7 estate. R. at 9.

The conversion schedules showed, as of the Petition date, a value of $350,000 on Cpl. Clegg's home, that Cpl. Clegg still owed Eclipse a debt of approximately $200,000, and disclosed the allegedly preferential transfers to Pink. R. at 9. In his statement of intention, Cpl. Clegg declared his goal to reaffirm the mortgage he owed to the Servicer and remain in his home. R. at 9; *see also* 11 U.S.C. § 524(c). Floyd initially concluded that the bankruptcy estate was mostly bereft of assets, but during the Chapter 7 meeting of creditors, Cpl. Clegg mentioned that home values in his neighborhood had increased. R. at 9. Floyd commissioned an appraisal of Cpl. Clegg's home, which revealed that the home's non-exempt equity had increased by $100,000 since the Petition date. R. at 9. Floyd then began marketing the home for sale, and Eclipse offered to purchase the home and the alleged preference claim against Pink for $470,000. R. at 9.

II. PROCEDURAL HISTORY

Floyd petitioned the bankruptcy court for permission to sell Cpl. Clegg's home and the alleged preference claim. R. at 9. Cpl. Clegg objected to both of these requests, arguing that the increase in the equity of his home should inure to his benefit and that Floyd could not sell her ability to avoid and recover transfers. R. at 10. The bankruptcy court agreed with Cpl. Clegg's arguments and held accordingly, and the United States Court of Appeals for the Thirteenth Circuit affirmed on both issues. R. at 10. The court held that a post-petition, pre-conversion increase in equity belongs to the debtor based upon Congressional intent. R. at 15, 16. The court further held that a trustee cannot sell the power to avoid and recover preferences under sections 547 and 550, because rather than being included in the "property of the estate," these are statutory powers belonging only to the trustee. R. at 17.

STANDARD OF REVIEW

The issues before this Court are based on statutory interpretation of the Bankruptcy Code and are therefore purely questions of law. *See Chandris, Inc. v. Latis*, 515 U.S. 347, 369 (1995). Thus, the standard of review is *de novo*. *See Salve Regina College v. Russell*, 499 U.S. 225, 231 (1991).

SUMMARY OF THE ARGUMENT

This Court should affirm the decision of the United States Court of Appeals for the Thirteenth Circuit ("Thirteenth Circuit"), which upheld the decision of the United States Bankruptcy Court for the District of Moot, denying Floyd's Sale Motion.

First, the Thirteenth Circuit correctly found that post-petition, pre-conversion increases in equity are not property of the estate. Section 348(f)(1)(A) of the Code is ambiguous, and, thus, the plain language cannot be considered in isolation. When interpreting any part of the Bankruptcy Code, it is a "cardinal rule" that it "be read as a whole, . . . since the meaning of statutory language, plain or not, depends on context." *King v. St. Vincent's Hosp.*, 502 U.S. 215, 221 (1991). Considering § 348(f)(1)(A) alongside §§ 348(f)(2) and 522 reveals that the statute's plain language is insufficient to determine if post-petition appreciation of estate property constitutes property of a converted estate. Furthermore, courts' diverging interpretations of what constitutes estate property under § 348(f)(1)(A) also highlights the statue's ambiguity. As such, the Thirteenth Circuit correctly turned to the legislative history behind 348(f)(1)(A).

Congress enacted § 348(f) to clarify the composition of the bankruptcy estate upon conversion. Prior to 1994, courts failed to reach a consensus as to whether property of an estate converted under § 348 included that which existed as of the date of filing, or which the debtor possessed at the date of conversion. As a result, Congress adopted the reasoning of *In re Bobroff*, which noted that limiting a converted Chapter 7 estate to property that existed as of the date of filing the original bankruptcy case furthers Congress' goal to incentivize debtors to file for Chapter 13 bankruptcy. 766 F.2d 797, 803 (3rd Cir. 1985). Since the House Report, the majority of courts tasked with addressing the issue have honored Congress' intent and held that post-petition, pre-conversion increases in equity inure to the debtor's benefit. *See In re Barrera*, 620 B.R. 645, 649-50 (Bankr. D. Colo. 2020); H.R. Rep. No. 103-835 at 57 (1994).

Second, the Thirteenth Circuit was correct when it held that the right of a trustee to avoid preferential transfers is a statutory power that cannot be sold and is not included in the property of the bankruptcy estate. Unlike the "interest[s] in property" that form the bankruptcy estate, the ability to sue on a preference is one of the "rights and powers" of a bankruptcy trustee. *See* 11 U.S.C. § 541(a);11 U.S.C. § 546(d). For over a century, courts have held that the avoidance powers of a bankruptcy trustee are not saleable. *See, e.g., United Capital Corp. v. Sapolin Paints, Inc.*, 11 B.R. 930, 937 (Bankr. E.D.N.Y. 1981). Section 541(a)(3) also includes in estate property the proceeds of suits brought with avoidance powers, but conspicuously makes no mention of avoidance powers themselves. And because 11 U.S.C. § 541(a)(6) includes in estate property the "proceeds" of other estate property, reading § 541 to include avoidance powers in property of the bankruptcy estate would render subsection (a)(3) superfluous insofar as it covers the proceeds of preference actions.

Sections 547 and 550 further corroborate the Thirteenth Circuit's holding, as they provide that "the trustee may" avoid preferential transfers and recover the proceeds thereof for the benefit of the bankruptcy estate. *See* 11 U.S.C. §§ 547; 550. When a statute dictates that "the trustee may" take certain action, the "most natural reading" of the statute is that *only* the trustee may take the action. *Hartford Underwriters Insurance Company v. Union Planters Bank,* 530 U.S. 1, 6-9 (2000). The unique role of the trustee in the bankruptcy process, and the requirement that a trustee conduct due diligence before suing on a preference, further support the notion that avoidance powers are not saleable. *See Hartford Underwriters,* 530 U.S. at 7; 11 U.S.C. § 547. And if Eclipse were allowed to pursue the alleged preferential transfer claim for its own benefit, it would frustrate the "prime bankruptcy policy of equality of distribution among creditors of the debtor." *Union Bank v. Wolas*, 502 U.S. 151, 161 (1991).

ARGUMENT

I. POST-PETITION, PRE-CONVERSION INCREASES IN EQUITY INURE TO THE BENEFIT OF THE DEBTOR UPON A CONVERSION FROM CHAPTER 13 TO CHAPTER 7 BANKRUPTCY.

The "principal purpose" behind the Bankruptcy Code ("Code") is to provide a "'fresh start' to the 'honest but unfortunate debtor.'" *Marrama v. Citizens Bank of Mass*., 549 U.S. 365, 367 (2007) (quoting *Grogan v. Garner*, 498 U.S. 279, 286-87 (1991)). If the debtor is an individual, both Chapter 7 and Chapter 13 of the Code afford the debtor the fresh start the Code aims to provide. Although the result is the same, the methods used in both Chapter 7 and Chapter 13 differ. Under Chapter 7, a debtor is offered a "clean break" by paying a "steep price: prompt liquidation of the debtor's assets." *Harris v. Viegelahn*, 575 U.S. 510, 513 (2015); *See* 11 U.S.C. §§ 704, 726. Conversely, under Chapter 13, a debtor volunteers to repay creditors through a court approved repayment plan, that once completed, discharges the debtor's remaining debts. *See* 11 U.S.C. § 1321-28.

Congress enacted Chapter 13 with the intention to "encourage more debtors to repay their debts over an extended period rather than opt for straight bankruptcy liquidation." H.R. Rep. 95-595 at 5. As such, Congress offered a debtor an incentive under Chapter 13 that liquidation did not – the ability to retain pre-petition assets that become property of the estate upon filing. *See* 11 U.S.C. § 1327 (vesting "all of the property of the estate in the debtor" upon court approval of debtor's repayment plan). Despite Congress' intentions, many debtors fail to successfully complete the plan they propose. Katherine M. Porter, *The Pretend Solution: An Empirical Study of Bankruptcy Outcomes*, 90 TEX. L. REV. 103, 107–111 (2011) (showcasing studies that reveal "only one in three" Chapter 13 plans are completed). Nevertheless, debtors may still have the fresh start the Code aims for by utilizing another benefit of Chapter 13: the right to convert a Chapter 13 case to another Chapter "at any time." 11 U.S.C. § 1307(a); *see In re Barerra*, 22 F.4th 1217, 1220 (10th Cir. 2022) (explaining that Congress enacted § 1307(a) to "incentivize debtors to opt for reorganization over liquidation.").

Converting a Chapter 13 case to Chapter 7 "does not effect a change in the date of the filing of the petition." 11 U.S.C. §. Rather, the former Chapter 13 case "continues along another track, Chapter 7." *Harris*, 575 U.S. at 515. However, upon conversion, the bankruptcy estate reverts back to property the estate possessed "*as of the date of filing of the petition*." 11 U.S.C. § 348(f)(1)(A) (emphasis added). Stated differently, the property of the estate upon conversion to Chapter 7 is *limited* to the "property belonging to the debtor 'as of the date' the original Chapter 13 petition was filed." *Harris*, 575 U.S. at 517 (citing 11 U.S.C. § 348(f)(1)(A)).

A. The plain language of section 348(f)(1)(A) is ambiguous as to whether post-petition, pre-conversion increases in equity belong to the debtor or to the converted estate.

Contrary to what the dissent argues, the plain language of § 348(f)(1)(A) is ambiguous when viewed within the context of the Bankruptcy Code ("Code"). When a court sets out to interpret the Code, it must first determine whether "the language at issue has a plain and unambiguous meaning with regard to the particular dispute in the case." *Robinson v. Shell Oil Co.*, 519 U.S. 337, 340 (1997). Furthermore, determining if a statute is ambiguous or not depends also on the "specific context in which [the statute's] language is used, and the broader context of the statute as a whole." *Id.* at 341. Examining §§ 348(f)(2) and 522 reveals that the text of § 348(f)(1)(A) cannot be the sole basis to determine whether post-petition, pre-conversion increases in equity of estate property belong to the estate when a case is converted from Chapter 13 to Chapter 7.

Additionally, a statute is ambiguous when it is "'capable of being understood in two or more possible senses or ways.'" *See Chickasaw Nation v. United States*, 534 U.S. 84, 90 (1985) (citing Webster's Ninth New Collegiate Dictionary 77); *see also Nat'l Credit Union Admin. Bd. v. Nomura Home Equity Loan, Inc.*, 764 F.3d 1199, 1226 (10th Cir. 2014) (holding that statues are ambiguous when it is "reasonably susceptible to more than one interpretation.") For the past thirty years, courts throughout the United States have disagreed on what § 348(f)(1)(A) says about the issue of who possesses post-petition, pre-conversion increases in equity. *See In re Barrera*, 620 B.R. 645, 649-50 (Bankr. D. Colo. 2020).

i. Because section 348(f)(2) includes property of the estate as of the date of conversion to penalize a debtor who converted in bad faith, section 348(f)(1)(A) cannot be read to include the same property.

Upon conversion of a case from Chapter 13 to Chapter 7, § 348(f)(1)(A) states that "except as provided in [§ 348(f)(2)]" property of an estate converted from Chapter 13 includes only "property of the estate, as of the *date of filing*." 11 U.S.C. § 348(f)(1)(A) (emphasis added). Stated differently, the property of the estate under § 348(f)(1)(A) "consists of the same interests in property that would have been included in the estate had the debtor originally filed under Chapter 7." *In re Barerra*, 22 F.4th at 1220. But, if a debtor converts a Chapter 13 case in "*bad faith*," § 348(f)(2) modifies what property is included as part of the converted estate to encompass the debtor's property "as of the *date of conversion*." 11 U.S.C. § 348(f)(2) (emphasis added).

In *Harris v. Viegelahn*, this Court found the existence of § 348(f)(2) particularly instructive as to what is property of the estate under § 348(f)(1)(A). 575 U.S. 510, 518 (2015). There, the debtor's post-petition wages that had not been disbursed to creditors before the debtor converted his Chapter 13 case to Chapter 7 were at issue. *Id*. at 515-16. Finding that the debtor converted in *good faith*, this Court held that the language of § 348(f)(1)(A) limited the property of the estate to that as of the date of the filing governed, because § 348(f)(2) "penalizes bad-faith debtors," by expanding the scope of available property to that which exists "as of the date of conversion." *Id*. at 518. This Court noted that shielding a good faith debtor's post-petition wages from creditors upon conversion further enabled this Court to allow the "'honest but unfortunate debtor[s]' to make the 'fresh start' the Bankruptcy Code aims to facilitate." *Id*. (quoting *Marrama v. Citizens Bank of Mass*., 549 U.S. 365, 367 (2007)).

Considering this Court's ruling in *Harris*, it should be clear that §§ 348(f)(1)(A) and 348(f)(2) are intended to treat a debtor differently if that debtor converts in good or bad faith. *Compare* § 348(f)(1)(A) (a converted estate includes "property of the estate as of the date of filing") *with* § 348(f)(2) (an estate converted "in bad faith" includes "property of the estate as of the date of conversion."). Stated differently, § 348(f)(2) penalizes a debtor who converts in bad faith by having more "interests [] included in the converted estate" than if the debtor had converted in good faith, in which case § 348(f)(1)(A) applies. *In re Barerra*, 22 F.4th 1217, 1221 (10th Cir. 2022). Although this underlying distinction between these statutes is clear to this Court, the fact that it is not explicit in the plain language of § 348(f)(1)(A) showcases that the statute is not as clear as the dissent claims.

Further supporting this notion is the fact that if property of a converted estate under § 348(f)(1)(A) were to include any post-petition property, § 348(f)(2) would be redundant. Under the canon of surplusage, this Court does not interpret statutes to "render superfluous another part of the same statutory scheme." *City of Chicago, Illinois v. Fulton*, 592 U.S. 154, 159 (2021). If § 348(f)(1)(A) were to include the same property as part of a converted estate as would be included under § 348(f)(2), there would be no reason for § 348(f)(2) to exist. A plain reading of §

348(f)(1)(A) could render this result as the statute does not explicitly state that it refers to debtors who convert in good faith. *See* 11 U.S.C. § 348(f)(1)(A).

ii. The "snapshot rule," which holds that exemption values are fixed as of the date the debtor files for bankruptcy, further demonstrates the latent ambiguity in section 348(f)(1)(A).

Section 348(f)(1)(A) does not explicitly state whether property of the estate is *valued* as of the date of the original petition or as of the date of conversion. *See* 11 U.S.C. § 348(f)(1)(A) Despite the lack of clarity, the dissent argues § 348(f)(1)(A) is sufficiently clear that property of the converted estate includes the value of property as of the date of filing along with its post-petition, pre-conversion increase in value. R. at 25, 26. However, the way exempt property is valued under § 522(a)(2) reveals the folly of relying solely on the plain language of § 348(f)(1)(A).

Under § 522, certain property may be exempt from being part of a bankruptcy estate, "immuniz[ing] [the exempt property] against liability for pre-petition debts." *In re Cunningham*, 513 F.3d 318, 323 (1st Cir. 2008); *see* 11 U.S.C. § 522. The idea of an exemption furthers the "fundamental bankruptcy concept of a fresh start." *Schwab v. Reilly*, 560 U.S. 770, 791 (2010) (citations omitted). Under § 522(a)(2), exempt property is valued at the "fair market value *as of the date of the filing*" for bankruptcy, absent applicable exceptions. 11 U.S.C. § 522(a)(2) (emphasis added). To ensure that the exempt property affords the debtor a fresh start, the exempt property's recorded value and its status remain unchanged after the date of filing, leaving it "frozen in time, as if someone had taken a snapshot of it." *In Re Rockwell*, 968 F.3d 12, 18 (1st Cir. 2020) (citations omitted). This principle, known as the "snapshot rule," protects exempt property "from later being made available to creditors" to ensure debtors are afforded "the 'fresh start' that the Code prizes." *Id.* at 21.

Section 348(f)(1)(A), like § 522(a)(2), governs “property as of the date of the filing.” *Compare* 11 U.S.C. § 348(f)(1)(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*”) (emphasis added) *with* 11 U.S.C. § 522(a)(2) (“‘value’ [of property of the estate] means fair market value *as of the date of the filing of the petition*”) (emphasis added). Because these statutes both refer to the same property, the Thirteenth Circuit found it logical to employ the snapshot rule to § 348(f)(1)(A) when valuing property of a converted estate. R. at 14. The court explained that holding otherwise would produce “vastly different valuations” of the same property in cases where estate property appreciates in value post-petition. R. at 14. To demonstrate this point, the court noted that the value of Cpl. Clegg’s home would unreasonably equal $350,000 for purposes of his homestead exemption, but $450,000 for purposes of the converted estate. R. at 14.

Further supporting this notion is the fact that including increased valuation of estate property upon conversion runs afoul with the Code’s “fresh start” purpose and how Chapter 7 accomplishes this result. Under Chapter 7, a debtor’s property which accrues *after* the filing date is shielded from creditors to afford the “‘honest but unfortunate debtor’ . . . the ‘fresh start’ the Bankruptcy Code aims to facilitate.” *Harris*, 575 U.S. 510, 518 (2015) (quoting *Marrama v. Citizens Bank of Mass*., 549 U.S. 365, 367 (2007)). Because Chapter 7 governs a bankruptcy case upon conversion from Chapter 13, it follows that a converted estate should not include property that accrues post-petition. *See Id.* at 520 (when a debtor converts his case from Chapter 13 to Chapter 7, “the case is placed under Chapter 7’s governance”). To ensure post-petition increases in the value of estate property are not part of the converted estate as Chapter 7 requires, § 348(f)(1)(A) should similarly apply a snapshot rule to freeze the value of estate property as of the date of filing. To achieve this, past courts adopted a similar approach without specifically referencing § 522. *See In re Slack*, 290 B.R. 282 (Bankr. D.N.J. 2003) (holding that any post-confirmation, pre-conversion property must be valued on the date the petition was filed pursuant to § 348(f)(1)(A)); *In re Wegner*, 243 B.R. 731 (Bankr. D. Neb. 2000) (same).

However, because the text of § 348(f)(1)(A) does not explicitly limit property of the estate to the value as of the filing date, some courts argue that *post-petition* increases of value of property belong to the newly converted estate. *See Castleman v. Burman (In re Castleman)*, 75 F.4th 1052, 1057-58 (9th Cir. 2023) (holding post-petition appreciation in the debtor's home was property of the converted Chapter 7 estate as the plain text of § 348(f)(1)(A) does not make a distinction otherwise); *see also In re Goetz*, 651 B.R. 292 (B.A.P. 8th Cir. 2023) ("Section 348(f) does not specify that debtors are entitled to retain equity resulting from payments during the Chapter 13 case"). These decisions allow a creditor access to property that the debtor accrues post-petition, contravening what is allowed under a Chapter 7 bankruptcy case. As explained above, Chapter 7 protects post-petition assets from the bankruptcy estate to offer a debtor a fresh start. *See Harris*, 575 U.S. at 518. As this Court has held, where the plain language of a statute "produce[s] a result demonstrably at odds with the intentions of its drafter," the plain text is not conclusive. *U.S. v. Ron Pair Enterprises, Inc*, 489 U.S. 235, 242 (1989). Thus, reading the plain text of § 348(f)(1)(A) cannot render a full understanding of what should or should not be property of a converted estate.

iii. Courts' inability to agree on section 348(f)(1)(A)'s meaning further proves the statute is ambiguous.

Two schools of thought have emerged among courts throughout the United States for interpreting § 348(f)(1)(A). *See In re Barrera*, 620 B.R. 645, 650 (Bankr. D. Colo. 2020). The first approach, endorsed by the Thirteenth Circuit, provides that post-petition, pre-conversion increases in equity inure to the benefit of the debtor. *See, e.g, In re Nichols*, 319 B.R. 854, 857 (Bankr. S.D. Ohio 2004). This approach has been favored by courts throughout the United States. *See In re*

Barrera, 620 B.R. at 649-50; *In re Sparks*, 379 B.R. 178, 181 (Bankr. M.D. Fla. 2006) ("For the most part, courts have held . . . [that] any post-petition, pre-conversion appreciation in the value of property will not go to unsecured creditors, but to the debtor following conversion to a Chapter 7 case."); *In re Burt*, Case No. 01-43253-JJR-7 at *10 (Bankr. N.D. Ala. Jul. 31, 2009) ("There is a consensus among courts that equity attributed to appreciation in a property's value *may not be claimed by the trustee* in a converted case.") (emphasis added). These courts have noted that the language of § 348(f) is ambiguous and have, thus, engaged in a discussion and analysis of Congressional intent using legislative history. *See In re Barrera*, 620 B.R. at 649-50; *In re Nichols*, 319 B.R. at 857.

The second, and less popular approach, dictates that post-petition, pre-conversion increases in equity belong to the bankruptcy estate. *See, e.g., Castleman v. Burman*, 75 F.4th 1052, 1058 (9th Cir. 2023) (cert. pending No. 23-615 filed December 7, 2023); *In re Goins*, 539 B.R. 510, 515 (Bankr. E.D. Va. 2015). These courts have decided that § 348(f) is unambiguous and can be read to allocate post-petition, pre-conversion increases in equity to the bankruptcy estate. *Id.* Thus, they have chosen to forego any analysis beyond § 348(f)(1)(A). *See Castleman*, 75 F.4th at 1058.

If nothing else, these diverging approaches, again, show that § 348(f)(1)(A) is anything but clear. Therefore, this Court should look beyond the plain language of § 348(f)(1)(A) to reach a well-informed decision.

iv. Using only the plain language of section 348(f)(1)(A) would still yield the conclusion that post-petition, pre-conversion increases in equity belong to the debtor.

In the alternative, even if this Court were to find that § 348(f)(1)(A) is unambiguous, the most logical reading still provides that any post-petition, pre-conversion increase in equity inures to the benefit of the debtor. Returning to the language of the statute, § 348(f)(1)(A) specifies that for property to be considered property of the estate, it must be "in the possession of" or "under the control of" the debtor. 11 U.S.C. § 348(f)(1)(A). Logically, post-petition, pre-conversion equity *cannot exist* at the time of petition because any such appreciation would occur thereafter. Importantly, this logic is not new. Courts in the past have used similar reasoning to reach the same conclusion. *See In re Salazar*, 465 B.R. 875, 880 (B.A.P. 9th Cir. 2012). There, analyzing § 348(f)(1)(A), the court looked to Merriam Webster's Collegiate Dictionary to interpret § 348(f)(1)(A)'s language. *Id.* The court noted that, according to the dictionary, "To 'remain' means. . . 'to continue unchanged.'" *Id.* By this logic, Cpl. Clegg's tangible home would be the property belonging to the Chapter 7 estate whereas any increase in the equity of the home would belong to Cpl. Clegg alone. Therefore, even the plain language of § 348(f)(1)(A) supports affirming the Thirteenth Circuit's decision.

B. <u>The legislative history behind section 348(f)(1)(A) reveals that Congress intended for post-petition, pre-conversion increases in equity to inure to the benefit of the debtor.</u>

Although the plain text of § 348(f)(1)(A) fails to clarify whether post-petition, pre-conversion increases in equity inure to the benefit of a debtor, the legislative history unveils that Congress intended such a result. Where the language of a statute is clear, "the sole function of the courts . . . is to enforce it according to the terms." *Lamie v. United States Tr.*, 450 U.S. 526, 534 (2004). However, if a statute's plain language is susceptible to an interpretation that is "plainly at variance with the policy of the legislation as a whole," this Court may employ other means of statutory interpretation. *See U.S. v. Am. Trucking Ass'n*, 310 U.S. 534, 543-44 (1940) (holding there is no "'rule of law'" that forbids "aid to construction" of the meaning of statutory language, "however clear the words may appear on 'superficial examination'") (footnote omitted). Given the ambiguity of § 348(f)(1)(A), highlighted by its context within the Code and courts' diverging interpretations of the statute, this Court may properly consider legislative history to uncover Congress' intent.

Prior to 1994, courts were split as to what property belonged to the estate upon conversion under § 348. *See* H.R. Rep. No. 103-835 at 57 (1994). On one hand, a minority of courts held that estate property included property owned by the debtor when the case was converted. *See In re Lybrook*, 951 F.2d 136, 139 (7th Cir. 1991) (holding the land a debtor inherited post-petition and was in possession of at the time of conversion from chapter 13 to Chapter 7 was estate property upon conversion). Conversely, a majority of courts held that estate property only included that which existed at the time the original Chapter 13 case was filed. *See, e.g. In re Bobroff*, 766 F.2d 797, 804 (3rd Cir. 1985) (holding a debtor's tort claim that arose after filing for Chapter 13 was not property of the estate upon conversion to Chapter 7); *In re Lepper* 58 B.R. 896, 902 (Bankr. D. Md. 1986) (holding that a debtor was not obligated to relinquish accounts receivable to the Chapter 7 trustee because they accrued post-petition date of the debtor's original Chapter 13 case); *In re Peters*, 44 B.R. 68, 70-71 (Bankr. M.D. Tenn. 1984) (holding that the debtor was entitled to wages the chapter 13 trustee accrued post-petition and did not distribute upon conversion from chapter 13 to chapter 7).

To resolve the split among courts, Congress enacted 11 U.S.C. § 348(f). *See* H.R. Rep. No. 103-835 at 57. In constructing § 348(f), Congress relied on the reasoning from *In re Bobroff*. H.R. Rep. No. 103-835 at 57. There, the United States Court of Appeals for the Third Circuit found that the debtor's tort actions that accrued post-petition of his Chapter 13 case, but pre-conversion to Chapter 7, were not property of the converted Chapter 7 estate. *In re Bobroff*, 766 F.2d at 804. Subsequently, the court stressed that "if debtors must take the risk that property acquired during the course of an attempt at repayment will have to be liquidated for the benefit of creditors if

Chapter 13 proves unavailing, the incentive to give chapter 13 . . . a try will be greatly diminished." *Id*. at 803. Similarly aligning with the Code's goal to incentivize debtors to file for Chapter 13, rather than disincentivize them, Congress adopted the Third Circuit's reasoning, explicitly overruling all other contravening precedent. H.R. Rep. No. 103-835 at 57. Thus, the legislative history reveals that Congress intended for property a debtor accrued post-petition to inure to the debtor. But what makes Congress' discussion around enacting § 348(f) particularly instructive to the present case is the example Congress gave to illustrate the issue the statute was enacted to address.

To demonstrate the issue courts were facing prior to 1994, Congress provided an example which focused on a *post-petition, pre-conversion increase in the value of a home*:

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

H.R. Rep. 103-835, 57, 1994 U.S.C.C.A.N. 3340, 3366. (emphasis added). The example confirms that the post-petition property Congress considered when it enacted § 348(f) included the *precise property* at issue in our case: the post-petition increases in the value of a debtor's home. As such, Congress clearly intended for cases like Cpl. Clegg's to follow the reasoning it adopted from *In re Bobroff*. Therefore, applying the reasoning from *In re Bobroff* to the case at bar, the post-petition increase in Cpl. Clegg's home would inure to his benefit, as any other result would disincentivize him and similar debtors from initially filing under Chapter 13. *See In re Bobroff*, 766 F.2d at 803. Finding otherwise, as the dissent argues, would contravene Congress' intent and, therefore, should not be followed.

Following § 348(f)(1)(A)'s enactment, courts have consistently chosen to follow this legislative history. *See Kendall v. Lynch*, 363 B.R. 101, 107 (B.A.P 9th Cir. 2007) (involving the sale of a home that had increased in value after the petition to convert from Chapter 13 to Chapter 7 was filed); *In re Barrera*, 620 B.R. 645, 653 (Bankr. D. Colo. 2020) *aff'd*, No. BAP Co-20-003, 2020 WL 5869458 (B.A.P. 10th Cir. Oct. 2, 2020); *In re Hodges*, 518 B.R. 445, 448-49 (Bankr. E.D. Tenn. 2014); *In re Woodland*, 325 B.R. 583, 586-87 (Bankr. W.D. Tenn. 2005); *In re Nichols*, 319 B.R. 854, 856 (Bankr. S.D. Ohio 2004); *In re Jackson*, 317 B.R. 511, 518 (Bankr. N.D. Ill. 2004); *see also In re Barrera*, F.4th 1217, 1225 (10th Cir. 2022) ("[T]he legislative history supports the outcome to which the plain text already points: the pre-conversion house-sale proceeds are not property of the Chapter 7 estate."). Due in large part to the legislative history of § 348(f)(1)(A), the majority view has accurately captured Congress' intention in enacting the 1994 amendment to the Code. Therefore, this Court should adopt the majority view that post-petition, pre-conversion increase in equity inure to the benefit of the debtor as it most accurately reflects the intent and spirit of Congress.

C. The Policy Behind the Code Further Supports the Finding that Post-Petition, Pre-Conversion Increases in Equity Inure to the benefit of a Debtor.

As alluded to above, the primary purpose of the Bankruptcy Code is to provide honest, but unfortunate debtors a fresh start. *See Harris*, 575 U.S. 510, 513 (2015). Although the Code has undergone several changes since its inception, "reliev[ing] the honest debtor from the weight of oppressive indebtedness" remains the main goal. *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934); *see also Harris*, 575 U.S. at 513 ("The Bankruptcy Code provides diverse courses overburdened debtors may pursue to gain discharge of their financial obligations, and thereby a 'fresh start.'") (quoting *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 367 (2007)); *Marrama*, 549 U.S. at 367 ("The principal purpose of the Bankruptcy Code is to grant a 'fresh start' to the 'honest but unfortunate debtor.') (quoting *Grogan v. Garner*, 498 U.S. 279, 286 (1991)); *Grogan*, 498 U.S. at 286 ("[A] central purpose of the Code is to provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.'") (quoting *Local Loan Co.*, 292 U.S. at 244).

When constructing Chapter 13 of the Code, Congress did not alter this primary purpose, but instead solidified it by providing debtors the opportunity to retain assets imperative to living – like one's home. *See Harris*, 575 U.S. at 514. Further supporting Chapter 13's incentives is the fact that both debtors and creditors benefit from Chapter 13 in ways they may not under Chapter 7. *See Harris*, 575 U.S. at 510 ("Debtors are allowed to retain their assets, commonly their home or car. . . . And creditors, . . . usually collect more under a Chapter 13 plan than they would have received under a Chapter 7 liquidation"). As such, Congress wanted to "encourage more debtors to repay their debts over an extended period rather than opt for straight bankruptcy liquidation." H.R. Rep. 95-595 at 5. However, acknowledging the reality that repayment plans under Chapter 13 often go unfinished, albeit not for a debtor's lack of trying, Congress wanted to ensure that debtors were "no worse off for having tried a repayment plan." *In re Barrera*, 620 B.R. at 648; *see also Harris*, 575 U.S. at 514 (understanding the reality of the unsuccessful rate at which debtor's complete Chapter 13 plans, debtors are afforded the "nonwaivable right to convert a Chapter 13 case to one under Chapter 7 'at any time'") (quoting 11 U.S.C. § 1307(a)). Thus, Congress provided a debtor the right to convert from Chapter 13 to Chapter 7. See 11 U.S.C. § 1307(a)

Protecting Cpl. Clegg's post-petition, pre-conversion increase in the value of his home from creditors does not contravene these principles. Rather, it further supports the notion both Congress and this Court has long held – debtors who voluntarily opt to pay creditors should not be punished if their dutiful efforts are unsuccessful. Cpl. Clegg volunteered to file under Chapter 13, but to no fault of his own, was unsuccessful in meeting its demands. R. at 6, 8. As such, Cpl. Clegg used his un-waivable right to convert, which every party in this case agrees was done in good faith. R. at 8, n. 8. Aligning with the purpose of Chapter 13 and Congress' planned incentives behind filing for Chapter 13 bankruptcy, Cpl. Clegg should be rewarded, not punished, for his noble attempt to fulfill his debts. Interpreting § 348(f)(1)(A) in the same manner as the Thirteenth Circuit will ensure Cpl. Clegg retains the assets that Congress intended debtors like him to keep.

D. The dissent's reliance on *Castleman* is flawed because it fails to consider section 348(f)(1)(A) in the context of the entire Code and relies on inapplicable caselaw.

In its opinion, the dissent heavily relies on *Castleman* to reach its decision that post-petition, pre-conversion increases in equity belong to the bankruptcy estate. R. at 27. However, the dissent's reliance on *Castleman* is misguided for two reasons. First, the court in *Castleman* believed that § 348(f)(1)(A) is unambiguous. *Castleman v. Burman*, 75 F.4th 1052, 1058 (9th Cir. 2023). However, the court is unable to explain § 348(f)(1)(A) *using just the plain language of the statute. Id*. Instead, the court looks to other provisions of the Code along with circuit precedent to determine that ". . . the plain language of § 348(f)(1)(A) dictates that any property of the estate at the time of the original filing that is still in the debtor's possession at the time of conversion once again becomes part of the bankruptcy estate . . . ." *Id.* at 1055-56. If § 348(f)(1)(A) was, as the court believed, unambiguous and clear, it would not have had needed to look to other sections of the Code along with opinions from other courts to reach its conclusion.

Second, the court in *Castleman* came to its conclusion using cases that are distinguishable from the issue of a converted case. The court relied on two sources of caselaw to support its conclusion: a case from Virginia and circuit precedent. *Id.* at 1056. The case from Virginia's Eastern Bankruptcy Court concluded that an increase in equity was inseparable from the property itself, relying only on § 541(a)(1). *In re Goins,* 539 B.R. 510, 516 (Bankr. E.D. Va. 2015). Put differently, the court believed, even in cases of conversion, § 348(f)(1)(A) would not apply to an increase in equity. *Id.* Thus, the court reached its conclusion *without considering § 348(f)(1)(A)*. *Id.* Additionally, the circuit precedent the *Castleman* court relied upon are simply inapplicable as they do not address cases in which conversion was at issue. *See Wilson v. Rigby,* 909 F.3d 306, 308 (9th Cir. 2018) (involving a Chapter 7 debtor who originally filed for Chapter 7 bankruptcy and never converted their case); *Schwaber v. Reed*, 940 F.2d 1317, 1320 (9th Cir. 1991) (decided before the 1994 Amendment to the Code was enacted and addressed a debtor who never converted their case).

Further, the debtor in *Castleman* has appealed the decision and petitioned this Court for review. *Castleman v. Burman*, 75 F.4th 1052 (9th Cir. 2023) (cert. pending No. 23-615 filed December 7, 2023). Indeed, if this Court overrules the United States Court of Appeals for the Ninth Circuit's decision, cases that had been abrogated by *Castleman* will be good law again. This is important because *Castleman* falsely conveyed that courts throughout the Ninth Circuit agreed that, in cases of conversion, post-petition, pre-conversion increases in equity belong to the bankruptcy estate. *Id.* at 1058. However, contrary to the *Castleman* court's conclusion, the Ninth Circuit was *just as split* on the issue as the rest of the United States. *See, e.g.*, *In re Cofer*, 625 B.R. 194, 202 (Bankr. D. Idaho 2021) (holding that an increase in value in a debtor's home that occurred post-petition, pre-conversion belonged to the debtor); *In re Niles,* 342 B.R. 72, 76 (Bankr. D. Ariz. 2006) ("While admittedly an increase in value is not the same as after-acquired property . . . it is similar in nature and justifies the same result. Denying the debtor the increase in value upon conversion would similarly act as a disincentive to filing chapter 13 in the first instance.").

Therefore, this Court should not adopt the holding from *Castleman* because the case was poorly reasoned and decided. Accordingly, this Court should adopt the majority view that post-petition, pre-conversion increases in equity inure to the benefit of the debtor.

II. THE RIGHT OF A BANKRUPTCY TRUSTEE TO AVOID TRANSFERS IS A STATUTORY POWER THAT ONLY THE TRUSTEE MAY USE, NOT ESTATE PROPERTY THAT CAN BE SOLD.

Preferences are a type of avoidance action. Avoidance powers allow a bankruptcy trustee to bring suit to "avoid" and recover certain transfers made by the debtor. *See* 11 U.S.C. §§ 544-553. The right of a trustee to pursue an avoidance action is not property of the bankruptcy estate, because rather than existing as "property," it is a statutory power found in 11 U.S.C. § 547(b). This section dictates "the *trustee* may" avoid certain preferential transfers, but only "based on reasonable due diligence in the circumstances of the case and taking into account a party's . . . affirmative defenses[.]" 11 U.S.C. § 547(b) (emphasis added). Once a trustee avoids a preferential transfer, § 550 provides for the recovery of affected property, as "*the trustee* may recover, for the benefit of the estate[.]" 11 U.S.C. § 550 (emphasis added). The plain language of these statutes indicates that they empower *only* the trustee to avoid a transfer, as do the requirements a trustee must fulfill before suing and recovering on a preference. *See Hartford Underwriters Insurance Company v. Union Planters Bank*, 530 U.S. 1, 6 (2000).

A. <u>The avoidance powers of a bankruptcy trustee are not included in the property of the bankruptcy estate.</u>

11 U.S.C. § 541(a), which states the components of the property of a bankruptcy estate, does not include the trustee's avoidance powers. Estate property includes "all legal or equitable interests of the debtor in property as of the commencement of the case," 11 U.S.C. § 541(a)(1), as well as "[a]ny interest in property that the estate acquires after the commencement of the case." 11

U.S.C. § 541(a)(7). The Petitioner cites §§ 541(a)(1) and (a)(7) as support for the notion that avoidance actions are the property of the bankruptcy estate, but a close examination of these statutes reveals that they are not so broad.

i. The right or power of a trustee to avoid a transfer is not an interest in property and is not included in the bankruptcy estate under section 541(a).

Section 541(a)(1) generally comprises all the debtor's property at the time of the bankruptcy petition, aligning with the century-old principle that the "estate cannot possess anything more than the debtor itself did" before bankruptcy proceedings began. *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1663 (2019) (citing 11 U.S.C. § 541(a)(1); *Board of Trade of Chicago v. Johnson*, 264 U.S. 1, 15 (1924)). This principle applies to causes of action as well, as "the estate succeeds to no more or greater causes of action against third parties than those held by the debtor." *United States v. Whitling Pools, Inc.*, 462 U.S. 198, 205 (1983). Stated differently, § 541(a)(1) includes only the interests and claims held by *the debtor* as of the commencement of the case, which are distinct from the rights and powers of *the trustee*. Further, because "avoidance actions accrue when a debtor commences a case by filing a bankruptcy petition," the debtor could not have had an interest in those actions "as of" filing a bankruptcy petition. *In re Raynor*, 406 B.R. 375, 381 (B.A.P. 8th Cir. 2009); 11 U.S.C. § 541(a)(1). Because § 541(a)(1) covers only property in which the *debtor* has an interest when it files for bankruptcy, this section cannot be read to indicate that the *trustee's* avoidance powers are the property of the bankruptcy estate.

Similarly, Section 541(a)(7) cannot be interpreted to mean that the trustee's avoidance powers are the property of the bankruptcy estate. Unlike avoidance actions, which "accrue when a debtor commences a case by filing a bankruptcy petition," *In re Raynor*, 406 B.R. at 381, § 541(a)(7) includes in the bankruptcy estate interests in property "that the estate acquires *after* the commencement of the case." 11 U.S.C. § 541(a)(7) (emphasis added). Thus, the temporal element of § 541(a)(7) precludes a finding that it encompasses avoidance actions.

The right of the trustee to avoid a preference is not an *interest in property,* nor is it *acquired* like the interests that constitute the property of the bankruptcy estate. The Code creates *causes of action,* not *interests in property*. *See In re Schwartz,* 383 B.R. 119, 126 (B.A.P. 8th Cir. 2008) ("Sections 547 and 550 of the Bankruptcy Code create . . . causes of action.") (citing *Cent. Va. Cmty. Coll. v. Katz,* 546 U.S. 356, 371–72 (2006); s*ee also Taniguchi v. Kan Pacific Saipan, Ltd*., 566 U.S. 560 (1997) ("When a term goes undefined in a statute, we give the term its ordinary meaning."). Unlike the interests in property that comprise a bankruptcy estate, the ability to pursue an avoidance action is one of the "rights and powers" of a bankruptcy trustee. *Compare* 11 U.S.C. § 541(a) (identifying what is included in the "property of the estate") *with* 11 U.S.C. § 546(d) (limiting the "rights and powers" of the trustee under, *inter alia*, § 547). Congress' use of "certain language in one part" of the Code and "different language in another" creates a presumption that "different meanings were intended" by the unalike terms. *See Sosa v. Alvarez-Machain*, 542 U.S. 692, 711 n. 9 (2004) (citing 2A N. Singer, Statutes and Statutory Construction § 46:06, p. 194 (6th rev.ed.2000).

ii. *For over a century, courts have held that property of the estate does not include a trustee's avoidance powers.*

Since the inception of bankruptcy legislation, courts have held that avoidance actions were not saleable. *See, e.g., Belding-Hall Manufacturing Co. v. Mercer & Ferdon Lumber Co*., 175 F. 335, 340 (6th Cir. 1909) (finding that under the 1898 Bankruptcy Act, "the trustee only could maintain a suit to avoid [a preferential transfer]. He may not transfer to another this right of avoidance."); *United Capital Corp. v. Sapolin Paints, Inc*., 11 B.R. 930, 937 (Bankr. E.D.N.Y. 1981) (collecting cases for the "well-settled principle that neither a trustee in bankruptcy, nor a debtor-in-possession, can assign, sell, or otherwise transfer the right to maintain a suit to avoid a preference."). And while the structure of bankruptcy law has undergone substantial overhauls since the enactment of the 1898 Bankruptcy Act, the operative language governing a trustee's avoidance powers has remained the same. *Compare* 11 U.S.C. § 547(b) ("the trustee may . . . avoid any transfer . . . ") *with* Bankruptcy Act of 1898, ch. 541, § 70(e), 30 Stat. 544, 566 (repealed 1978) ("The trustee may avoid any transfer . . . "). Such a legislative history allows this Court to rely on interpretations of the old provisions, as "Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change." *Lamar, Archer & Cofrin LLP v. Appling*, 138 S.Ct. 1752, 1762 (2018) (quoting *Lorillard v. Pons*, 434 U.S. 575, 580 (1978)). Accordingly, with its enactment of 11 U.S.C. § 547(b), Congress reaffirmed the century-old principle that a trustee may not sell the right to avoid preferential transfers.

Under the current rendition of the Code, Courts have continued to hold that avoidance powers are not estate property and that the trustee cannot transfer them. *See, e.g., In re Boyer*, 372 B.R. 102, 106 (D. Conn. 2007) *aff'd,* 328 Fed.Appx. 711 (2nd Cir. 2009) ("the Code allows only the trustee or debtor-in-possession to sue on a preference because only [that party] represents the interests of all the creditors"); *Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery (In re Cybergenics Corp.)*, 226 F.3d 237, 245 (3d. Cir. 2000) (reaching the "inescapable conclusion that the fraudulent transfer claims . . . were never assets of [the debtor]."); *In re Clements Manufacturing. Liquidation Co*., LLC, 558 B.R. 187, 189 (Bankr. E.D. Mich. 2016) ("Trustee in this case may not assign any of the avoidance actions/powers as he seeks to do"); *In re McGuirk*, 414 B.R. 878, 879 (Bankr. N.D. Ga. 2009) (holding that the trustee was not permitted to sell its "unique statutory powers" under §§ 547, 548 and 549); *In re Saunders,* 101 B.R. 303, 305 (Bankr. N.D. Fla. 1989) (finding that a "cause of action itself is not considered property of the estate since the avoidance of [] a transfer is not a cause of action assertable by the debtor."); *Foster Dev. Corp. v. Morning Treat Coffee Co. (In re Morning Treat Coffee Co.),* 77 B.R. 62, 65 (Bankr. M.D. La. 1987) (holding that "the Bankruptcy Code does not include in 'property of the estate' the trustee's power to act . . . but only includes the property that is actually recovered by the trustee."). Indeed, the principle that a trustee may not transfer its avoidance powers has stood the test of time.

Particularly instructive is the United States Court of Appeals for the Third Circuit's decision in *In re Cybergenics Corp.,* which held that avoidance actions could not be sold to creditors of the debtor. 226 F.3d at 239. There, creditors sought to avoid allegedly fraudulent transfers, and the defendants argued that the fraudulent transfer claims had been sold in a court-approved sale of assets under Chapter 11. *Id.* at 240. The court found that the claims could not have been sold, because they "were never assets of Cybergenics."[1] *Id.* at 245. Analogizing a bankruptcy trustee's avoidance power to a public official's power to act in a representative capacity, the court held that "[t]he avoidance power itself . . . was likewise not an asset of Cybergenics, just as this authority would not have been a personal asset of a trustee, had one been appointed." *Id.* at 245. While it did not reach the precise issue of whether the "property of the estate" included the fraudulent transfer claims, the court cited support for the notion that "avoiding powers are not property of the estate, but, rather, statutorily created powers." *Id.* at 246 n. 16 (citing 5 *Collier on Bankruptcy* ¶ 541.14 n. 1 (16th ed. rev. 1999). All told, *Cybergenics* stands for the "inescapable conclusion" that a bankruptcy trustee, as fiduciary to the bankruptcy estate, may not sell the trustee's statutory rights and powers to individual creditors. *Id.* at 245.

---

[1] Cybergenics, the debtor corporation, served as the debtor-in-possession. When there is no bankruptcy trustee appointed to a case, the debtor can sometimes stand in for the trustee as debtor-in-possession, pursuant to 11 U.S.C. § 1107(a).

iii. Section 541 explicitly includes the proceeds of avoidance actions in the bankruptcy estate but makes no mention of avoidance actions themselves.

Section 541 further indicates that avoidance powers are not estate property as the statute is conspicuously devoid of any reference to avoidance actions, despite explicitly including proceeds from such actions in the bankruptcy estate. *See* 11 U.S.C. § 541(a)(3) (providing that the bankruptcy estate includes "[a]ny interest in property that the trustee recovers under section . . . 550 . . . of this title."). The explicit reference to the proceeds of avoidance actions in § 541, which does not reference the actions themselves, further indicates that Congress intended to exclude these actions from the "property of the estate," which is limited to the interests enumerated in § 541(a). *See* 11 U.S.C. § 541(a) (the bankruptcy "estate is comprised of all *the following* property, wherever located and by whomever held:") (emphasis added).

Conversely, when Congress wanted a section of the Code to affect avoidance actions, it explicitly said so, as the Code cross-references § 547 in over fifteen other sections. *See, e.g.*, 11 U.S.C. § 349(b)(1)(B) (dismissal of a case reinstates any transfer avoided under § 547); § 546(d) (setting forth limitations on avoidance powers); § 926(a) (section 547 does not apply to transfers made on account of bond held by transferee); § 1523(a) (recognized foreign representatives have standing to initiate actions under § 547). But unlike the sections of the Code that reference a trustee's avoidance powers, § 541 makes no mention of these powers, only of the proceeds of avoidance actions. *See* 11 U.S.C. § 541(a)(3). This is telling, as "Congress generally acts intentionally when it uses particular language in one section of a statute but omits it in another." *Department of Homeland Security v. Maclean*, 574 U.S. 383, 391 (2015). Thus, this Court may presume that Congress intended to exclude a trustee's avoidance powers from the property of the bankruptcy estate.

iv. *Reading section 541 to include a trustee's avoidance powers would create superfluity within the statute.*

The canon against surplusage further supports the conclusion that avoidance powers are not estate property, as reading 11 U.S.C. § 541(a)(1) to include avoidance actions would render other parts of the statute wholly unnecessary. Although the canon against surplusage is not absolute, it "is strongest when an interpretation would render superfluous another part of the same statutory scheme." *City of Chicago v. Fulton*, 592 U.S. 154, 159 (2021). The Code differentiates between the trustee's avoidance powers and the trustee's ability to recover the property interests stemming from a successful avoidance action. *See* 11 U.S.C. § 547(b) ("the trustee may . . . avoid any transfer . . . "); 11 U.S.C. § 550(a) ("the trustee may recover . . . the property transferred"). Correspondingly, § 541(a)(3) provides that the property of the estate includes any property interest recovered under § 550. 11 U.S.C. § 541(a)(3); *see also In re Redding*, 247 B.R. 474, 477 (B.A.P. 8th Cir. 2000) ("Only if the trustee is successful in avoiding the transfer [pursuant to § 547] and recovering money [via § 550] would it be property of the estate" per section 541(a)(3)). Section 541(a)(6), on the other hand, provides that estate property includes "[p]roceeds . . . or profits of or from property of the estate[.]" 11 U.S.C. § 541(a)(6). And "'proceeds . . . or profits' from estate property" includes funds "derived from assets that form part of the estate." *United States v. Mitchell*, 476 F.3d 539, 544 (8th Cir. 2007) (quoting 11 U.S.C. § 541(a)(6)).

This Court has referred to property recovered through a preferential transfer claim as the "proceeds from such a suit." *Czyzewski v. Jevic Holding Corp.*, 580 U.S. 451, 459 (2017) (noting that the "proceeds from such a suit would belong not to the [] creditors, but to the bankruptcy estate."). This means that if avoidance actions were estate property under § 541(a)(1), then § 541(a)(6) regarding "proceeds" of estate property would encompass funds recovered under 11 U.S.C. § 550. Thus, reading § 541(a)(1) to include avoidance actions would render subsection (a)(3) utterly redundant insofar as it includes property interests recovered under § 550. Such a reading of § 541(a)(1) would not only "render superfluous another part of the same statutory scheme," it would render superfluous another subsection of the *very same statute*. *580*, 592 U.S. at 159. Thus, the canon against surplusage applies to the greatest extent possible, further reinforcing the notion that avoidance actions are not estate property.

B. <u>The Code explicitly allows a trustee to avoid preferences and recover the proceeds, but not to transfer the right to avoid a preference.</u>

i. The plain text of section 547(b) indicates that only the trustee may use the power it creates.

When 11 U.S.C. § 547(b), which sets forth the avoidance power of the bankruptcy trustee, states that "the trustee may" avoid certain transfers of interests in property, it means that *only* the trustee may use this power. *See Hartford Underwriters Insurance Company v. Union Planters Bank*, 530 U.S. 1, 6 (2000) (hereinafter "*Hen House*"). In *Hen House*, a creditor sought to charge unpaid insurance premiums to property that was subject to the security interest of another creditor. *Id*. at 4. The former creditor sought to invoke 11 U.S.C. § 506(c), which allows the trustee to recover certain expenses from property encumbered by another creditor's security interest. *Id*. Section 506(c) states that "[t]he trustee may recover . . ." the enumerated expenses. Even though "all [that] [§ 506(c)] actually 'says' is that the trustee may seek recovery under the section, not that others may not," this Court had "little difficulty" holding that "the trustee is the *only* party empowered to invoke the provision." *Id*. at 6 (emphasis added). The statute authorized specific action and empowered a particular party to take the action, a situation "among the least appropriate in which to presume nonexclusivity." *Id*. at 6. Further, the unique role of the trustee in bankruptcy proceedings made it "entirely plausible that Congress would provide a power to him and not to others." *Id*. at 7. While the statute did not specify that it extended *only* to the trustee, this Court believed this to be "by far the most natural reading of § 506(c)." *Id*. at 9.

This Court's rationale in *Hen House* should apply with equal force here, as § 547(b) invites an identical reading to § 506(c). Both provisions simply state that "the trustee may" take certain action, with no other authorized actors. 11 U.S.C. §§ 506(c); 547(b). As this Court had "little difficulty" concluding that the trustee was the only party empowered to invoke § 506(c), it should also interpret the identical language of § 547(b) with similar ease. *Hen House*, 530 U.S. at 6.

ii. *Courts that have allowed a trustee to transfer its avoidance powers have done so in disregard of the plain text of section 547(b) and this Court's precedent interpreting identical operative language.*

In reaching its conclusion, the dissent primarily relied on a recent line of Circuit Court cases that ignored the plain text of 11 U.S.C. § 547(b) in favor of including causes of action in estate property. R. at 33-34; *see Pitman Farms v. ARKK Food Co. (In re Simply Essentials)*, 78 F.4th 1006 (8th Cir. 2023); *Silverman v. Birdsell*, 796 F. App'x 935 (9th Cir. 2020) (unpublished decision); *Cadle Co. v. Mims*, 608 F.3d 253 (5th Cir. 2010); *Morley v. Ontos, Inc.*, 478 F.3d 427 (1st Cir. 2007). A close examination of *In re Simply Essentials* illustrates how these cases misread both the Code and this Court's precedent. There, the United States Court of Appeals for the Eighth Circuit relied on this Court's decision in *United States v. Whitling Pools*, noting that "541(a)(1) can be read 'to include in the estate any property made available to the estate by other provisions of the Bankruptcy Code'" and that "there are no requirements in the [C]ode 'that the debtor hold a possessory interest in the property at the commencement of the [] proceedings.'" *In re Simply Essentials*, 78 F.4th at 1008-1009 (quoting *Whitling Pools, Inc.*, 462 U.S. at 205-206 (1983)). However, the court conveniently failed to mention this Court's declaration that "the estate succeeds to no more or greater *causes of action* against third parties than those held by the debtor," *Whitling*

Pools, 462 U.S. at 204 n.8 (emphasis added), meaning the estate cannot contain preference actions, which are held by the trustee and "accrue when a debtor commences a case by filing a bankruptcy petition." *In re Raynor*, 406 B.R. 375, 381 (B.A.P. 8th Cir. 2009). Because the court cited *Whitling Pools* but reached a conclusion directly contradicting this Court's statement therein, the persuasive value of *In re Simply Essentials* is negligible.

In *In re Simply Essentials*, the United States Court of Appeals for the Eighth Circuit also relied on its own prior holding that "[t]he scope of this section is very broad and includes property of all descriptions, tangible and intangible, as well as causes of action." *Id.* at 1008 (quoting *Whetzal v. Alderson*, 32 F.3d 1302, 1303 (8th Cir. 1994)). But this decision failed to consider the text of § 547(b) and the Eighth Circuit's own precedent that when a statute reads "the trustee may" take an action, the statute "permits only the trustee to proceed under that section." *In re Hen House Interstate, Inc.*, 177 F.3d 719, 722-725 (8th Cir. 1999) *aff'd,* 530 U.S. 1 (2000). As noted above, *Hen House* wholly undermines the notion that a trustee may transfer its avoidance powers under § 547(b). *See Hen House*, 530 U.S. at 6 (when a statute provides that "the trustee may" take certain action, "the trustee is the only party empowered to invoke the provision"). This critical omission subverts the United States Court of Appeals for the Eighth Circuit's reading of 11 U.S.C. § 541(a)(1) and illustrates the inherent folly of allowing a trustee to transfer avoidance actions.

C. <u>The overall policy behind the Code and the unique role of a trustee in the bankruptcy process further demonstrate the inappropriateness of allowing a trustee to transfer its avoidance powers.</u>

i. The trustee, as fiduciary of the estate, is the only party feasibly equipped to conduct due diligence as required by section 547.

The requirements a trustee must fulfill before avoiding a transfer, and the unique role of the trustee throughout the bankruptcy process, provide further evidence that only a trustee may take such action. Section 547(b) allows a trustee to avoid a transfer only if the trustee acts "based on reasonable due diligence in the circumstances of the case and taking into account a party's . . . affirmative defenses under subsection (c)." These requirements make sense given the trustee's "unique role" in the bankruptcy process, as the trustee is a neutral party required by law to be informed as to the circumstances of the case and to act in the interest of the bankruptcy estate. *See, e.g., Hen House,* 530 U.S. at 7; 11 U.S.C. § 704(a) (enumerating the duties of a trustee, including investigation of the debtor's financial affairs). A creditor has no such obligation, and to allow a single creditor to pursue an avoidance action for its own benefit would fly in the face of the "prime bankruptcy policy of equality of distribution among creditors of the debtor." *Union Bank v. Wolas*, 502 U.S. 151, 161 (1991).

ii. *Allowing a single creditor to avoid a transfer for its own benefit would disadvantage other creditors and frustrate the policy behind the Code.*

The policy underlying the Code further bolsters the conclusion that a trustee, the fiduciary of the bankruptcy estate, may not sell its avoidance powers. Only the trustee represents the interests of *all the creditors* in maximizing the value of the debtor's estate. *See In re Boyer*, 372 B.R. 102, 106 (D. Conn. 2007) *aff'd,* 328 Fed.Appx. 711 (2nd Cir. 2009). Thus, allowing individual creditors to purchase avoidance actions for their own benefit would lead to inequality of distribution among creditors. When it codified the trustee's avoidance powers, Congress "feared that by allowing one creditor to buy a claim from the trustee and pursue that claim on [its] own behalf, that creditor may be allowed to recover more of the estate's assets than would otherwise rightfully be due to that creditor." *Id*. Rather, a creditor may only assert a trustee's avoidance powers *for the benefit of the estate* through the doctrine of derivative standing. *See* 11 U.S.C. § 503(b)(3)(B); *In re Trailer Source, Inc*., 555 F.3d 231, 241 (6^{th} Cir. 2009) (finding that "the practice of derivative standing is available in both Chapter 11 and Chapter 7 proceedings."). And unlike the theory that a trustee may transfer his avoidance powers, the principle of derivative standing has historical support under old iterations of bankruptcy legislation. *See COM–1 Info, Inc. v. Wolkowitz,* 278 B.R. 189, 197 (B.A.P 9th Cir. 2002) ("Section 503(b)(3)(B) carries forward the long-settled authority under former Bankruptcy Act § 64a(1) for creditors to sue in the name of the trustee to recover property for the benefit of the estate.").

When property is recovered for the benefit of the estate, it facilitates the policy of equality of distribution among creditors. But if creditors were allowed to recover for their own benefit, it would fly in the face of this indispensable policy, as well as the plain text of §§ 541, 547, and 550. Here, Eclipse Credit Union ("Eclipse") seeks to purchase the alleged preference claim against Emily Clegg ("Pink") worth $20,000. R. 4-5, 7, 9. If Floyd, the trustee, were allowed to sell both Cpl. Clegg's home and the alleged preference claim to Eclipse, then the bankruptcy estate would be "bereft of assets" for Cpl. Clegg's other creditors, such as Another Brick in the Wall Financial Corporation. R. 6, 9. If Pink is "required to disgorge" the alleged preferential transfers, if must be "so that all [creditors] may share equally." *Wolas*, 502 U.S. at 161. Thus, it is Floyd's duty to ensure that the estate's preference claims are only pursued for its benefit. Floyd, the fiduciary of the estate, may not sell to Eclipse her statutory power to avoid an allegedly preferential transfer.

CONCLUSION

For the foregoing reasons, Respondent, Corporal Eugene Clegg, respectfully requests that this Honorable Court affirm the decision of the United States Court of Appeals for the Thirteenth Circuit and find that a post-petition, pre-conversion increase in equity in a debtor's property inures to the benefit of the debtor upon conversion from Chapter 13 to Chapter 7 bankruptcy, and that a bankruptcy trustee may not sell its power to avoid preferential transfers.