CHAPTER 3

Preference Recovery

If the trustee can prove the five preference elements by a preponderance of the evidence, and the creditor cannot prove that any of the preference defenses apply, then the trustee may recover either the property that was transferred, or, if the court so orders, the value of such property.

Parties who may be held liable for preferential transfers are (1) the initial transferee or the entity for whose benefit the transfer was made or (2) any immediate or mediate transferee ("downstream transferee") of the initial transferee.[87] The trustee may not recover from a downstream transferee that takes for value (including satisfying or securing present or antecedent debts), in good faith, and without knowledge of the voidability of the transfer.[88] If one downstream transferee is protected under this provision, then all of its subsequent downstream transferees are also protected from preference liability.

The issue as to whether a first recipient of an interest in property of the debtor is actually the initial transferee has sometimes been raised where the recipient claims to be a "mere conduit" of the transferred interest. A "conduit" is generally described by the courts to be someone obtaining possession of the property but who does not have control over the property. Examples of "conduits" are depository banks, brokerage houses and attorneys who hold stocks or cash on deposit for the creditors. The effect of determining that an initial recipient is a mere "conduit" is that the conduit is not liable for the preference, but the party who has control over the funds is held to be the initial transferee and loses the protections that he or she may have had as a downstream transferee.

Notwithstanding the fact that the debtor received and transferred assets, the transferee may avoid liability if the debtor had no control

87 *See* 11 U.S.C. §550(a).
88 *See* 11 U.S.C. §550(b).

over the disposition of the asset. The "Earmarking Doctrine" is discussed above.

In any case, the trustee is entitled to only a single satisfaction of the amount of the preferential transfer from all defendants. This rule prevents the trustee from recovering the full amount transferred from more than one transferee.

If the trustee recovers property from a good-faith transferee, the transferee is given a lien on the recovered property to secure the lesser of: (A) the cost, to the transferee, of any improvement made to the property after the transfer, less the amount of any profit realized by or accruing to the transferee from such property; and (B) any increase in the value of such property as a result of such improvement.[89] The term "improvement" includes physical additions or changes to the property transferred, repairs to the property; payment of any taxes on the property, payment of any debt secured by a lien on the property that is superior or equal to the rights of the trustee and preservation of such property.

Trustees possess an additional remedy against a creditor who has received a preference and has not turned over the property or funds to satisfy its liability. Any unsecured claim filed by such a creditor will be disallowed and the creditor will not receive distributions from the estate until the avoidable transfer is returned.[90]

Conclusion

The power of the trustee to avoid, invalidate and set aside certain completed commercial transactions between the debtor and a third party is one of the distinctive features of bankruptcy law. Preference law is one of the trustee's most important powers. An understanding of the law's basic principles and statutory requirements is essential

89 *See* 11 U.S.C. §550(e).
90 *See* 11 U.S.C. §502(d).

to the defense against preference actions. The next section of this *Handbook* provides some practical guidance on how to avoid or limit exposure to preference liability.