No. 23-0115

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

BRIEF FOR RESPONDENT

TEAM NUMBER 50
COUNSEL FOR RESPONDENT

JANUARY 18, 2024

QUESTIONS PRESENTED

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

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

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The Thirteenth Circuit Court of Appeals opinion can be located at Case No. 22-0359. Both the bankruptcy court and the district court decided in favor of the Debtor, Cpl. Eugene Clegg. On appeal, the United States Court of Appeals for the Thirteenth Circuit affirmed in favor of the Debtor, Cpl. Eugene Clegg.

STATEMENT OF JURISDICTION

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

STATEMENT OF CONSTITUTIONAL AND STATUTORY PROVISIONS

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

The relevant portion of 11 U.S.C. § 348(f)(1)(A) provides:

> (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, 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)(1) provides:

> (a) The commencement of a case under §§ 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.

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(a) provides:

(a) Except as otherwise provided in this section, to the extent that a transfer is avoided under §§ 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

This appeal arises from Petitioner's erroneous construction of the Bankruptcy Code. Petitioner is a Chapter 7 Trustee, attempting to recover more from the Debtor than Congress intended and, at the same time, sell to a creditor what Congress has made inalienable.

I. FACTUAL HISTORY

Cpl. Eugene Clegg (ret.) ("Debtor") owned and operated The Final Cut, LLC ("Final Cut"), after a distinguished career in the United States Army. R. at 4. Final Cut was a historic, single screen movie theater in the City of Moot. R. at 5. In 2016, the Debtor caused Final Cut to borrow $850,000 ("Loan") from Eclipse Credit Union ("Eclipse") with the purpose of renovating the theater. R. at 5. Final Cut granted Eclipse first-priority liens on Final Cut's real and personal property. R. at 5. The liens were properly perfected, and the Debtor granted Eclipse an unconditional, unsecured personal guaranty in an unlimited amount. R. at 5.

The COVID-19 pandemic severely impacted both Final Cut, which had to temporarily close, and the Debtor, who was unable to take a salary from Final Cut. R. at 6. On September 8, 2020, the Debtor subsequently borrowed $50,000 on an unsecured basis from his mother, Emily Clegg ("Pink"). R. at 6. In February of 2021, Final Cut reopened, but continued to have significant cash flow problems as customers did not return at pre-pandemic levels. R. at 6. The Debtor forewent his salary to help remedy Final Cut's problems. Unfortunately, because he was without income, the Debtor fell behind on his mortgage payments for several months. R. at 6. As a result, the servicer of his home mortgage, Another Brick in the Wall Financial Corporation ("Servicer"), commenced foreclosure proceedings. R. at 6.

In the face of these financial troubles, the Debtor sought relief under Chapter 13 of the Bankruptcy Code on December 8, 2021 ("Petition Date"). R. at 6. At the time of the petition, the

Debtor's home was worth $350,000, according to an appraisal he obtained a few days prior to filing. R. at 6. On the Debtor's schedules, he claimed a state law homestead exemption in the amount of $30,000. R. at 6. $320,000 remained outstanding on the Servicer's Mortgage. R. at 6. On the petition, the Debtor also disclosed that he had made payments totaling $20,000 to Pink within one year prior to the Petition Date. R. at 7. After negotiations, the Debtor was able to get a Chapter 13 plan confirmed, in exchange for a declaration of partial non-dischargeability.

Eight months after the Chapter 13 plan confirmation, the Debtor contracted COVID. The resulting health complications rendered him unable to continue working, and in October of 2022, the Debtor had to permanently close Final Cut. R. at 7. Eclipse commenced foreclosure proceedings against Final Cut. R. at 8. Without any source of income, the Debtor subsequently converted his case from a Chapter 13 to a Chapter 7. R at 8. Vera Lynn Floyd ("Trustee") was appointed as Trustee of the resulting Chapter 7 estate. R. at 4.

After the case was converted to a Chapter 7 the Trustee appraised the Debtor's home and found a $100,000 increase in equity since the petition date. R. at 9. After the Trustee marketed the home for sale, Eclipse offered to purchase both the home and the preference claim against Pink. R. at 9. The Trustee was content with the offer and filed a motion ("Sale Motion") to sell the home to Eclipse. R. at 9. The Debtor objected, arguing that any post-petition, pre-conversion increase in the equity of his home inured to his benefit, and that because there was no equity for the estate as of the Petition Date, the Trustee was not able to sell the home. R. at 10. The Debtor also objected to the Trustee's purported sale of her statutory avoidance and recovery powers under §§ 547 and 550 of the United States Bankruptcy Code. R. at 10. The bankruptcy court ruled in favor of the Debtor on both issues, denying the Sale Motion. R. at 10.

II. PROCEDURAL HISTORY

The bankruptcy court, when considering both issues, held in favor of the Debtor. First, the court held that any post-petition, pre-conversion increase in equity of the Debtor's home inured to the benefit of the Debtor. R. at 10. Second, it held that the Trustee was unable to sell the ability to avoid and recover preferential transfers under §§ 547 and 550 of the Bankruptcy Code. R. at 10. The Trustee appealed, and the United States Court of Appeals for the Thirteenth Circuit affirmed the ruling of the lower court on both issues. R. at 10.

STANDARD OF REVIEW

The questions presented are based on a statutory interpretation of the Bankruptcy Code and are thus purely questions of law. As a result, the standard of review for this appeal is *de novo*. *Pierce v. Underwood*, 487 U.S. 552, 558 (1988).

SUMMARY OF THE ARGUMENT

The Thirteenth Circuit correctly ruled in favor of the Debtor when it held that post-petition, pre-conversion increase in equity in the Debtor's property inures to the benefit of the Debtor due to the legislative history behind § 348(f)(1)(A). The Thirteenth Circuit also correctly held that the ability to avoid and recover transfers made prior to a bankruptcy filing remains solely with the trustee as this best aligns with a literal interpretation of the statute as well as the policy goals of the Bankruptcy Code.

Section 348(f)(1)(A) requires the increase in equity in the Debtor's home to inure to his benefit, rather than to the Chapter 7 estate. The statutory scheme underlying consumer bankruptcies incentivizes debtors to file under Chapter 13 rather than liquidating under Chapter 7. Yet, the literal meaning of § 348(f)(1)(A) creates the risk that a Chapter 13 debtor might lose their home or post-petition increases in home equity. This is especially true in circumstances where the debtor would have been able to keep their home or equity had they initially filed a Chapter 7 instead. Because this risk contradicts the incentive scheme, the drafters of the Bankruptcy Code likely did not intend for a literal meaning to apply. Further, because § 348(f)(1)(A) is ambiguous in meaning, such ambiguity should be resolved in favor of the Thirteenth Circuit's interpretation, which allocates all post-petition, pre-conversion increases in equity to the debtor.

As to the second issue presented to this Court, the Thirteenth Circuit correctly held that the ability to avoid and recover transfers made prior to a bankruptcy filing remains solely with the trustee. This is both consistent with a literal statutory interpretation; as well as supports underlying bankruptcy policies such maximization of the estate, cost of the action versus the benefit received, and ensuring efficiency in the bankruptcy process. For example, while a trustee's goal is to maximize the estate, it is evident that Congress intended avoidance and recovery powers to be reserved solely for the trustee. This is clear from the repeated use of the term "trustee" in §§ 547 and 550 rather than broader terms such as "representative of the estate" or "party in interest" as seen elsewhere in the Bankruptcy Code. Moreover, prohibiting a creditor or third party's purchase of an avoidance action (1) preserves and effectuates the principle of fairness amongst creditors by permitting one creditor to obtain more than their share of the property recovered; and (2) helps ensure the expedient administration of the bankruptcy estate in such a way to avoid extraneous oversight and needless litigation.

This Court should affirm on both issues.

ARGUMENT

This Court should affirm the Thirteenth Circuit's decision that a debtor's post-petition, pre-conversion increase in equity in a debtor's property inures to the benefit of the debtor, rather than to the estate. Additionally, the Court should affirm the Circuit Court's decision denying a Chapter 7 trustee's power to sell the ability to avoid and recover transfers pursuant to 11 U.S.C.A. §§ 547 and 550.

I. THE THIRTEENTH CIRCUIT CORRECTLY HELD THAT A DEBTOR'S POST-PETITION, PRE-CONVERSION INCREASE IN EQUITY IN A DEBTOR'S PROPERTY INURES TO THE BENEFIT OF THE DEBTOR.

The post-petition pre-conversion increase in equity in the Debtor's home residence should inure to the benefit of the debtor because: (A) the legislative scheme surrounding consumer bankruptcies incentivizes debtors to file Chapter 13 by protecting their home equity from liquidation; and (B) the context and legislative history shows that the purpose of enacting § 348(f)(1)(A) was specifically to preserve the debtor's post-petition equity in the event of a conversion.

A. The legislative scheme surrounding consumer bankruptcies incentivizes debtors to file Chapter 13 by protecting their home equity from liquidation.

Statutory interpretation typically begins with the text. See *Dubin v. United States*, 143 S. Ct. 1557, 1567 (2023). The plainness or ambiguity of the text depends on both "specific context in which the language is used," and "the broader context of the statute as a whole." See *Yates v. United States*, 574 U.S. 528, 537 (2015) (quotations omitted); see also *Dubin*, 143 S. Ct. at 1566; *City of Maui v. Haw. Wildlife Fund*, 140 S. Ct. 1462 (2020); *King v. Burwell*, 576 U.S. 473 (2015); *King v. St. Vincent's Hosp.*, 502 U.S. 215, 221 (1991). Where the literal meaning of the text of a statute appears to be sufficiently in conflict with the surrounding statutory scheme, the ambiguity must be resolved to maintain the coherence of said scheme. See, e.g., *City of Chicago v. Fulton*, 141 S. Ct. 585 (2021)*; Haw. Wildlife Fund*, supra.

Here, § 348(f)(1)(A) provides that, in the event the debtor converts from a Chapter 13 to a Chapter 7, the Chapter 7 estate shall consist of "property of the estate" as of the petition date of the original Chapter 13 filing. The term "property of the estate" includes "all legal and equitable interests" of the debtor as of the commencement of the case. 11 U.S.C.A. § 541(a)(1). It might appear that the term "property of the estate" in the former provision is meant to be used the same way as in the latter, as Petitioner suggests. See *Ratzlaf v. United States*, 510 U.S. 135, 143 (1994). However, there are two aspects of the Code's scheme which cast doubt on this reading. The first is the different treatment of debtors' property rights under Chapter 13 versus under Chapter 7. The second is the general organization of § 348(f).

1. It is inconsistent with the incentive scheme created by Chapter 13 to require a forfeiture of the Debtor's post-petition, pre-conversion equity

Chapter 13 imposes a number of requirements on debtors filing thereunder. Under § 1325(a)(1) a plan must comply with applicable provisions of Title 11, which includes, particularly, § 109(e) (debtor must have regular monthly income to qualify for filing under Chapter 13). Also relevant is § 1325(a)(4) which holds that the value of property, as of the effective date of the plan, to be distributed under the plan on account of each allowed unsecured claim cannot be not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under Chapter 7. However, "[e]xcept as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor." § 1327(b). The exchange implicated by this scheme is simple and fair—'you don't have to sell your real or personal property if you pay the unsecured creditors as much as they would have gotten from you in a Chapter 7.'

This deal is generally not palpable to debtors like the Debtor in this case because, at the time of the initial filing, the applicable homestead exemption covered all of the Debtor's equity. Had the Debtor initially filed a Chapter 7, nothing would have prohibited him from retaining ownership of his home while paying the secured lender. *Dewsnup v. Timm*, 502 U.S. 410 (1992) (interpreting 11 U.S.C.A. § 506(d)). Still, the Debtor filed Chapter 13, likely under the impression that: (1) his struggling movie theater for which he personally guaranteed loans would be rehabilitated; and (2) that he would be able to keep his home in a Chapter 13. The plain text of § 348(f)(1)(A) undercuts that second assumption by putting an invisible asterisk at the end of § 1327, making it read, for practical purposes, as follows: "the confirmation of a plan vests all of the property of the estate in the debtor (subject to a potential future divestiture under § 348(f), which could happen if, God forbid, the debtor's ability to make income is altered by conditions possibly beyond the debtor's control)."

The Court has been reluctant to give provisions literal effect of a text where it might plausibly conflict with the purpose of the surrounding scheme. See, e.g., *Cty. Of Maui v. Haw. Wildlife Fund*, supra. In *Haw. Wildlife Fund*, the Court considered the meaning of a provision of the Clean Water Act, which required a permit for the discharge of pollutants by sewage treatment plants and similar infrastructure, or a 'point source.' 140 S. Ct. at 1468. The Act defined the term "discharge of a pollutant" as "'any addition of any pollutant to navigable waters *from* any point source.'" *Id*. at 1469 (citing 33 U.S.C.A. §§ 1311(a), 1362(12)(A)) (emphasis added). If taken literally, this requirement would require a permit in "bizarre circumstances, such as. . . the 100-year migration of pollutants through 250 miles of groundwater to a river." *Id*. at 1471. Given this feature, in conjunction with the fact that the Act also provided grants to the EPA to help States study the more indirect ways in which water pollution might occur, *see id*., the Court inferred that the scheme was designed to allocate management of relatively indirect pollution sources to the States. *Id*. Therefore the term "from" in the definition of the term "pollutant" should not be read literally, and should instead be read to imply a more proximate relationship, befitting of the federal-state allocation *Id*.

Similar to the interpretative reading discussed above, the phrase "property of the estate at the time of the petition," in § 348(f) should not be read literally because it would cause a comparable disruption to the modern consumer bankruptcy scheme, which purports to incentivize debtors to file Chapter 13. The literal interpretation of § 348(f) presents two alternatives from the perspective of a debtor whose home-equity is completely exempt. On the one hand, filing a Chapter 7 will result in the debtor liquidating their personal property (much of which is exempt under § 522), whilst the Chapter 7 trustee is almost certain to abandon a residence in which there is no non-exempt equity. 11 U.S.C.A. 554(b); *In re Murphy*, 22 B.R. 663, 665 (Bankr. D. Colo. 1982) (holding that the trustee should abandon property if there is no equity besides that covered by an exemption, which is protected from unsecured creditors). In this scenario, the debtor is discharged of their debt and keeps paying their mortgage, business as usual. If the property appreciates in value, that value is theirs to keep. On the other hand, the debtor can file a Chapter 13, keeping their personal property, but risking the possibility of missing a payment or losing their source of regular income. In this situation, upon conversion, the debtor will lose their post-petition equity, and any gains in value they would have kept in the former case (should a sale of the home be necessary to keep the debtor afloat).

There are few financial disasters more devastating than losing one's home. A debtor sensitive to this risk, whose equity is exempt, would probably prefer the greater degree of certainty presented by a Chapter 7 than risking losing that value in a failed Chapter 13, the latter of which is well known to be a likely outcome. Porter, *The Pretend Solution: An Empirical Study of Bankruptcy Outcomes*, 90 Texas L. Rev. 103, 107-111 (2011). Applying the plain text of § 348(f)(1)(A) creates this incentive to file a Chapter 7, and therefore counteracts the incentive embedded in §§ 1325(a)(1), 1325(a)(4), and 1327. For these reasons, the language of § 348(f)(1)(A) should not be given literal effect, and the debtor should retain post-petition increases in their home equity.

2. It is inconsistent with the structure of § 348(f) itself for one of its provisions to operate as a divestiture of the debtor's post-petition property.

Subsection 348(f)(1) applies to debtors who convert "in good faith." Following, Subsection 348(f)(1)(B), provides that the "valuations of property and of allowed secured claims in the Chapter 13 case shall [not] apply . . . in a case converted to a . . . Chapter 7 [case] . . ." The language of this statute enables a debtor to be protected from a creditor asserting a secured claim in a property far greater than the present value of the property. See, e.g., *In re Airhart*, 473 B.R. 178 (2012) (vehicle declined in value so much that debtor could redeem it in cash). By contrast, subsection 348(f)(2) applies to debtors who convert in *bad faith*, and accordingly defines the estate as the property at the time of conversion, thereby including any property such debtor obtained after the petition. Naturally, this latter provision appears to be a *deterrent* to bad faith abuse of the benefits of the Code.

Firstly, if both § 348(f)(1)(A) and § 348(f)(2) are to be given full effect, the former cannot, as a matter of common sense, also operate as a deterrent against the *good* faith behavior to which it applies. See *Fulton*, 141 S. Ct. at 591 ("the canon against surplusage is strongest when an interpretation would render superfluous another part of the same statutory scheme"). Because § 542 provides the trustee the power to turn over property of the estate in the debtor's possession, a holding that the passive retention of property was a violation of the automatic stay would render § 542 largely (though not completely) superfluous. See *Id*. Therefore, a strictly literal reading of § 348(f)(1)(A) would likewise fail to give full effect to § 348(f)(2) because it would ultimately penalize the debtor for converting in good faith by requiring a forfeiture of their post-petition increase in equity, just as it would penalize the debtor for converting in bad faith by enhancing the Chapter 7 estate. It would be bizarre indeed if Congress intended such negative consequences for good faith conduct, when it explicitly requires good faith for a confirmation of any bankruptcy plan in the first place. See §§ 1129, 1225, 1325.

Petitioner may erroneously assert that the statute's language is so plain that the Court need not consult the other provisions to ascertain its meaning—"property of the estate" he might assert ought to be construed as it is in other portions of the Bankruptcy Code. There are a few reasons why this should not be the case. Firstly, the asserted legal premise of that argument would be incorrect, as "identical language may convey varying content in different statutes, sometimes even different provisions of the same statutes." *Yates*, 574 U.S. at 537 (citing, inter alia, *FAA* v. *Cooper*, 566 U.S. 284, 292-293 (2012)) ("actual damages" has different meanings in different statutes)). Secondly, this argument would fail because "property interests are created and defined by state law" "*unless some federal interest requires a different result* . . ." See *Travelers Cas. & Sur. Co. of Am. v. PG&E,* 549 U.S. 443, 451 (2007) (citing *Butner v. United States*, 440 U.S. 48, 55 (1979)) (emphasis added). Consequently, the federal interest in providing a Chapter 13 debtor an opportunity to pay back his debts without losing his home, even where a Chapter 7 liquidation would not have, is apparent from the consumer bankruptcy scheme and § 348(f) specifically.

Moreover, Petitioner may alternatively assert that § 541(a)(6) requires the inclusion of any profit which might be bound in the property of the estate. However, the meaning of terms in a statute are generally known by the "company they keep." *United States v. Taylor*, 142 S. Ct. 2015, 2023 (2022) (citations omitted). The term "proceeds," "products," "offspring," and "rents," which accompany the term profits in § 541(a)(6), are more properly construed as derivative property interests—distinct from the legal title to the home itself, given their placement before the article and preposition, "of" and "from," which alternately modify the original term "property of the estate." See *United States v. Ron Pair Enters.*, 489 U.S. 235, 241-42 (1989) (using the grammatical structure of § 506(b) to divine its meaning). The term "profit" itself is a type of interest resembling an easement in land rather than equity in the land on which the easement lies. See, e.g., *Goss v. C.A.N. Wildlife Tr., Inc.*, 157 Md. App. 447, 457 (2004) (citing *Black's Law Dictionary* 527 (7th ed. 1999)) (describing a 'profit a prendre' or 'profit' as a use interest in land). As used in §541(a)(6), it is not meant to include the increase in equity of "property of the estate."

Finally, Petitioner may adopt the dissent's position, that it is not the Court's role to subvert the plain meaning of the text. R. at 19 (citing *Lamie v. United States Tr.*, 540 U.S. 526, 534 (2004)). However, this would be incorrect. In *Lamie*, Lamie and the Government provided conflicting statements of congressional intent concerning the meaning of § 330(a)(1), which provides for reasonable compensation to a professional for actual, necessary services or expenses. *Id.* Congressional comments, as well as possible inferences one might make from the surrounding scheme, were conflicted on the issue of whether this 'professional' included the debtor's attorney. *Id*. at 539-540, with some aspects of the legislative history supporting each side of the argument. *See id*. (comparing *Collier's* interpretation of an unexplained deletion of the term "or the debtor's attorney" from the draft as a scrivener's error with an amendment sponsor's statement that the omission was a part of an abuse-prevention initiative). This is distinguishable from the case at hand, given that Congress only articulated one intended meaning behind § 348(f)(1)(A)--especially since that meaning is consistent with its general design for consumer bankruptcies.

For these reasons, both the broad and specific statutory context warrant a non-literal reading of § 348(f)(1)(A), or at the very least creates an ambiguity as to its meaning. See *Haw. Wildlife Fund*, 140 S. Ct. at 1469; *cf. Trump v. Hawaii*, 138 S. Ct. 2392, 2412 (2018); *Matal v. Tam*, 582 U.S. 218, 218 (2017) (same). Such ambiguity is normally resolved by consultation of the legislative history of a statute, see *Haw. Wildlife Fund*, supra,, which supports the interpretation of the provision as a protection of the debtor's equity interest, as explained below:

B. The context and legislative history show that the purpose of enacting § 348(f)(1)(A) was specifically to preserve the debtor's post-petition *equity in the event of a conversion.*

The purpose of an ambiguous statute can be inferred from its legislative history. See *Haw. Wildlife Fund*, 140 S. Ct. at 1469; see also *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 242 (1989) ((internal quotation omitted)). An "authoritative source" of legislative history includes Committee Reports on the bill. *Garcia v. United States*, 469 U.S. 70, 76 (1984) (citing *Zuber* v. *Allen*, 396 U.S. 168, 186 (1969)). Other useful sources include research articles that comment on the legislative history or provide applicable legal or statistical analysis of the effect of certain statutes. See, e.g., *Haw. Wildlife Fund*, supra.

In 1994, Congress enacted § 348(f) to address post-petition, pre-conversion interests in property. See H.R. Rep. No. 103-835, at 57 (1994), *as reprinted in* 1994 U.S.C.C.A.N. 3340, 3366. There, the House of Representatives commented that permitting post-petition property to become part of the estate 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 $10,000 homestead exemption, would have to be counseled . . . 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."

Id. This scenario, the report divined, would create "a serious disincentive to Chapter 13 filings." *Id*. (adopting the reasoning of *In re Bobroff*, 766 F.2d 797 (3d Cir. 1985)). The alternative reading would be far more "consonant with the Bankruptcy Code's goal of encouraging the use of debt repayment rather than liquidation." *Bobroff*, 766 F.2d at 803 (citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 118 (1977), U.S. Code Cong. & Admin. News p. 5904).

The Senate also weighed in on the subject, stating that: "the basic purpose of Chapter XIII has been to permit an individual to pay his debts and avoid [liquidation] by making periodic payments to a trustee under bankruptcy court protection, with the trustee fairly distributing the funds deposited to creditors until all debts have been paid." S. Rep. No. 95-989, at 12-13 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5798-99. This has been one of the principal purposes of Chapter 13 bankruptcies since its instantiation in the Hastings-Michener Bill and, subsequently, the Chandler Act. Timothy W. Dixon & David G. Epstein, *Where Did Chapter 13 Come from and Where Should It Go*, 10 Am. Bankr. Inst. L. Rev. 741, 744-55 (2002) (discussing the modern drafters' concern with rehabilitating debtors rather than liquidation of the debtors' assets).

Here, the Debtor is in practically the same scenario as the 1994 House Report, a sadly common situation amongst Chapter 13 debtors. Porter, 90 Texas L. Rev. at 107-111 (14% of filers in this survey had already lost their home whereas 59% were in default on the path to foreclosure). Given the extraordinary effect this ruling might have, it is only reasonable that the result Congress expressly endorsed ought to be read into the statute they drafted. Furthermore, where the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters, “the intention of the drafters, rather than the strict language controls.” *States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 242 (1989) ((internal quotation omitted)).

Nevertheless, Petitioner may assert that House Report’s factual scenario was not incorporated in the final statutory text, and therefore it was not intended to have any effect. However, the Court has directly contradicted this rule in *CBOCS West, Inc. v. Humphries* when they construed 42 U.S.C. § 1981(a), which guaranteed every person’s right “to make and enforce contracts,” as prohibiting “retaliation,” even though the statute did not expressly include the term. 553 U.S. 442 (2008). There, the Court construed 42 U.S.C. § 1981(a), which guaranteed every person’s right “to make and enforce contracts” as prohibiting “retaliation,” even though the statute did not expressly include the term. *Id.* The majority endorsed this interpretation even though a similar civil rights statute, drafted and enacted since § 1981, *did* explicitly use the term “retaliation,” and prior to the case arising, Congress added more provisions to § 1981 *without* adding an anti-retaliation provision. *Id.* at 453-454. Likewise, the failure to expressly limit the equity included in the Chapter 7 estate (upon good faith conversion from Chapter 13) to the value of the property at the time of the petition does definitively indicate the absence of Congress’s intent to do so.

Both the scheme surrounding § 348(f)(1)(A) and the legislative history behind the provision show that its purpose is to protect Chapter 13 debtors from losing post-petition increases in home equity in the event of conversion, even though the plain text of that statute might counsel otherwise. This approach is consistent with that of Valentine J. Nesbit, the referee responsible for designing and field testing the original Chapter XIII of Chandler Act with its predecessor statute. See 10 Am. Bankr. Inst. L. Rev. at 70. Even he indulged in a “very liberal interpretation of the law" to protect debtors under the predecessor Bankruptcy Code. Dixon & Epstein, 10 Am. Bankr. Inst. L. Rev. at 750. In calculating the debtor's payments, Nesbit specifically took into account the debtor's social station so that the debtor could maintain appearances. *Id*. Nesbit even established the use of the term "debtor" as opposed to "bankrupt" to help eliminate the stigma of bankruptcy. *Id*. at 759. It is wholly consistent with the general purpose of the consumer bankruptcy scheme–protecting and rehabilitating the debtor–to deviate from the plain language in this case. A reading to the contrary would do considerable harm to the intent of the drafters of the Code.

Although a non-literal reading is appropriate for § 348(f) in light of the foregoing considerations, the plain terms as well as the context surrounding §§ 547 and 550 warrant a *literal* reading of those provisions, as such reading relates to the next issue.

II. THE THIRTEENTH CIRCUIT CORRECTLY RULED THAT THE TRUSTEE MAY NOT SELL THE POWER TO AVOID AND RECOVER TRANSFERS UNDER §§ 547 AND 550.

The ability to avoid and recover preferential transfers should remain solely with the trustee because (A) such interpretation is consistent with the plain text, the statutory scheme surrounding avoidance powers, and the historical context behind the trustee's avoidance powers; and (B) prohibiting the sale of the avoidance power is consistent with the underlying policy motivations of the United States Bankruptcy Code.

A. Prohibiting the trustee from transferring the avoidance power is consistent with the plain text and the statutory scheme surrounding §§ 547 AND 550.

As already stated, statutory interpretation begins with the text. See *Dubin*, 143 S. Ct. at 1566. Whether that text is to be given literal effect depends on the context. See *Yates*, 574 U.S. at 537; *St. Vincent's Hospital*, 502 U.S. at 221 (citations omitted); *Burwell*; *Haw. Wildlife Fund*.

Where the statute's meaning is plain, in light of such context, the inquiry into the meaning of the statute ends. *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 254 (1992) (citations omitted).

Here, the statute in question provides that "the trustee may. . . avoid any [preferential] transfer of an interest of the debtor in property." 11 U.S.C.A. § 547(b) (emphasis added). It does not say "the trustee, or anyone to whom the trustee assigns the foregoing power for good and valuable consideration. . ." See *Bittner*, 143 S. Ct. at 720 ("expressio unius est exclusio alterius"). In this section, Congress chose to use the word "trustee" ten separate times; each referencing a specific power or burden associated with the avoidance of a preferential transfer. See 11 U.S.C.A. § 547. "[A] situation in which a statute authorizes specific action and designates a particular party empowered to take it is surely among the least appropriate in which to presume nonexclusivity." *Hartford Underwriters Ins. Co. v. Union Planters Bank N.A.*, 530 U.S. 1, 6 (2000) (commenting further that the trustee's individualized role in a bankruptcy proceeding "makes it entirely plausible that Congress would provide [the power to charge premiums under § 506(c)] to him and not to others"); see also *In re Texas Gen. Petroleum Corp.*, 58 B.R. 357, 358 (Bankr. S.D. Tex. 1986) (the ability to avoid and pursue a preference action may only be asserted by someone with a personal right to do so). Furthermore, in § 550 of the Bankruptcy Code, Congress utilized the word "trustee" six times; each time referencing a power or burden associated with the recovery of preferential transfers. Applying ordinary canons of construction to this provision in isolation plainly vests the trustee's power solely in the trustee.

In addition, the trustee is also enlisted with the burden to prove the elements of avoidability. For example § 547(g) states "... the trustee has the burden of proving the avoidability of a transfer…" 11 U.S.C.A. § 547(g). If the trustee bears the burden, then it must be the trustee who is pursuing this action. This is further supported in *In re Libby Inter., Inc.* 247 B.R. 463 (B.A.P.

8th Cir. 2000). There, the court stated that to recover the preferential transfer made to the transferee (AlliedSignal), there were six elements to be proven. *Id.* at 466. The court further held that it was the duty of the trustee to prove these six elements, thus proving avoidability under § 547(b). 11 U.S.C.A. § 547(b).

Rather than obscure the meaning of this provision, the other Code sections strengthen this interpretation. Section 541(a)(1) of the Code defines "property of the estate" as consisting of "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C.A. § 541(a)(1). The power to avoid is not a "legal or equitable interest of the debtor as of the commencement of the case," and § 547 only provides for the power to avoid a transfer of an "interest of the debtor in *property*." § 547(b) (emphasis added). To the extent that a transfer is avoided under § 547, "the trustee may recover, for the benefit of the estate, the property transferred. . ." § 550(a) (emphasis added). Any transfer avoided under § 547 is "persevered for the benefit of the estate but only with respect to *property* of the estate." § 551 (emphasis added).

The trustee is granted the express power to "abandon any property of the estate that is burdensome to the estate or that is of inconsequential value . . ." 11 U.S.C. 554(a). By contrast, any "party in interest," not just the trustee, may request a hearing on whether to order the trustee to abandon such property. 11 U.S.C. 554(b). This disparate allocation of rights and powers to the "trustee" versus a "party in interest" further shows that Congress specifically designed the Code to vest powers to the trustee at the exclusion of other parties. *Field v. Mans*, 516 U.S. 59, 67 (1995) ("where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion").

As the New Mexico bankruptcy court observed in *Gonzales v. Nabisco Div. of Kraft Foods, Inc. (In re Furrs)*, "§ 1123(b)(3)(B) allows 'a representative of the estate', other than the trustee, to prosecute [preference] claims…" 294 B.R. 763, 768–69 (2003). However, because the original Chapter 11 case was converted to a Chapter 7 case, "[the § 1123(b)(3)(B)] provision is not and could not be applicable." *Id*. at 770 (citations omitted). If Congress did want the Chapter 7 trustee to vest its avoidance power in another, it would have explicitly done so, like in § 1123(b)(3)(B). *See id.* at 770; *see also In re Metal Brokers Intern., Inc.* 225 B.R. 920 (Bankr. E.D. Wis. 1998) (quoting *Fogerty v. Fantasy, Inc.*, 510 U.S. 517, 538, 114 S.Ct. 1023, 127 L.Ed.2d 455 (1994)) and *In re Bargdill*, 238 B.R. 711 (Bankr. N.D. Ohio 1999).

Further, the principle that the trustee is the only person permitted to avoid transfers under the bankruptcy statute predates the modern Bankruptcy Code. In *Belding-Hall Mfg. Co. v. Mercer & Ferdon Lumber Co.*, an assignee of the trustee attempted to avoid and recover a preferential transfer of hemlock lumber made by the debtor. 175 F. 335 (6th Cir. 1909). However, the court held that only the trustee may maintain a suit to avoid a preferential transfer; and could not transfer that right of avoidance. *Id.* at 340. In *Neuberger v. Felis*, the debtor conveyed his homestead to his wife four months before his bankruptcy. 203 Ala. 142 (Ala. 1919). There, the court also found that the trustee alone has the power to exercise the right to sue for the recovery of property. *Neuberger*, 203 Ala. at 144. The court went so far as to hold that "on the failure of the trustee to sue… the right may not be transferred by him to a creditor." *Id.*

It is clear that the trustee is a specific statutory entity with specific powers, and has been understood by American courts since before the enactment of the Code as having sole authority to exercise avoidance powers. As explained below, this principle is consistent with the underlying policy motivations of the Bankruptcy Code.

B. Prohibiting the trustee to sell avoidance powers is consistent with the underlying policy motivations of bankruptcy.

There are two policy motivations underlying the Bankruptcy Code which would be better effectuated by prohibiting the sale of avoidance powers: (1) the trustee's purpose as fiduciary to maximize the estate for creditors equally; and (2) the interest in efficient administration of bankruptcy cases.

1. The trustee has a fiduciary duty to maximize the bankruptcy estate for creditors *equally*.

The trustee is "accountable for all property received," and has the duty to maximize the value of the estate. *See Commodity Futures Trading Com v. Weintraub*, 471 U.S. 343 , 352 (1985) (citing 11 U.S.C. §§ 323, 541, 704, 1106, among other authorities); *see In re McGuirk*, 414 B.R. 878 (Bankr. N.D. Ga. 2009); *Wellman v. Wellman*, 933 F.2d 215 (4th Cir. 1991). This duty requires the trustee to serve all creditors equally. See *Moore v. Bay*, 284 U.S. 4, 5 (1931) ("what thus is recovered for the benefit of the estate is to be distributed in 'dividends of equal percentum on all allowed claims, except such as have priority or are secured'") (citing to the predecessor of the modern bankruptcy act).

The Third Circuit applied this principle in *In re Cybergenics Corp.* 226 F.3d 237, (3d Cir. 2000). There, the court questioned whether certain fraudulent transfers were included in a sale of all assets so as to foreclose the creditors from pursuing the claims on behalf of the bankruptcy estate. *Id.* The court stressed "'Cybergenics assets' and 'property of the estate' have different meanings, evidenced in part by the numerous provisions in the Bankruptcy Code that distinguish between property of the estate and property of the debtor, or refer to one but not the other." *Id.* at 246. The reason for drawing this distinction was that, "[r]ather than improving the debtor's own bottom line, empowering the trustee or debtor in possession to avoid a transaction by pursuing an individual creditor's cause of action is a method of forcing that creditor to share its valuable right with other unsecured creditors." *Id*. at 245 (citing Thomas H. Jackson, A*voiding Powers in Bankruptcy*, 36 Stan. L. Rev. 725, 749 (1984) and Charles Jordan Tabb, The Law of Bankruptcy § 6.2 at 336 (1997), among other authorities). The presence of a trustee with the sole authority to avoid a transfer ensures the fair and equitable distribution of monies that, had they not been unlawfully transferred, the creditors would have been entitled to pro-rata. *see Id*.

The fact that the trustee has a duty to maximize the estate does not, however, mean that the trustee may do whatever is necessary to maximize the estate. In addition to a literal reading of §§ 547 and 550 delegating avoidance and recovery powers solely to the trustee, it also supports the policy argument that the trustee may not use maximization ends to justify the maximization means. Rather, considering the language of the Code, trustees are limited in what they may do to maximize the estate. Such limitations may take the form of refraining from selling specific powers, such as the ability to avoid and recover preferential transfers. If Congress' intent was to prioritize maximization of the estate at any cost, Congress would not have chosen such specific, exclusive language.

This is further supported in *In re Cybergenics Corp.* 226 F.3d 237 (3d Cir. 2000). There, the court questioned whether certain fraudulent transfers were included in a sale of all assets so as to foreclose the creditors from pursuing the claims on behalf of the bankruptcy estate. *Id.* The court stressed "'Cybergenics assets' and 'property of the estate' have different meanings, evidenced in part by the numerous provisions in the Bankruptcy Code that distinguish between property of the estate and property of the debtor, or refer to one but not the other." *Id.* at 246. This differentiation showcased the importance of underlying policy surrounding the estate. There, the court was unwilling to include certain items as property of the estate, regardless of the maximization effect they may have. *Id.*

Moreover, in *In re Furrs,* the defendants moved to dismiss the avoidance proceedings brought against them, arguing a lack of standing. The court held that "the language of the statute, '.... the trustee may recover…', explicitly limits to the trustee the standing needed to recover avoidance for a Chapter 7 estate." 294 B.R. 763, 768–69 (Bankr. D.N.M. 2003); *E.g., Met–Al, Inc., v. Gabor (In re Metal Brokers Int'l, Inc.),* 225 B.R. 920, 921–22 (Bankr.E.D.Wis.1998). The defendants attempted to argue that the Chapter 7 trustee lacked standing after the case converted from a Chapter 11 to a Chapter 7. *In re Furrs,* 294 B.R., 768. However, the court explained its application of Chapter 7 provisions rather than Chapter 11 provisions. *Id.* In doing so, the court acknowledged the initial Chapter 11 filing stating that § "1123(b)(3)(B) allows 'a representative of the estate', other than the trustee, to prosecute [preference] claims…" *Id.* at 770. Nonetheless, considering the conversion of the case, the court further stated that "this case is no longer a Chapter 11 case" and "that [the § 1123(b)(3)(B)] provision is not and could not be applicable." 11 U.S.C. § 103; *North Atlantic Millwork*, 155 B.R. at 281, 283; *In re Furrs*, 294 B.R. at 770. Thus, courts have clearly shown a preference for proper delegation of power and appropriate statutory interpretation over maximization of the estate.

Here, that preference ought to be considered. Here, the Debtor originally filed under Chapter 13, and later converted his case to a Chapter 7 case. R. at 8. Considering that *In re Furrs* classified the case at hand as "no longer a Chapter 11 case", it would follow that the case at hand today is no longer a Chapter 13 case. *In re Furrs*, 294 B.R. at 770. Rather, this is a Chapter 7 and the applicable provisions are those of a Chapter 7; which, as previously discussed, do not support a maximization of the estate at any cost necessary. Thus, the trustee here would be unable to sell the power to avoid and recover the preferential transfer made to Pink.

2. Selling avoidance powers would disrupt the efficiency of the bankruptcy process, increasing its administrative costs above the short-term benefits of an expedient payout.

A central and pervasive concern of bankruptcy is the speedy and efficient resolution of the issues concerning the debtor's estate. See *Zimmerman v. Continental Airlines*, 712 F.2d 55, 59 (3d Cir. 1983); see *In re Amalgamated Foods, Inc.*, 41 B.R. 616, 618 (Bankr. C.D. Cal. 1984); *In re T.D.M.A., Inc.*, 66 B.R. 992, 997 (Bankr. E.D. Pa. 1986); *In re BFW Liquidation, LLC*, 459 B.R. 757, 797 (Bankr. N.D. Ala. 2011).

To effectuate that policy, the avoidance and recovery powers should remain with the trustee. As already explained, vesting the recovery power in the trustee forced creditors to share the benefit of the estate. Further, prohibiting the trustee to sell the power to avoid and recover a transfer could exacerbate the recovery process. Recovery actions against pre-petition transfers can be quite contentious even when pursued by a neutral third party such as the trustee. Creditors who were capable of recovering preferential transfers might be hesitant to return money to the estate to which they feel entitled. Other creditors, concerned for the apparent unfairness of the sale of the cause of action will likely challenge a recovery action from another creditor rather than a court-sanctioned trustee. Thus, allowing this power to be sold would further exacerbate the already tedious avoidance and recovery process. *In re Greenberg*. 266 B.R. 45 (Bankr. E.D.N.Y. 2001) ("the sale of the trustee's powers to a single creditor, no matter how impartially executed, may nevertheless contribute to the appearance of unfairness and a lack of neutrality").

Here, it is likely that Pink will feel similar. As the Debtor's mother, previous owner of The Final Cut, and a creditor herself, it is likely that Pink will be unresponsive to Eclipse's request for return of the preferential transfer. This is especially true given the original agreement between the Debtor and Chapter 13 trustee in which the trustee agreed not to seek and recover the payments made to Pink. R. at 8. However, should Pink receive a communication from the Trustee--a public officer of sorts--requesting a return of the funds, Pink would be less likely to litigate than if confronted by some unknown creditor.

Petitioner might assert that delegating avoidance and recovery powers to a third party is a practical exception to the general rule–one that helps effectuate a speedy resolution of the bankruptcy estate through motivated creditors. Even if the Court were to adopt this position, the lower courts have generally recognized standards for permitting the transfer of the avoidance power that entail that the recovery be remitted to the estate. For example, in *In re AmeriServe Food Distribution, Inc.* the court held that a preferential transfer can be avoided or recovered by the debtor, trustee, or a representative of the estate appointed for such purpose. 315 B.R. 24, 31 (Bankr. D. Del. 2004). To determine whether an individual is a "representative of the estate" the court laid out a two-prong test. First, the party must be appointed; and second, the party must represent the estate, meaning that any recovery by the party must be to the benefit of the estate. *Id.* Likewise in *United States v. Gen. Res., Ltd.*, the Colorado district court held that a creditor may only be permitted to pursue an avoidance action "if the trustee unjustifiably refuses to sue." 204 F. Supp. 872, 876 (1962). Recent courts have concurred with this holding. See, e.g., *In re Ontos, Inc.*, 478 F.3d 427, 431–32 (1st Cir. 2007); *See Pilavis*, 233 B.R. at 3–4 (citing *Glinka v. Abraham and Rose Co.*, 199 B.R. 484, 493–94 (D.Vt.1996)).

Here, the creditor was not appointed to pursue the preferential transfer, nor has the Trustee unjustifiably failed to pursue the claim. At the beginning of the case, the Trustee objected to the Debtor's plan on the grounds that the creditor must receive no less than it otherwise would under a Chapter 7. R. at 7. The Debtor and trustee resolved this issue so that the Debtor would pay the creditors more over the commitment period and the trustee would not seek to avoid and recover the payments made to Pink. R. at 7-8. When the Debtor converted his case, the Trustee did not attempt to recover the preferential transfer. Rather, the first response was to sell the power to pursue the preferential transfer to one of the Debtor's other creditors. R. at 9. Such actions do not call upon either exception previously accepted by the courts. The creditor was not appointed to pursue the preferential transfer, nor was the Trustee unjustifiably refusing to pursue the action against Pink. In fact, the Trustee was indifferent to the situation, attempting to sell her avoidance power speedily. Therefore, the case at hand is not an exception. Rather, it supports the rule that the trustee is and should be the sole individual able to pursue avoidance and recovery actions for preferential transfers.

CONCLUSION

For the reasons adduced above, the Respondent requests that this Court AFFIRM the decision of the Thirteenth Circuit providing that: (I) the post-petition increases in equity should inure to the benefit of the debtor; and (II) the trustee may not transfer its avoidance power to an unsecured creditor.