No. 22-0115

IN THE

Supreme Court of the United States

IN RE EUGENE CLEGG, DEBTOR

VERA LYNN FLOYD, CHAPTER 7 TRUSTEE, PETITIONER,

v.

EUGENE CLEGG, RESPONDENT.

ON WRIT OF CERTIORARI FOR THE

UNITED STATES COURT OF APPEALS

FOR THE THIRTEENTH CIRCUIT

BRIEF IN SUPPORT OF RESPONDENT

JANUARY 18, 2024

TEAM NUMBER 46

COUNSEL FOR RESPONDENT

QUESTIONS PRESENTED

I. Does post-petition, pre-conversion increase in equity in a debtor's property inure to the benefit of the debtor or to the benefit of the bankruptcy estate upon the conversion of a case from chapter 13 to chapter 7 pursuant to 11 U.S.C. §§ 348 and 541.

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

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OPINIONS BELOW

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

STATEMENT OF JURISDICTION

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

RELEVANT STATUTORY PROVISIONS

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

The relevant portion of 11 U.S. Code § 348 provides:

> (a) Conversion of a case from a case under one chapter of this title to a case under another chapter of this title constitutes an order for relief under the chapter to which the case is converted, but, except as provided in subsections (b) and (c) of this section, does not effect a change in the date of the filing of the petition, the commencement of the case, or the order for relief.
>
> (b) Unless the court for cause orders otherwise, in sections 701(a), 727(a)(10), 727(b), 1102(a), 1110(a)(1), 1121(b), 1121(c), 1141(d)(4), 1201(a), 1221, 1228(a), 1301(a), and 1305(a) of this title, "the order for relief under this chapter" in a chapter to which a case has been converted under section 706, 1112, 1208, or 1307 of this title means the conversion of such case to such chapter.
>
> (c) Sections 342 and 365(d) of this title apply in a case that has been converted under section 706, 1112, 1208, or 1307 of this title, as if the conversion order were the order for relief.
>
> (d)A claim against the estate or the debtor that arises after the order for relief but before conversion in a case that is converted under section 1112, 1208, or 1307 of this title,

other than a claim specified in section 503(b) of this title, shall be treated for all purposes as if such claim had arisen immediately before the date of the filing of the petition.

(e) Conversion of a case under section 706, 1112, 1208, or 1307 of this title terminates the service of any trustee or examiner that is serving in the case before such conversion.

(f)

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

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

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

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

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

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

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

…

The relevant portion of 11 U.S. Code § 363 provides:

(a) In this section, "cash collateral" means cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property and the fees, charges, accounts or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties subject to a security interest as provided in section 552(b) of this title, whether existing before or after the commencement of a case under this title.

(b)

(1) The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate, except that if the debtor in connection with offering a product or a service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell or lease personally identifiable information to any person unless—

(A) such sale or such lease is consistent with such policy; or

(B) after appointment of a consumer privacy ombudsman in accordance with section 332, and after notice and a hearing, the court approves such sale or such lease—

(i) giving due consideration to the facts, circumstances, and conditions of such sale or such lease; and

(ii) finding that no showing was made that such sale or such lease would violate applicable nonbankruptcy law.

…

The relevant portion of 11 U.S. Code § 522 provides:

(a) In this section—

(1) “dependent” includes spouse, whether or not actually dependent; and

(2) “value” means fair market value as of the date of the filing of the petition or, with respect to property that becomes property of the estate after such date, as of the date such property becomes property of the estate.

(b)

(1) Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate the property listed in either paragraph (2) or, in the alternative, paragraph (3) of this subsection. In joint cases filed under section 302 of this title and individual cases filed under section 301 or 303 of this title by or against debtors who are husband and wife, and whose estates are ordered to be jointly administered under Rule 1015(b) of the Federal Rules of Bankruptcy Procedure, one debtor may not elect to exempt property listed in paragraph (2)

and the other debtor elect to exempt property listed in paragraph (3) of this subsection. If the parties cannot agree on the alternative to be elected, they shall be deemed to elect paragraph (2), where such election is permitted under the law of the jurisdiction where the case is filed.

(2) Property listed in this paragraph is property that is specified under subsection (d), unless the State law that is applicable to the debtor under paragraph (3)(A) specifically does not so authorize.

(3) Property listed in this paragraph is—

(A) subject to subsections (o) and (p), any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition to the place in which the debtor's domicile has been located for the 730 days immediately preceding the date of the filing of the petition or if the debtor's domicile has not been located in a single State for such 730-day period, the place in which the debtor's domicile was located for 180 days immediately preceding the 730-day period or for a longer portion of such 180-day period than in any other place;

(B) any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law; and

(C) retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986.

…

The relevant portion of 11 U.S. Code § 541 provides:

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

(2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is—

(A) under the sole, equal, or joint management and control of the debtor; or

(B)liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.

(3) Any interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title.

(4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title.

(5) Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date—

(A) by bequest, devise, or inheritance;

(B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or

(C) as a beneficiary of a life insurance policy or of a death benefit plan.

(6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.

(7) Any interest in property that the estate acquires after the commencement of the case.

(b) Property of the estate does not include—

(1) any power that the debtor may exercise solely for the benefit of an entity other than the debtor;

(2) any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease before the commencement of the case under this title, and ceases to include any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease during the case;

(3) any eligibility of the debtor to participate in programs authorized under the Higher Education Act of 1965 (20 U.S.C. 1001 et seq.; 42 U.S.C. 2751 et seq.),[1] or any accreditation status or State licensure of the debtor as an educational institution;

(4) any interest of the debtor in liquid or gaseous hydrocarbons to the extent that—

…

The relevant portion of 11 U.S. Code § 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.
>
> (b) The trustee may not recover under section [1] (a)(2) of this section from—
>
> > (1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or
> >
> > (2) any immediate or mediate good faith transferee of such transferee.
>
> (c) If a transfer made between 90 days and one year before the filing of the petition—
>
> > (1) is avoided under section 547(b) of this title; and
> >
> > (2) was made for the benefit of a creditor that at the time of such transfer was an insider;
>
> the trustee may not recover under subsection (a) from a transferee that is not an insider.
>
> (d) The trustee is entitled to only a single satisfaction under subsection (a) of this section.
>
> (e)
>
> > (1) A good faith transferee from whom the trustee may recover under subsection (a) of this section has a lien on the property recovered to secure the lesser of—
> >
> > > (A) the cost, to such transferee, of any improvement made after the transfer, less the amount of any profit realized by or accruing to such transferee from such property; and
> > >
> > > (B) any increase in the value of such property as a result of such improvement, of the property transferred.
> >
> > (2) In this subsection, "improvement" includes—
> >
> > > (A) physical additions or changes to the property transferred;
> > >
> > > (B) repairs to such property;
> > >
> > > (C) payment of any tax on such property;

(D) payment of any debt secured by a lien on such property that is superior or equal to the rights of the trustee; and

(E) preservation of such property.

(f) An action or proceeding under this section may not be commenced after the earlier of—

(1) one year after the avoidance of the transfer on account of which recovery under this section is sought; or

(2) the time the case is closed or dismissed.

The relevant portion of 11 U.S. Code § 1325 provides:

(a) Except as provided in subsection (b), the court shall confirm a plan if—

(1) The plan complies with the provisions of this chapter and with the other applicable provisions of this title;

(2) any fee, charge, or amount required under chapter 123 of title 28, or by the plan, to be paid before confirmation, has been paid;

(3) the plan has been proposed in good faith and not by any means forbidden by law;

(4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

(5) with respect to each allowed secured claim provided for by the plan—

(A) the holder of such claim has accepted the plan;

(B)

(i) the plan provides that—

(I) the holder of such claim retain the lien securing such claim until the earlier of—

(aa) the payment of the underlying debt determined under nonbankruptcy law; or

(bb) discharge under section 1328; and

(II) if the case under this chapter is dismissed or converted without completion of the plan, such lien shall also be retained by such holder to the extent recognized by applicable nonbankruptcy law;

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; and

(iii) if—

(H) property to be distributed pursuant to this subsection is in the form of periodic payments, such payments shall be in equal monthly amounts; and

(II) the holder of the claim is secured by personal property, the amount of such payments shall not be less than an amount sufficient to provide to the holder of such claim adequate protection during the period of the plan; or

(C) the debtor surrenders the property securing such claim to such holder;

(6) the debtor will be able to make all payments under the plan and to comply with the plan;

(7) the action of the debtor in filing the petition was in good faith;

(8) the debtor has paid all amounts that are required to be paid under a domestic support obligation and that first become payable after the date of the filing of the petition if the debtor is required by a judicial or administrative order, or by statute, to pay such domestic support obligation; and

(9) the debtor has filed all applicable Federal, State, and local tax returns as required by section 1308.

…

Other:

H.R. REP. NO. 103-835, at 57 (1994), as reprinted in 1994 U.S.C.C.A.N. 3340, 3366.

> These later courts have noted that to hold otherwise would create a serious disincentive to chapter 13 filings. For example, a debtor who had $10,000 equity in a home at the beginning of the case, in a State with a $10,000 homestead exemption, would have to be counseled concerning the risk that after he or she paid off a $10,000 second mortgage in the chapter 13 case, creating $10,000 in equity, there would be a risk that the home could be lost if the case were converted to chapter 7 (which can occur involuntarily). If all the debtor's property at the time of conversion is property of the chapter 7 estate, the trustee would sell the home, to

realize the $10,000 in equity for the unsecured creditors and the debtor would lose the home.

STATEMENT OF FACTS

I. FACTUAL HISTORY

Retired Corporal Eugene Clegg (the "Debtor"), a decorated veteran and small business owner, filed for chapter 13 bankruptcy on December 8, 2021 (the "Petition Date"). R. at 4. Cpl. Clegg pursued the chapter 13 route because he valued his business and wanted to save his home. *Id.* Ultimately, the filing was converted from a chapter 13 to a chapter 7 liquidation of the small business due to mounting debt and an inability to pay back creditors in accordance with his chapter 13 plan. *Id.*

In 2011, Cpl. Clegg received 100% interest in The Final Cut, LLC ("Final Cut") from his mother, Pink Clegg. R. at 5. Final Cut owned and operated a single-screen movie theater in the City of Moot. *Id.* At the time of the transfer, Final Cut was generating yearly profits and had no outstanding liabilities. *Id.* Cpl. Clegg was taking a modest yearly salary as payment for his work within Final Cut. *Id.*

In 2016, Final Cut borrowed $850,000 (the "Loan") from Eclipse Credit Union ("Eclipse") to renovate the ornate ceilings and interior of the theater. *Id.* Eclipse granted the loan in exchange for a a first-priority lien on Final Cut's real and personal property, and the lien was properly perfected. *Id.* To provide for additional security to Eclipse, Cpl. Clegg executed a good faith, "unconditional, unsecured personal guarantee in an unlimited amount." *Id.*

Cpl. Clegg cleverly mitigated costs by personally undertaking much of the renovation work and recruiting the efforts of local veterans who nobly volunteered their time and efforts for the renovations. *Id.* Because he had reduced labor costs exponentially, a portion of the $850,000 loan remained untouched. *Id.* As an act of gratitude to the veterans, Cpl. Clegg donated the remainder of the Loan proceeds, approximately $75,000, to the Veterans of Foreign Wars (the "VFW") in

2017. *Id.* This donation was not disclosed to Eclipse. *Id.* For three years following the reopening of Final Cut, local residents proudly attended the renovated theater, and the business profited. R. at 6.

Unfortunately, in 2020 the local government declared a public health emergency in response to the global COVID-19 pandemic, and Final Cut was unable to open its doors, operate, or generate profits for over a year. *Id.* Struggling from the lack of income, on September 8, 2020, Cpl. Clegg begrudgingly borrowed $50,000 from Pink on an unsecured basis. *Id.*

In February 2021, Cpl. Clegg was finally able to reopen the theater, but despite his best efforts, numbers failed to rebound to pre-pandemic levels. *Id.* Hindered by a lack of steady income, Cpl. Clegg was forced to incur significant credit card debt and fell behind on his mortgage payments. *Id.* Soon after, Another Brick in the Wall Financial Corporation (the "Servicer") commenced foreclosure proceedings on Cpl. Clegg's home, and Cpl. Clegg turned to the bankruptcy system for help. *Id.*

December 8, 2021, marked the Petition Date of the chapter 13 bankruptcy. *Id.* Cpl. Clegg followed all procedures and attached all relevant schedules. *Id.* On Schedule A/B of the filing, Cpl. Clegg included a recent appraisal value of his home at $350,000. *Id.* Schedule D identified a non-contingent, liquidated, and undisputed secured debt of $320,000 to the Servicer. *Id.* Schedule E/F and Schedule H both included a contingent and unliquidated unsecured debt in an unknown amount owed to Eclipse. *Id.* On Schedule C, Cpl. Clegg properly claimed a state law homestead exemption of $30,000, the maximum amount in the State of Moot. *Id; see* 11 U.S.C. § 522(b).

Finally, Cpl. Clegg disclosed in his Statement of Financial Affairs that he had made payments to Pink within one year of the Petition Date of $20,000.[1] R. at 7.

The chapter 13 plan proposed to pay the creditors over a three-year period. *Id*. Regarding his mortgage, Cpl. Clegg proposed to cure the pre-petition debts and to make the ongoing, continuing monthly payments to the Servicer. *Id.* The plan conformed to the Schedule A/B amount, which listed Cpl. Clegg's home at $350,000 and stated that Cpl. Clegg maintained no equity in the home as of the Petition date due to the secured indebtedness and the homestead exemption. *Id.* Cpl. Clegg's plan to fund the plan derived from expected profits from Final Cut, which Cpl. Clegg and all interested parties firmly believed would return to profitability. *Id.*

At the meeting of creditors, Eclipse learned of Cpl. Clegg's donation to VFW for the first time. *Id.*; *see* 11 U.S.C. § 341. Furious, Eclipse quickly filed an adversary proceeding seeking to have Cpl. Clegg's debt related to the Loan declared non-dischargeable under § 523(a)(2)(A). R. at 7.

The chapter 13 trustee noted two flaws in Cpl. Clegg's proposed chapter 13 plan. *Id.* First, the plan paid each creditor less than they would have received in a chapter 7 liquidation. *Id.* Second, that in a chapter 7 filing, the transfer of $20,000 to Pink would be recovered through the trustee's avoidance powers as a preferential transfer and subsequently distributed to the creditors. *Id.*; s*ee* 11 U.S.C. §§ 1325(a)(4), 547(b)(4). Cpl. Clegg demonstrated his good faith commitment to his creditors when he amended the plan and increased the aggregate payments to the creditors

[1] The Trustee appeals whether preference actions are property of the estate that can be sold by the Trustee. Debtor does not concede that the transfer to Pink was preferential and can assert viable defenses speaking to the nature of the transfer. However, that issue is not before this Court on appeal so the Debtor will not address it.

by $20,000 to resolve the trustee's concerns. Accordingly, the chapter 13 trustee agreed she would not avoid and recover the payment Cpl. Clegg had made to his mother. R. at 7.

Eclipse, still fueled by anger, objected to the plan on the grounds that it was not made in good faith. *Id*; *see* 11 U.S.C. § 1325(a)(3). After negotiations between Eclipse, Cpl. Clegg, and the trustee, Eclipse agreed to withdraw its plan objection in exchange for an additional claim in the amount of $150,000—$25,000 of which was considered nondischargeable in the event of a conversion. R. at 8. Subsequently, the bankruptcy court confirmed Cpl. Clegg's plan and entered an order approving the settlement between Cpl. Clegg and Eclipse. *Id.*

For eight months, Cpl. Clegg diligently made payments to his creditors; however, his efforts were marred when he contracted a long bout of COVID-19. *Id.* Fatigued and weak from the illness, Cpl. Clegg could not continue working at the theater, which was financially suffering under the pandemic's weight. *Id.* On October 19, 2022, the theater permanently closed its doors. *Id.* Without the Final Cut income, Cpl. Clegg was unable to continue the payments on the plan. *Id.* With no reprieve, Eclipse commenced foreclosure proceedings against Final Cut and other creditors resumed their race to collect their debt. Cpl. Clegg had no choice but to convert his case to a chapter 7 filing. *Id.*

The court order confirmed the conversion of Cpl. Clegg's case from a chapter 13 to chapter 7 filing, and Floyd was appointed as the chapter 7 trustee (the "Trustee"). *Id.* In the chapter 13 trustee's final report, she stated that she had returned to Cpl. Clegg all funds she had held in reserve for Eclipse. *Id.* She further noted that through Cpl. Clegg's plan payments, she had distributed $10,000 to the Servicer. *Id.* The conversion schedules and documents assigned a value of $350,000 to Cpl. Clegg's home, noted the transfer made to Pink, and highlighted the $200,000 debt owed to

Eclipse.[2] R. at 9. Cpl. Clegg's statement of intention declared that he would reaffirm the mortgage debt that he owed to the Servicer and remain in his home. *Id.*

The Trustee determined that the estate was essentially devoid of any assets. *Id.* However, to further indicate his good faith commitment to the bankruptcy process, Cpl. Clegg mentioned at the chapter 7 meeting of creditors that due to market increases in properties in the years following COVID-19, his property value had likely increased. *Id.*; *see* 11 U.S.C. § 341. A subsequent appraisal of the home corroborated that the non-exempt equity in the home had indeed increased by $100,000 since the Petition Date. R. at 9.

To maximize the property of the estate for the benefit of the creditors, the Trustee began advertising the home for sale. *Id.* Eclipse, still waging a personal vendetta against Cpl. Clegg, offered to purchase the home and the alleged preference claim against Pink for $470,000. *Id.* Content that the offer maximized the value of the assets, the Trustee filed a section 363(b) motion ("Sale Motion") to sell both the home and the alleged preference claim to Eclipse in its credit bid of Cpl. Clegg's home. *Id.*

Cpl. Clegg objected to the Sale Motion on two grounds. R. at 10. First, Cpl. Clegg argued that any post-petition, pre-conversion increase in the equity of his home should inure to his benefit. *Id.* Accordingly, because there had been no equity available for the estate as of the Petition Date, there is no incentive for the Trustee to sell his home. *Id.* Second, Cpl. Clegg contended that the Trustee's statutory ability to avoid and recover transfers under sections 547 and 550 cannot be sold. *Id.*

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[2] Parties do not dispute these material facts.

II. PROCEDURAL POSTURE

The bankruptcy court ruled in favor of the Debtor on both objections and denied the Sale Motion. *Id.* The Trustee timely appealed the court's ruling. *Id.* Upon the request of the parties, the disputes were certified for direct appeal to the United States Court of Appeals for the Thirteenth Circuit pursuant to 28 U.S.C. § 158(d)(2)(A). *Id.* The Court of Appeals ruled in favor of the Respondent Debtor on both issues. *Id.*

STANDARD OF REVIEW

The questions presented are purely issues of law based on statutory interpretation of the Bankruptcy Code. As such, the appropriate standard of review is de novo. *See, e.g.*, *Fox v. Hathaway (In re Chicago Mgmt. Consulting Grp.)*, 929 F.3d 804, 809 (7th Cir. 2019).

SUMMARY OF THE ARGUMENT

The Court of Appeals for the Thirteenth Circuit correctly ruled that post-petition, pre-conversion increases in property belong to the debtor and the trustee's power to avoid and recover preferential transfers cannot be sold. This decision reflects sound statutory construction and aligns with the primary goals of the Bankruptcy Code— ensuring a good faith debtor is left no worse off post-petition and granting equitable and just distribution to innocent creditors.

Congress enacted § 348(f) to resolve who receives the benefit of a pre-conversion increase in the value of the debtor's property – the debtor or his creditors. The statute makes clear that in the case of a good faith debtor, any increase in value is his.

In enacting the Bankruptcy Code, Congress took care to build in protections for the good faith debtors, who despite their efforts, were unable to fulfill their chapter 13 plan obligations. Congress was aware that a bankruptcy process that left a good faith debtor worse off for attempting to reorganize and repay his debts, would discourage trust in and use of the bankruptcy system. To effectuate this goal, Congress has built a protection in § 348(f). Section 348(f)(1)(A) provides that only property as of the petition date becomes property of the converted estate. *Id.* This section operates to take a "snapshot" of the debtor's property and its value as of the petition date—so long as the debtor acts in good faith, that snapshot protects any increase in equity the debtor generates post-confirmation as the debtor's property. *Id.* If the debtor attempts to abuse the bankruptcy system, that snapshot is eradicated, and all protections are lost; any increases in equity are free to become property of the estate eligible for distribution to creditors. 11 U.S.C. § 348(f)(2).

To allow the chapter 7 trustee to reach such equity would not just be "unfortunate," but wholly incompatible with § 348(f)'s statutory design, which intends to only penalize a bad faith debtor and encourages chapter 13 filings. *In re* Castleman, 631 B.R. 914, 921 (Bankr. W.D. Wash. June 4, 2021.

The legislative history piles on. By enacting § 348(f) Congress overruled cases like *In re Lybrook* which granted post-petition increases in equity to creditors. 951 F.2d 136,137 (1991). This intent is supported by Congress' example laid out in the House Report, which is analogous to the facts of this case. H.R. REP. NO. 103-835, at 57 (1994), as reprinted in 1994 U.S.C.C.A.N. 3340, 3366; 11 U.S.C. § 348(f)(1). Further, subsequent judicial interpretation of § 348(f)(1) confirms that the debtor's earned equity belongs to the debtor. *See Harris v. Viegelahn*, 575 U.S. 510 (2015). Because reading § 348(f) to provide the benefit of post-petition increases in equity to Cpl. Clegg aligns with the core purpose of the Code, this Court should uphold the snapshot rule which leaves debtors no worse off for having tried at chapter 13.

A trustee's statutorily granted avoidance and recovery powers are not property of the estate and cannot be sold. See 11 U.S.C. §§ 541, 547(b), 550. Congress created the trustee's role to ensure that a neutral third party would administer and act on behalf of the estate; given the natural tension between debtors and creditors, this fiduciary position balances both interests and maintains the integrity of the bankruptcy process. Congress empowered the trustee with the power to avoid and recover preferential transfers so that the trustee could step into the "overshoes" of the creditor and secure equitable distribution among creditors. *In re Cybergenics Corp*., 226 F.3d 237, 244 (3d Cir. 2000). This power is just that, a power. *Id.* The Petitioner's assertion that this power is § 541 property of the estate that can be sold under 11 U.S.C. § 363 undermines Congress' intent to ensure the power is not abused by interested parties to the bankruptcy proceeding. This response represents an attempt to preserve the fiduciary role of the trustee.

A natural reading of § 541, supports the assertion that avoidance and recovery powers are not an asset of the estate, but rather powers possessed by the trustee. 11 U.S.C. § 541. Reading avoidance and recovery powers into the statute, as Petitioner suggests, would undermine Congress' diligent effort to explicitly define property of the estate, and thus what can be sold. Such a reading opens the door for misuse of powers entrusted in and intended for use solely by the trustee. Even if this Court finds that avoidance and recovery powers are "property," they are property of the trustee, not of the estate— Congress intended to empower the trustee alone. *See* 11 U.S.C. § 506(c). Consequently, it is a well-established principle that the trustee cannot sell, transfer, or assign these powers; doing so would threaten the purpose for which these powers have been created. *See Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6-7 (2000). The trustee's powers may be assigned in one limited circumstance—by establishing derivative standing. Through derivative standing, a non-trustee acts on behalf of the trustee to recover a preferential transfer for the estate's benefit. This limited exception is only permissible because it aligns with the Code's scheme of securing equitable distribution for all creditors. *In re Pursuit Mgmt., LLC*, 595 B.R. 631, 658 (Bankr. D. Del. 2018). A sale of the trustee's avoidance and recovery powers to Eclipse, a hostile creditor looking to fulfill its personal vendetta against Cpl. Clegg, is inconsistent with the Code's statutory construction and compromises the integrity of the bankruptcy process.

ARGUMENT

I. THE THIRTEENTH CIRCUIT CORRECTLY ADOPTED AND APPLIED THE "SNAPSHOT RULE" WHICH PROTECTS EQUITY THE DEBTOR CREATED POST-PETITION FROM THE REACH OF CREDITORS.

Petitioner's effort to treat property and its value as inseparable across § 348(f)(1) and (f)(2) is contrary to the plain meaning of the statute, its purpose, and sound bankruptcy policy.

A. Upon Conversion, the Bankruptcy Estate's Property, as Defined by Sections 348(f) and 541(a), Is Unambiguously Limited to the Debtor's Interest in the Value of the Property as of the Petition Date.

Section 348(f)(1)(A) ensures that a good faith debtor like Cpl. Clegg, who fails to complete his chapter 13 plan, is no worse off for having done so. *See* 11 § U.S.C. 348(f). To carry out that goal, the text of § 348(f)(1)(A) commands that only "*property . . . as of* the date of filing" becomes property of the converted estate. (emphasis added). Along with § 522, Congress intended this provision to create a snapshot of the debtors' property and its value upon filing to protect equity created by the debtor throughout the course of a chapter 13 plan. 11 U.S.C. § 348(f)(1)(A). A debtor who converts his case in bad faith loses this protection and faces steep penalties. 11 § U.S.C. 348(f)(2). Section 348(f)(2) commands that the "*property . . . as of* the conversion [date]," shall become property of the estate. (emphasis added).

Section 348(f)(1) grants post-petition equity to the debtor, and the snapshot rule respects the statute's unambiguous command by capturing the property and its value as of the petition date.

See 11 § U.S.C. 348(f)(1), (2). If this Court were to treat "property" and its value as one and the same under § 348(f)(1) and (f)(2), it would both disregard the intent of Congress and have the effect of making debtors worse off for having attempted chapter 13. *See, e.g.*, *Castleman v. Burman* (*In re Castleman*), 75 F.4th 1052 (9th Cir. 2023) (upon good faith conversion, debtor was forced to relinquish $200,000 in post-petition increase in equity because the court held that appreciation was also part of the estate). The statute says:

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

11 U.S.C. § 348(f)(1)(A)

As a good faith debtor, Cpl. Clegg's conversion is governed by § 348(f)(1)(A), which expressly limits property of the estate in two notable ways: first, the property of the estate consists of only that property held by the debtor "*as of the petition date*;" second, in the event of conversion, that property may only enter the estate to the extent it "remains *in the possession* of or is under the control of the debtor on the date of the conversion." (emphasis added). Essentially, § 348(f) takes a snapshot of the chapter 13 debtor property and its value as of the commencement of the case, should their best laid plans go awry. Therefore, in the case of Cpl. Clegg's good faith conversion, the converted estate can only include those legal or equitable interests that existed as of the Petition Date, fixed by § 348(f)(1)(A); conversely, those which accrued after the Petition Date are property of Cpl. Clegg. 11 U.S.C. §§ 541(a), 348(f)(1)(A).

This fact is further confirmed by the second limitation which § 348(f)(1)(A) places on a converted chapter 7 estate. Property "that *remains in the possession* of or is under the control of the debtor on the date of conversion" is to become property of the estate. By limiting property of the estate to only property that "remains in possession" of the debtor, Congress recognized that if a good faith conversion realizes a loss in pre-petition equity the bill does not fall on the debtor for trying. 11 U.S.C. § 348(f)(1)(A). Petitioner's objections on this ground are meritless because the express language of the statute clearly indicates Congress' intent. Thus, had the equity in Cpl. Clegg's house depreciated, the text of § 348(f)(1)(A) would exclude this depreciation from "property of the estate" and protect him from footing the bill.

Congress intended § 348(f) to align with § 522(a)(2) to maintain consistency in the definition of "value" for "property of the estate. Any ambiguity about § 348(f) is cleared up when it is read in the broader context of the Bankruptcy Code—sections 522 and 541(a)(1) provide that vital context. *See Kelly v. Robinson*, 479 U.S. 36, 43 (1986) ("In expounding [the Bankruptcy Code], we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy.") For exemptions, section § 522(a)(2) contemplates two periods of time for ascertaining the "value" of a debtor's "interest" in his property, which are parallel to § 348(f)(1) and (2). First, § 522(a)(2) states the fair market value of the exempted interest is determined "as of the date of the filing of the petition," which is congruous with § 348(f)(1) which "values" "property as of the petition date.[3]" Second, for the bad faith debtor property is valued "as of the date such property becomes property of the estate" and that is "the date of conversion." *Id.* Congress clearly contemplated § 348(f)(1)(A) and 348(f)(2) bearing the statutory construction of § 522(a)(2) in mind, and intended to maintain the definition of "value" of property of the estate across both sections, rather than nonsensically willing "value" to mean one thing for purposes of exemptions and another for conversions.

[3] Not to be confused with "valuations" which do not apply in a converted case and no party disputes. *See* § 348(f)(1)(B); *VALUATION, Black's Law Dictionary* (11th ed. 2019) (defining valuations as "[t]he process of determining the value of a thing or entity,").

Sections 522(d)(2) and 541(a) provide further context to § 348(f)(1). Both define "property of the estate" as limited to the debtor's interest in that property. For the purposes of § 522(d)(2), that interest is limited to the "value" of $15,000. 11 U.S.C. § 522(d)(2); *Schwab v. Reilly*, 560 U.S. 770 (2010) (holding a debtor's exemptions are interests rather than property with inseparable value). Section 541(a)(1) works similarly by limiting the property of the estate to the debtor's interest in that property "as of the commencement of the case." 11 US.C. § 541(a)(1). While Congress used the words "all legal or equitable interests" in § 541(a)(1) to define the scope of property broadly, it also intended those "interests," like the debtor's exemptions, to be tied directly to their fair market value "as of the commencement of the case." *Id.*; § 348(f)(1). Reading these together, it is clear that in the context of chapter 7, Congress did not intend for changes in value in an asset to be considered, but rather intended for the fair market value of the property to simply be regarded as equivalent to the estates' interest in that property as of the petition date. *See* 11 U.S.C. §§ 541(a)(1); 348(f)(1). Thus, after the commencement of the case, for a debtor who has some way of increasing his interest in an asset post-petition, the increase in value belongs to him.

Cpl. Clegg's home is unquestionably property of the estate. R. at 25. He held title and possession as of the Petition Date. All parties agree that, as of the Petition Date, the fair market value of Cpl. Clegg's home was $350,000. R. at 8. In an ordinary chapter 7 case, Cpl. Clegg would have received a "clean break" from his financial past at the steep cost of losing his home. *Harris*, 575 U.S. at 513; 11 U.S.C. § 704(a)(1). Then, in chapter 7, the trustee would have distributed the proceeds from his home as property of the estate. 11 U.S.C. 541(a)(6).

In *Harris*, this Court held that § 348(f)(1)(A) limited a converted chapter 7 estate to property belonging to the debtor "as of the petition date." *Harris*, 575 U.S. at 517. There, the trustee argued that because Congress did not expressly designate who had rightful possession over post-petition, pre-conversion property, it presumptively belonged to the creditors. *Id.* Even without Congress' express command, this Court found that liquidating and distributing the debtor's undistributed post-petition, pre-conversion property to creditors in a converted case was incompatible with § 348(f)'s statutory design. *Id.* at 518 ("We resist attributing to Congress, after explicitly exempting from chapter 7's liquidation-and-distribution process a debtor's [post-petition] wages, a plan to place those wages in creditors' hands another way.")

Today, the Petitioner attempts to recycle the faulty logic this Court rejected in *Harris* by suggesting that it is necessary for Congress to use language they have used in other parts of the Code to indicate exclusion. This reasoning is incompatible with *Harris* which found exclusion of the equity based on both the text of the statute and its design. *Id.*; *contra, In re Adams,* 641 B.R. 147, 152 (Bankr. W.D. Mich. 2022). The case before the Court is clear under the plain language of the text. *See Hartford Underwriters Ins. Co.,* 530 U.S. 1, 6 (2000). Cpl. Clegg's new equity was acquired after the Petition Date. R. at 8. Per § 348(f)(1)(A)'s plain text and this Court's reading of the statute in *Harris,* the $100,000 appreciation-equity is rightfully Cpl. Clegg's and outside the reach of creditors. *Id.*; *Harris*, 575 U.S. at 518.

1. At minimum, the debtor is entitled to increases in equity attributable to payments made during the chapter 13 plan.

This Court's precedents have treated undistributed post-petition monies in a converted case, not as property of the creditors, but rather as that of the debtor's. *Harris*, 575 U.S. at 518. A debtor who increases his equity in a chapter 13 case through a paydown must be entitled to that equity upon conversion from chapter 13 to chapter 7.

Upon confirmation, all property of the bankruptcy estate is vested in the debtor and is rendered "free and clear of any claim or interest of any creditor provided for by the plan." *Bullard* *v. Blue Hills Bank*, 575 U.S. 496, 502 (2015) (quotations omitted); 11 U.S.C. § 1327(b),(c). As discussed above, § 348(f)(1)'s unambiguous language limits a trustee from reaching post-petition increases in equity. *See* 11 U.S.C. §§ 348, 541(a)(6). Section 541 property of the estate includes:

> (1) . . . all legal or equitable interests of the debtor in property as of the commencement of the case.
>
> . . .
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> (6) Proceeds, product, offspring . . . of . . . property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.

See 11 U.S.C. § 541(a) (emphasis added).

In *In re Barrera III*, post-petition appreciation from a pre-conversion sale was deemed property of the debtor. *Rodriguez v. Barrera (Barrera III)*, 22 F.4th 1217 (10th Cir. 2022). There, the trustee argued that appreciation from the sale of the debtor's home in a pre-conversion sale should go to creditors when the debtor converted to chapter 7, because proceeds and the property were one and the same–both belonged to the estate. *Id.* at 1223. The court rejected the trustee's argument because the appreciation was not "proceeds from property of the estate, but instead proceeds from property of the debtor." *Id.* (citing § 541(a)(6)). Since the underlying property was vested in the debtor under § 1327(b) during the time of appreciation, proceeds were not derived "from property of the estate," and the post-petition appreciation generated from the pre-conversion sale was not property of the estate. *Id.* (citing § 541(a)(6)).

Section 541(a)(6) provides important context here, because the pay down equity in Cpl. Clegg's case was created from property he acquired after the Petition Date, and post-petition property is traditionally never property of the estate. Section 348(f)(1)(A) precipitates this outcome, and it would be senseless to attribute to Congress a scheme which would run around its exemption to simply place those "post-petition wages in creditors' hands another way." *Cf. Harris*, 575 U.S. at 513. While the monies here were not distributed to the Mr. Clegg in chapter 13, the fact that the his payments under the plan were not from property of the estate necessarily means that paydown equity in the post-petition property must inure to his benefit regardless of whether the sale is pre- or post-petition. *Id.*

Cpl. Clegg elected to file chapter 13. In doing so, he entered an open negotiation to confirm a repayment plan. Cpl. Clegg worked with his creditors and imposed strict financial requirements on himself to retain possession of his home. 11 U.S.C. § 1306. As of the petition date, Cpl. Clegg retained no interest in his property but, upon confirmation of the chapter 13 plan the home was vested in Cpl. Clegg's name. *Bullard*, 575 U.S. at 502; 11 U.S.C. §§ 522, 1327(b). With the property back in his possession, during the next eight months, Cpl. Clegg made timely payments under the confirmed plan, contributing $10,000 of his post-petition income to the chapter 13 estate. R. at 8. Through his effort and market forces, $100,000 in equity accrued to his benefit. *Id.*; *see also*, 11 U.S.C. § 541(a)(6). The equity attributable to post-confirmation property must be returned to Cpl. Clegg. Otherwise the chapter 7 estate would include proceeds from property which were not "property of the estate" during the relevant time.

2. Capturing the post-petition appreciation and distributing it to creditors is incompatible with § 348(f) 's statutory design which seeks to penalize only the bad faith debtor.

Reading the statute any other way would altogether diminish the impact and goals of § 348(f). This court identified in *City of Chicago v. Fulton*, that Congress enacts legislation targeting a specific problem—in the case of § 348(f) that problem is whether post-petition appreciation is property of the estate. 592 U.S. 154, 166 (2021). Congress sought to encourage good faith by enacting § 348(f)(1)(A) to protect good faith debtors through the snapshot rule and discourage bad faith debtors through § 348(f)(2) by allowing the property of the estate in the converted case to include all legal or equitable interests of the debtor, "as of the date of conversion."11 U.S.C. § 348(f)(1)(A), (2).

In a bad faith conversion, the now-chapter 7 case and the new estate are free from the limitations of § 348(f)(1)(A). As discussed in Part I.A.1, because property of the estate now includes all property as of the conversion, "all legal or equitable" interests created by the debtor up to that date must become property of the new chapter 7 estate and be liquidated for the benefit of creditors. This substantial penalty is meant to be a deterrent to a bad acting debtor, rather than the norm.

If Congress had intended for post-confirmation, pre-conversion increases in value to inure to the benefit of the estate, then the only difference between converting in bad faith versus good faith would be the monies (and the property acquired with it) that the debtor earned post-conversion above the tight budget imposed on the chapter 13 debtor. *See* 11 U.S.C. § 348(f).

The snapshot rule also protects creditors. Without a serious deterrent, abuse of § 348(f)(1)(A) would lead to mistrust in the chapter 13 process for the creditors who are faithfully upholding the congressional scheme. While Congress sought to protect debtors, they sought to protect creditors just the same. The tension between § 348(f)(1) and (2) is easily resolved by adopting the snapshot rule and ensures § 348(f)(2) is consequential.

B. *Congress Anticipated this Dispute and Passed Section 348(f)(1) to Preclude Trustees from Making this Argument.*

The statutory history shows that Congress specifically intended to solve for post-petition appreciation when it amended § 348(f). The Court should re-affirm its reasoning in *Harris* and interpret the language of the statute considering *Bobroff* and its progeny. *See e.g.,* 575 U.S. 510; 766 F.2d 797 (3d Cir. 1985).

1. Reading section 348(f) to forfeit debtor's earned equity would be consistent with *Lybrook*, which Congress expressly overturned by enacting this provision.

Before the passage of the Bankruptcy Reform Act of 1994, circuits were split on whether, in cases of conversion from chapter 13 to chapter 7, undistributed post-petition property, like equity, belonged to the benefit of the debtor or creditors. *Harris*, 575 U.S. at 516-17. As this Court said in *Harris,* Congress resolved that split by adopting the reasoning of *Bobroff v. Continental* and overruling that of *In re Lybrook. See Harris*, 575 U.S. at 517 (first citing *In re Bobroff*, 766 F.2d at 802-803, then citing *In re Lybrook*, 951 F.2d 136,137 (7th Cir. 1991)). *Bobroff's* reasoning is consistent with reading § 348(f) as granting post-petition, pre-conversion equity to the debtor. *Bobroff*, 766 F.2d at 802-803. Because Congress failed to indicate whether undistributed property should be distributed to debtors or creditors, this Court determined in *Harris*, that § 348(f) provides that undistributed property is rightfully the debtor's. *Harris*, 575 U.S. at 518.

In *Bobroff*, after filing a chapter 7 bankruptcy, the debtor attempted to convert his case to one under chapter 13. During that time, the debtor filed a tort action against Continental Bank for damaging his reputation during the bankruptcy proceedings by stating that he was "concealing assets from the bank and from the Bankruptcy Court." *In re Bobroff*, 766 F.2d at 800. The Bank argued that under the Code, the cause of action which accrued during the case was property of the estate. *Id.* at 803. To support this proposition, the Bank contended that because the case remained open during chapter 13, the property of the estate refilled with the cause of action as after-acquired property. *Id.*; 11 U.S.C § 1306.

Rejecting these arguments, the court found that the cause of action was not property of the estate for two reasons. *In re Bobroff*, 766 F.2d 803. First, claims the Bank made under the provisions of chapter 13 were void *ab initio* because when the debtor attempted to convert his case to chapter 13, he was not eligible for relief under that chapter. *In re Bobroff*, 766 F.2d 797, 803 (3rd Cir. 1985). Second and most importantly, the court reasoned that even though this case never entered chapter 13, the Code's goal of encouraging reorganization demanded the result.

> 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—which must be voluntary—a try will be greatly diminished. Conversely, when chapter 13 does prove unavailing "no reason of policy suggests itself why the creditors should not be put back in precisely the same position as they would have been had the debtor never sought to repay his debts...."

Id. (citing *In re Hannan,* 24 B.R. 691, 692 (Bankr. E.D. N.Y. 1982)).

The *Lybrook* court repudiated *Bobroff* by holding that an inheritance the debtor received post-petition, pre-conversion was property of the new chapter 7 estate. *In re Lybrook*, 951 F.2d at 138. The court argued that a conversion in chapter 13 merely assures the case's continuity for fees, preferences, and statute of limitations. *Id.* at 137. In holding this way, the *Lybrook* court rejected claims that this would discourage chapter 13 filings and claimed that the risk of encouraging conversions at the expense of creditors was too high. *Id.*; *but see, Barrera III*, 22 F.4th at 1226. As mentioned earlier, this court rejected the reasoning of *Lybrook* in *Harris. Harris*, 575 U.S. at 517. This Court should adopt *Harris*' reasoning and the snapshot rule recognizing the important policy considerations of encouraging chapter 13 so that the decision aligns with *Bobroff* which Congress embraced when it enacted § 348(f).

When Cpl. Clegg filed his case under chapter 13 and confirmed a plan to resolve his debts, he acted in precisely the way Congress had hoped. He entered chapter 13 for the sole purpose of retaining his home and unfortunately failed. Under *Harris* and *Bobroff*, this Court is then compelled to read the § 348(f) to protect debtors that risk property they acquired during an attempt at repayment. Even when a chapter 13 debtor fails, putting the debtor back in at least the same position as of the commencement of the case is required. *See* 11 U.S.C. § 348(f)(1)(A). In this case, the debtor increased the equity in his home by $100,000. R. at 8. This was no free lunch, and to do so, Cpl. Clegg siphoned large portions of his salary to the chapter 13 plan. He exhausted time and energy upkeeping his property and paid taxes and insurance. Congress sought to recognize this effort when it adopted § 348(f), which is consistent with *Bobroff*'s reasoning for granting the property acquired after the chapter 13 petition to the debtor. Holding otherwise would undermine Congress' intent.

2. The facts of this case were expressly anticipated by Congress, confirming that section 348(f)(1) was meant to shield the debtor's post-petition increases in equity.

Congress clearly believed that home equity which accrues after the Petition Date, should not be included in the converted estate. The House Report says as much:

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

H.R. REP. NO. 103-835, at 57 (1994), as reprinted in 1994 U.S.C.C.A.N. 3340, 3366.

The example provided highlights a circumstance similar to Cpl. Clegg's, where the debtor increases the equity in his home after paying down his secured loan. The House Report's example reiterates that equity is meant to be attributed to the debtor alone; equity is equity, and whether the equity is created through a pay down, market forces, or some other means, Congress clearly contemplated granting increases in equity to the debtor when it passed § 348(f)(1). While other provisions of the Code provide general guidance about how equity created by the debtor should be treated, in all statutory interpretation, the more specific § 348(f) which governs property of the estate in a converted case controls over those more general provisions. *See Law v. Siegel*, 571 U.S. 415 (2014); *See, e.g.*, 11 U.S.C. § 541(a)(6) (expressly excluding proceeds from services performed by the debtor).

When Cpl. Clegg filed for bankruptcy, his home was worth $350,000 and was vested in him as a result of his confirmed chapter 13 plan. R. at 8. Cpl. Clegg could have simply filed for chapter 7, quickly erasing all his debts, resolving this case, and allowing him to place his full focus on his business. R. at 17. Instead, he did what Congress encouraged him to do— wishing to make good on his debts, Cpl. Clegg voluntarily entered a three-year chapter 13 plan, paying creditors his post-petition income. R. at 7. Circumstance and a global pandemic had other plans, and while Cpl. Clegg tried his best, the market crushed any chance of repaying his creditors. R. at 8.

Fortunately for Cpl. Clegg, this effort was not meaningless. Congress anticipated this problem when it passed § 348(f) and resolved for it. Consistent with the text of the Code, and relevant to the case at hand, this legislative history confirms that appreciation in Cpl. Clegg's home is his property, and not property of the chapter 7 estate. *See In re Castleman*, 75 F. 4th at 1064 (Tallman, C.J., dissenting).

C. Awarding Appreciation to the Debtor Best Serves the Interests of Chapter 13.

Post-petition appreciation exists only because of Cpl. Clegg's faithful performance under his chapter 13 plan. This Court should apply the snapshot rule already adopted in *Harris* and give the post-petition appreciation to Cpl. Clegg. To deprive Cpl. Clegg of his property's post-petition increase in value deters potential chapter 13 debtors from using chapter 13.

1. Encouraging chapter 13 is in the best interest of both creditors and debtors.

The Thirteenth Circuit acknowledged and appropriately applied the significant policy considerations behind § 348(f)(1) and (f)(2) which were enacted by Congress to best serve good faith debtors and protect creditors from bad faith acts. *See, e.g., In re Boggs,* 137 B.R. 408, 411 (Bankr. W.D. Wash. 1992). ("[T]he Congressional policy of encouraging debtors to repay their creditors via chapter 13 is furthered by debtors (and their counsel) knowing they will not be penalized for attempting chapter 13.") The Bankruptcy Code encourages chapter 13 bankruptcies because they are largely seen as a "win-win"—chapter 13 allows debtors to retain assets, and creditors to "collect more than they would have under a chapter 7 liquidation." *Harris*, 575 U.S. 514; Collier on Bankruptcy ¶ 1322.01 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2012).

Admittedly, not all debtors are like Cpl. Clegg. A bad faith debtor seeking to game the system faces serious penalties. *See* § 348(f)(2). Under the snapshot rule, a bad-faith debtor must think twice before acting. *Id.* However, adopting a rule that treats the property and its value as indistinguishable in good and bad faith conversions is inapposite to the careful balance between encouraging chapter 13 and protecting creditors that Congress struck when it passed § 348(f).

A chapter 13 debtor like Cpl. Clegg faces a steep road ahead of him. Roughly two thirds of all chapter 13 bankruptcies end in chapter 7 liquidations, and during the 3 to 5-year repayment period debtors face the challenges of life. *See* Sara S. Greene, Parina Patel, & Katherine Porter, *Cracking the Code: An Empirical Analysis of Consumer Bankruptcy Outcomes,* 101 MINN. L. REV. 1031, 1042 (2017); R. at 8. Cpl. Clegg worked tirelessly to save his home, siphoning large portions of his income to fund his plan. R. at 8; *see* § 348(f)(2). Unfortunately, as is the case with many chapter 13 debtors, Cpl. Clegg was unable to complete his plan after making eight months of timely payments and chose to convert his case to one under chapter 7 in good faith. 11 U.S.C. 348(f)(1)(A); *see also* Greene, et. all, 101 MINN. L. REV. at 1042.

Here the Code worked as intended, and this case was a "win-win" for both Cpl. Clegg and his creditors. *See Harris*, 510 U.S. 514. Admittedly not all cases will end so perfectly. *See supra*, Part I.A. However, to combat these challenges Congress provided for plan payments and adequate protection for creditors. S*ee* 11 U.S.C. § 1326(a)(1)(C). Creditors are no worse off as a result of Cpl. Clegg's effort to proceed in chapter 13. R. at 8. Eclipse received $20,000 of non-dischargeable debt, and a $150,000 unsecured claim through chapter 13 negotiations; in fact, worried that chapter 13 left them worse off Eclipse, originally disputed Cpl. Clegg's filing before settling, as Congress intended. R. at 8; *See* 11 U.S.C. § 1325.

Chapter 13 incentivizes debtors to repay their debts rather than simply liquidating all of their assets under chapter 7, and § 348(f) is essential to that bargain as both carrot and stick. The Thirteenth Circuit's ruling as it stands is the most equitable course.

2. Holding otherwise would be to the detriment of debtors and ignores the policy Congress promoted when enacting section 348.

Without the snapshot rule, the Court leaves the promise of safe harbor from creditors in chapter 13 up to "market conditions." *In re Castleman*, 75 F. 4th at 1058. In fact, holding otherwise presents a particularly perverse result in this case, as Cpl. Clegg "likely would have been able to keep his home had he simply decided to file for relief under [C]hapter 7 in the first place." R. at 17. The possibility of returning this equity to creditors would have produced even greater uncertainty for Cpl. Clegg on the cusp of bankruptcy. This would leave debtors like himself uncertain of whether to take the risk of Chapter 13 to keep their home or forgo that possibility knowing that if they fail that effort would be wasted.

The facts of this case favor preserving the policy Congress expressly intended when it adopted § 348(f)(1). In fact, limiting the bankruptcy estate to the property as of the petition date, not only advances Congress' intent to protect good faith debtors like Cpl. Clegg under § 348(f)(1), but also preserves the best interests of creditors. Creditors will receive just what they had expected at the outset of this case, when appreciation was not a factor. It also provides incentive to debtors who file for chapter 13, confirm a plan, and for reasons out of their control are forced to give up their attempt at repayment. Congress recognized that effort and it promised debtors the benefits of post-petition equity should their plans fail. 11 U.S.C. § 348(f)(1).

Consistent with the purposes of chapter 13, and the balance Congress struck when enacting § 348(f)(1) and (2), the good faith debtor should be protected from those "market conditions" as Congress intended and reap the reward for trying to repay his creditors. *In re Castleman*, 75 F. 4th at 1058. To incentivize chapter 13 filings, Cpl. Clegg must be entitled to the appreciation-equity he rightfully earned post-petition. This Court should adopt the snapshot rule and affirm the ruling of the Court of Appeals for the Thirteenth Circuit in favor of the Debtor, Cpl. Clegg.

II. A CHAPTER 7 TRUSTEE CANNOT SELL THE STATUTORY POWER TO AVOID AND RECOVER TRANSFERS OF PROPERTY.

Congress created the trustee's position to ensure an impartial third party would balance the conflicting interests of debtors and creditors while preserving the integrity of the bankruptcy process. As a fiduciary, Congress empowered the trustee with avoidance and recovery powers to recover preferential transfers for the benefit of the estate. These powers are unique to the trustee;

the sale of these powers to self-interested third parties would open the door for abuse of the Bankruptcy Code.

A. The trustee's ability to pursue preferential actions is a statutory power, and not traditional property of the estate.

1. The power to avoid and recover preferential transfers is a statutorily created and granted power, rather than one arising through ownership.

In 1990, the Tenth Circuit labeled avoidance and recovery powers a "legal fiction" fashioned by Congress to enable the trustee to maximize the value of the bankruptcy estate. *Zilkha Energy Co. v. Leighton*, 920 F.2d 1520, 1523 (10th Cir. 1990). Through this fiction, the trustee is empowered to simultaneously stand in the shoes of the debtor "to set aside transfers to third parties," and in the shoes of the creditor "to effect a recovery from a third party." *Id.* Preferential transfers prompt the trustee to step into the latter's pair of shoes.

The trustee's power to avoid and recover preferential transfers is just that, a power. *In re Cybergenics Corp.*, 226 F.3d 237 n.16 (3d Cir. 2000) (citing 5 Collier on Bankruptcy ¶ 541.14 n. 1 (Lawrence P. King, ed., 1999)). This power is different from the ordinary property rights that the trustee automatically inherits as trustee of the estate upon petition date. It is a special equitable tool created and conferred upon the trustee to enforce the Bankruptcy Code's central "scheme for ensuring equitable distribution among creditors." *West v. Freedom Med., Inc.,* 465 B.R. 452, 463 (Bankr. S.D. Tx. 2011). By exercising its avoidance and recovery powers, the trustee steps into the "'overshoes' of a creditor" while still juggling its "administrator hat." *In re Cybergenics Corp.*, 226 F.3d 237, 244 (3d Cir. 2000) (citation omitted). In these "overshoes," the trustee prevents the debtor from playing favorites among creditors and recovers the preferentially transferred assets to distribute them on a pro-rata basis amongst all creditors. *Id.*; *In re Freedom Group, Inc.*, 50 F.3d 408, 410 (7th Cir. 1995). This function highlights the distinct character of avoidance and recovery powers relative to the ordinary property rights the trustee asserts over estate property in its administrative capacity. *West v. Freedom Med., Inc.,* 465 B.R. at 463.

These powers cannot be labeled as an asset of the estate. As the *Cybergenics* court recognized, the trustee's avoidance and recovery powers[4] are equivalent to the powers bestowed upon public officials "by virtue of the office or public trust." 226 F.3d at 244. Just as public officials cannot delegate away or sell their powers, a trustee is similarly bound. *In re Parirokh*, 2013 Bankr. LEXIS 5871 at *5 (Bankr. W.D. Mich., May 2, 2013) (citing *In re Cybergenics Corp.*, 226 F.3d at 244). Consequently, the trustee's ability to avoid and recover transfers must be categorized as a statutorily granted *power* of the role rather than an *asset*, to which the elements of possession, ownership, and transfer are tied.

2. Section 541 does not recognize the trustee's avoidance powers as property of the estate.

The plain language of 11 U.S.C. § 541 makes abundantly clear that avoidance powers are not property of the estate. *See* 11 U.S.C. § 541(a)(1), (6), (7); *Lamie v. U.S. Tr.*, 540 U.S. 526, 534 (2004) ("[W]hen the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd— is to enforce it according to its terms"). The statute defines what constitutes property of the estate with specificity; had Congress intended to include avoidance powers as property of the estate, it would have expressly done so.

As a preliminary matter, no matter how broadly the Petitioner encourages § 541(a)(1) to be read, it cannot be used to label avoidance powers as estate property. R. at 19, 31. Section 541(a)(1) states that "all legal or equitable interests of the debtor in property *as of the*

[4] Unless otherwise specified, §§ 547 and 550 avoidance and recovery powers will be referred to jointly as "avoidance powers" hereinafter.

commencement of the case" are property of the estate. (emphasis added). It is well established that the phrase "as of the commencement of the case" means that § 541(a)(1) only brings those legal or equitable interests that existed prior to the petition date into the estate. *See* 348(f)(1). Because the avoidance powers are granted to the trustee only once the debtor files for bankruptcy, § 541(a)(1) axiomatically does not apply. Timing issue aside, Cpl. Clegg never possessed a right, legal or equitable, to avoid the alleged preferential transfer. Section 541(a)(1) only includes a debtor's pre-petition interests in property of the estate, and Cpl. Clegg terminated his pre-petition interest in the funds upon transfer to Pink. 11 U.S.C. § 541(a)(1); R. at 7; *see, e.g.*, *Beiger v. IRS*, 496 U.S. 53, 58-59 (1990). Even still, the relevant question at issue is not whether the funds remained property of the estate, but whether the *power* to avoid preferences is property of the estate. The power to avoid preferences is a product of bankruptcy; outside of bankruptcy, the power never existed, and Cpl. Clegg did not derive the power to avoid any alleged preferential transfer he had made to Pink through other statutory authority. The statute granted the power to avoid preferential transfers exclusively to the trustee upon commencement of the bankruptcy case. *See* 11 U.S.C. §§ 547(b), 550. Avoidance powers fall squarely outside of the scope of § 541(a)(1).

Avoidance powers also cannot be included as property of the estate under § 541(a)(7), which pulls into the estate "[a]ny interest in property that the estate acquires after the commencement of the case." 11 U.S.C. § 541(a)(7). As discussed in Part II.A.1 the ability to avoid and recover transfers is not an interest "acquired" by the trustee from the debtor or from the estate post-commencement, but rather a power created by and granted to the trustee from the Code itself. *Cf. Meoli v. Huntington Nat'l Bank (In re Teleservices Group, Inc.)*, 463 B.R. 28, 34 (Bankr. W.D. Mich. 2012) (discussing the nature of avoidance powers, specifically in the context of fraudulent transfers).

In fact, when § 541(a)(7) is read within the overall context of § 541, it gives rise to the negative inference that avoidance powers are not and were never intended to be property of the estate. *See* 11 U.S.C. § 541(a)(3),(4),(6). It is understood that each provision within a statute must be read bearing in mind the overall intended statutory scheme. *See Kelly v. Robinson*, 479 U.S. 36, 43 (1986) ("In expounding [the Bankruptcy Code], we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy.") In writing § 541, Congress expressly defined *all* items that constitute property of the bankruptcy estate— one of the express inclusions is the recovery derived from the exercise of the trustee's avoidance powers. *See* 11 U.S.C. § 541(a)(1)-(7); 11 U.S.C. § 541(a)(3). It can be inferred, then, that if Congress had intended for avoidance powers to be recognized as property of the estate, it would have expressly stated as such. Reading § 541(a)(7) to include avoidance powers as property of the estate undermines Congress' meticulous enumeration of the definition of property. 11 U.S.C. § 541(a).

The canon against surplusage, which is strongest when "an interpretation would render superfluous another part of the same statutory scheme," also supports this reading of § 541(a)(7). *Marx v. General Revenue Corp.*, 568 U.S. 371, 386 (2013). Construing § 541(a)(7) to include avoidance powers as property of the estate would render § 541(a)(3) superfluous. Section 541(a)(3) expressly recognizes as property of the estate "[a]ny interest in property that the trustee recovers" under § 550, not any interest that the trustee *can* recover. 11 U.S.C. § 541(a)(3); *In re Sweetwater*, 55 B.R. 724, 730 (D. Utah 1985). In plain language, this means that property *actually recovered* under § 550 becomes property of the estate, but neither the trustee's avoidance power nor the asserted claim, which only has the potential for recovery, becomes property of the estate. *See In re Colonial Realty Co.,* 980 F.2d 125, 131 (2d Cir. 1992).

The *In re Colonial Realty Co*. court considered the congressional intent behind § 541(a)(3) as it evaluated whether fraudulent conveyance claims were property of the estate, and relied on the following logic: "the inclusion of property recovered by the trustee pursuant to his avoidance powers in a separate definitional subparagraph clearly reflects the congressional intent that such property is not to be considered property of the estate until it is recovered." *Id.* (quoting *In re Saunders*, 101 Bankr. 303, 304-06 (Bankr. N.D. Fla. 1989) (quotations omitted)). Though *In re Colonial Realty Co*. was evaluating the nature of fraudulent conveyance claims, analogous reasoning is appliable here because both fraudulent conveyance claims and preferential transfer claims are derived from a trustee's statutorily granted avoidance powers. *See id.* Section 541(a)(3) would be rendered meaningless with respect to property actually recovered under § 550 if § 541(a)(7) was construed to recognize the trustee's exercise of its avoidance powers as property of the estate.

This superfluity argument is further corroborated by the existence of § 541(a)(6). Section 541(a)(6) articulates that "[p]roceeds…of or from property of the estate" constitute property of the estate. 11 U.S.C. § 541(a)(6). If avoidance powers were considered property of the estate, then § 541(a)(3) would be fully subsumed within (a)(6) and add no independent value. Congress purposefully created § 541(a)(3) to place the recovery derived from the exercise of avoidance powers in a category separate from general proceeds derived from traditional estate causes of action. *Compare* 11 U.S.C. § 541(a)(3), *with* 11 U.S.C. § 541(a)(6). The fact that Congress made this distinction between § 541 proceeds and "'property that the trustee recovers' under § 550" serves as "strong evidence that the two species of property are different, at least in some respects." *Generation Resources Holding Company, LLC*, 964 F.3d 958, 968 (10th Cir. 2020). Section 541(a)(3) only exists and operates independently because Congress never intended for avoidance power causes of action to be recognized as property of the estate. Consequently, if § 541(a)(7) is interpreted to include avoidance powers, and thereby avoidance causes of action, as property of the estate, then § 541(a)(3) is meaningless when read alongside § 541(a)(6).

The trustee's avoidance powers fall outside of the language of § 541.

B. Alternatively, if the court finds that avoidance powers are property, they are property of the trustee, and the trustee cannot sell or assign these powers under section 363(b).

The ability to avoid and recover preferential transfers flows from the statutory power granted to trustees upon commencement of the bankruptcy. 11 U.S.C. §§ 547(b), 550. Avoidance powers are accordingly property of the trustee and cannot be sold or assigned. *See In re Saunders*, 101 B.R. 303, 305 (Bankr. N.D. Fl. 1989).

1. Per *Hartford Underwriters*, Congress intended for avoidance and recovery powers to belong solely to the trustee.

In *Hartford Underwriters,* this Court held that when Congress designated the "trustee" to exercise a specific statutorily authorized action within the Bankruptcy Code, it intended to empower the trustee alone and no one else. *See Hartford Underwriters Ins. Co.*, 530 U.S. at 6-7. While the this Court was considering the specific language of § 506(c) in *Hartford Underwriters*, the statutory construction principles used to interpret § 506(c) should be applied to §§ 547 and 550. Like § 506(c), the language of both §§ 547 and 550 expressly empowers the "trustee," and no one else, to exercise the avoidance and recovery powers. *See id.*; 11 U.S.C. §§ 547(b), 550.

This Court began its analysis with the basic understanding that "Congress 'says in a statute what it means and means in a statute what it says there.'" *Hartford Underwriters,* 530 U.S. at 6-7. The language of both §§ 547 and 550 plainly identifies who may use the powers created by §§ 547 and 550, just as § 506 did, and must, therefore, be enforced according to its terms. *Id*. This reading follows from a well-established understanding of statutory construction and is further supported by "the fact that the sole party named—the trustee—[who] has a unique role in bankruptcy proceedings[,] makes it entirely plausible that Congress would provide that power to him and not to others." *Id.* at 7. Had Congress intended for § 506 or the §§ 547 and 550 avoidance and recovery powers to be broadly exercisable, it would have communicated as much. *Id.* (comparing § 503(b)(4)'s language which empowers "an entity" to submit a request with the narrowly tailored § 506(c) language). Restrictive language like "only" is not necessary to maintain the exclusivity intended within a statutory provision. *Id.* at 8. The Supreme Court rejected asserted pre-Code guidance and policy arguments in favor of the most natural reading of § 506(c), which it read to be exclusively limited to use by the trustee. *Id.* at 9. The most natural reading of §§ 547 and 550 must also be followed here— the trustee, and the trustee alone, holds the avoidance and recovery powers. *See id*. Consequently, these powers are solely property of Floyd, the Trustee. They cannot be sold or assigned because Eclipse, a creditor, is not allowed to use them pursuant to *Hartford Underwriters*. *Id*. at 6-9.

2. It is a well-established pre-Code principle that the trustee cannot sell, assign, or otherwise transfer the power to avoid and recover preferences.

Where there is ambiguity in the statute, pre-Code practice can help "inform[] our understanding of the language of the Code." *Kelly*, 479 U.S. at 46. A long line of pre-Code cases supports the proposition that the trustee's avoidance powers belong to the trustee, not the estate, and cannot be sold, assigned, or otherwise transferred. *In re Sweetwater*, 55 B.R. at 731.

The seminal pre-Code case analyzing the assignability of a trustee's avoidance powers is *In re Sapolin Paints, Inc*.. 11 B.R. 930, 938 (Bankr. E.D.N.Y 1981). The court was presented with the task of determining whether a third party who had purchased the debtor's assets from the trustee could exercise the trustee's power to void a preference. *In re Sapolin Paints, Inc*., 11 B.R. at 938.

If allowed, the third party would have used the avoidance power to unjustly enrich itself by increasing the value of its assets and in turn, "reduce[d] the assets available for distribution to the general creditors." *Id.* In the eyes of the court, the third party was "attempting to stand the law of preferences on its head" because such a use of the trustee's avoidance power would have been entirely contrary to the purpose for which the power was created in the first place. *Id.* It was well-established that the trustee's power to avoid preferences was created in the interest of "securing *equality* of distribution among creditors." *Id*. at 937 (emphasis added)(citations omitted). The court viewed trustees as agents of the creditors while exercising this power— the ability to sell or assign this power to purchasers of the debtor's assets is perverse to the fiduciary duty trustees owe to creditors because it would have placed the purchaser's interest above the interest of the creditors. *Id.* at 938. The court's decision that the trustee's avoidance powers cannot be sold or assigned aligned with established precedent and the underlying goals of the Bankruptcy Act.[5] *See also Grass v. Osborn*, 39 F.2d 461 (9th Cir. 1930); *Canright v. General Finance Corp.*, 35 F. Supp. 841, 844 (E.D. Ill. 1940), *aff'd* 123 F.2d 98 (7th Cir. 1941); *Webster v. Barnes Banking Co.*, 113 F.2d 1003 (10th Cir. 1940).

When Congress enacted the Bankruptcy Code of 1978, it did not materially amend the predecessor statutory language to §§ 547 and 550. *Compare* 11 U.S.C. §§ 547, 550 *with* Bankruptcy Act of 1898, ch. 541, sec. 50, 30 Stat. 562 (codified as amended at 11 U.S.C. § 96 (1958). If Congress had intended to deviate from the well-established pre-Code principle that

[5] Collier on Bankruptcy echoed the principles established within the pre-Code case law. The Bankruptcy Act of 1898 did not allow avoidance powers to be sold or assigned. *See* 3 Collier on Bankruptcy P 60.57 at p. 1095 (14th ed. 1979) ("(T)he right to recovery vested by the Act in the trustee is not assignable); 4 Collier on Bankruptcy P 547.01 (15th ed. 1980) (explaining that the power to avoid a preference must be exercised for the benefit of the estate).

trustees cannot sell or assign their avoidance powers, it would have communicated as much. *See Lamar, Archer, & Cofrin, LLP v. Appling*, 138 S. Ct. 1752, 1762 (2018) (holding that when Congress enacted the Bankruptcy Code of 1978, it was presumptively aware of "the longstanding judicial interpretation" of existing statutory phrases and if it chose not to materially amend them, Congress "intended for [them] to retain [their] established meaning").

Following the enactment of the 1978 Bankruptcy Code, courts continued to uphold the principle that trustees cannot sell or assign their power to avoid preferences. They reiterated that individual creditors do not possess any remedies to avoid preferences themselves; they must go through the trustee. *See e.g., In re Vogel Van & Storage, Inc.*, 210 B.R. 27, 32 (N.D. N.Y. 1997); *In re Conley*, 159 B.R. 323, 324 (Bankr. D. Idaho 1993); *In re New York Int'l Hostel, Inc.,* 157 B.R. 748, 753 (S.D. N.Y. 1993); *In re Carragher*, 249 B.R. 817, 820 (N.D. Ga. 2000). Given that Congress has not indicated an intent to deviate from the "longstanding judicial interpretation" of a trustee's avoidance powers and the limits on assignability, a reading of sections 547 and 550 which permits otherwise cannot follow. *See Lamar*, 138 S. Ct. at 1762.

C. Even if the trustee can sell or assign avoidance powers, a spiteful purchase by Eclipse runs contrary to the Code's underlying intent and primary policy goals.

The trustee sits in a unique fiduciary position. *See supra*, Part II.A.1. Congress granted the trustee the power to avoid preferential transfers so that the trustee could recover property on behalf of the estate, and in turn, maximize the distribution available to *all* creditors. *In re Cybergenics Corp.*, 226 F.3d at 243. Allowing the trustee to sell the avoidance powers to Eclipse so that it can pursue recovery for its own benefit is not only entirely inconsistent with the policy of equitable distribution the Code seeks to advance, but also threatens the deference the Code grants to the trustee.

It is well established that avoidance powers cannot be transferred except in the limited circumstance where derivative standing is established—and derivative standing is inapplicable in this case. *In re Pursuit Mgmt.*, *LLC*, 595 B.R. at 658-661 (collecting cases); *In re Carragher*, 249 B.R. at 820. Derivative standing is established when a third party pursues the avoidance actions *on the trustee's behalf* and *for the benefit of the estate*. *Id.* No one suggests, nor do the facts indicate, that Eclipse is pursuing recovery of the preferential transfers through derivative standing. R. at 9. Eclipse has offered to purchase the avoidance power to pursue its own personal vendetta against Cpl. Clegg—any recovery derived from the prosecution of the alleged preferential transfer would not be distributed for the benefit of the estate, but rather absorbed wholly by Eclipse. *Id.* The prohibition on sale, transfer, or assignment of the trustee's powers, and the single exception to that prohibition exist to preserve the Code's goal of maximizing equitable distribution for creditors. *In re Sapolin Paints Inc.*, 11 B.R. at 937. The Trustee's attempted sale to Eclipse undermines the principles of equity upon which the Code is built. *Id.* If allowed, this sale would not only "compromise[] the integrity of the bankruptcy system," but also promote problematic litigation and encourage future creditors with deep pockets to buy their way around the traditional bankruptcy process. R. at 24.

Congress created the trustee's role to ensure a neutral third party oversaw the administration of and acted on behalf of the bankruptcy estate; this sale threatens the Trustee's ability to fulfill its role. *See Zilkha Energy Co.*, 920 F.2d at 1523. This sale conflicts with the Trustee's fiduciary duty to creditors because it places the purchaser's interest above the interest of all creditors. It is also impermissible because it assigns the trustee's powers to Eclipse without sufficient reason. The *Cybergenics II* court discussed at length circumstances in which it would be appropriate to employ a third party with the tools to bring suit on behalf of the trustee for the benefit of the estate. *Official Committee of Unsecured Creditors of Cybergenics Corp. (Cybergenics II)*, 330 F.3d 548, 565-567 (3d Cir. 2003) (holding that a non-trustee may bring suit on behalf of the estate where the trustee "unjustifiably" fails to, the trustee consents to the assignment, and so long as it is approved by the court); *see also In re Pursuit Mgmt.*, *LLC*, 595 B.R. 631, 658 (Bankr. D. Del. 2018) (holding that derivative standing may be permitted to enable a third party to use the trustee's avoidance powers "in appropriate circumstances, i.e. when the Code's envisioned scheme has broken down"). This is not one of those "appropriate" circumstances. *In re Pursuit Mgmt.*, *LLC*, 595 B.R. at 658.

The Trustee asserts that without the sale of its avoidance powers, the creditors could have been deprived of any other available recovery. R. at 9, 23. This is not only insufficient but incorrect reasoning— an alternative method for recovery existed through derivative standing. Section 503 authorizes derivative actions and bankruptcy courts have allowed creditors to use derivative standing in limited circumstances to pursue avoidance actions on behalf of the trustee and for the benefit of the estate, as mentioned earlier. *See* 11 U.S.C. § 503(b)(3)(B), (b)(4); *Hyundia Translead, Inc., v. Jackson Truck & Trailor Repair, Inc.* (*In re Trailer Source, Inc.*), 555 F.3d 231-238-45 (6th Cir. 2009); *In re Pursuit Mgmt.*, *LLC*, 595 B.R. at 658. Therefore, it is quite clear that another viable alternative for recovery existed that would have benefited the estate as a whole and resulted in equal distribution of recovery amongst all creditors.

This attempted sale hands a hostile creditor avoidance powers created for and conferred solely upon the Trustee. Granting this sale would undermine the deference granted to Trustees when they stand in the "overshoes" of creditors and is wholly incompatible with the central scheme of equitable distribution interwoven within the Bankruptcy Code. *In re Cybergenics Corp*., 226 F.3d at 244.

CONCLUSION

For the reasons listed above, this Court should find in favor of the Respondent, Cpl. Eugene Clegg, and uphold the decision of the Court of Appeals for the Thirteenth Circuit.