POKING AT PREFERENCE ACTIONS: SBRA AMENDMENTS SIGNAL THE NEED FOR CHANGE

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INTRODUCTION

Buried in the list of proposed changes for the Small Business Reorganization Act ("SBRA"), most of which amend chapter 11 of the Bankruptcy Code (the "Code"), are two provisions targeting more general provisions of the Code. The first provision amends the language of section 547(b), which authorizes a trustee to avoid preferential transfers.[1] The second provision amends section 1409 of title 28, which prescribes the "venue of certain proceedings."[2] Many presume that these certain proceedings include actions to avoid preferential transfers, commonly referred to as preference actions.[3]

These two amendments are conspicuous in the SBRA as they are not clearly linked with small business reorganization cases. Preference actions certainly arise in small business reorganizations, but they also occur in every reorganization, and more broadly, in every chapter of the Code. Indeed, section 547 is one of the most frequently used provisions in the Code, arising in the context of liquidations just as often, if not more, than they do in reorganizations.[4] However, preference actions are particularly noteworthy in small business reorganizations because of the effect they can have on both debtors and creditors. Preference law is highly controversial and, for preference defendants, extremely counter-intuitive.[5] It is unclear whether preference actions fulfill the goals set out by Congress,[6] and preliminary data suggests these actions may be inefficient, at least when pursued in business cases.[7] Amendments to the law of preference avoidance are long overdue, and those provided by the SBRA, while a step in the right direction, do not go nearly far enough.

This Article will explain why sections 547 and 1409 are of particular interest to small businesses and also why the amendments proposed in the SBRA are unlikely to promote the change they were intended to inspire. Part I will briefly explain how preference actions function in bankruptcy proceedings. Part II will then explore how preferences can be used in the business bankruptcy context, and in particular, the effect that preference actions can have on small businesses, both those who bring an

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[1] *See* 11 U.S.C. § 547 (2018).

[2] *See* 28 U.S.C. § 1409 (2018).

[3] *See* Small Business Reorganization Act of 2019, Pub. L. No. 116-54, § 3, 133 Stat. 1079, 1085 (codified at 11 U.S.C. §§ 1181-1195 and scattered sections of 11 U.S.C. and 28 U.S.C.).

[4] *See* CHARLES JORDAN TABB, LAW OF BANKRUPTCY 488 (4th ed. 2016) (noting that the preference provision is the most litigated of the bankruptcy avoidance powers by a considerable margin).

[5] *See* Erwin I Katz et al., *Types of Bankruptcy-related Disputes*, *in* ABI GUIDE TO BANKRUPTCY MEDIATION (1st ed. 2005) ("Preference actions seem particularly unfair: creditors are often shocked to learn that they may have to repay money to a debtor for receiving payment that was lawful at the time but has become actionable upon the filing of bankruptcy.").

[6] *See* Brook E. Gotberg, *Conflicting Preferences in Business Bankruptcy: The Need for Different Rules in Different Chapters*, 100 IOWA L. REV. 51, 81 (2014) (explaining "how preference law currently struggles to fulfill its intended policy goal of equal distribution"); David A. Lander, *Is Preference Litigation Worth Its Cost? Toward a Data-Based Answer*, 11 NORTON BANKR. L. ADVISOR (2019) (noting there is no data to support the policy assumptions underlying preference avoidance powers).

[7] *See* Lander, *supra* note 6 (observing in twenty-one large chapter 11 cases that preference recoveries are marginal and costs are high).

action to avoid preferences and those who are targets of the action. Part III will provide a critique of the amendments, which are incremental at best and ineffectual at worse. Finally, this article will conclude with a plea for true reform of the law governing preference actions and provide suggestions for a path forward.

I. PREFERENCE ACTIONS GENERALLY

All students of bankruptcy law have a basic familiarity with preference liability and many students of the law outside of bankruptcy will have at least heard of the term.[8] Section 547 of the Code allows a trustee in bankruptcy to claw back payments or transfers of value made by the debtor to transferees in the ninety days prior to the date of the bankruptcy filing, so long as the debtor was insolvent at the time the transfer was made[9] and the transfer made the transferee better off than it would have been without it under the normal bankruptcy distribution.[10] Avoidance of such transfers is allowed primarily to promote equal distribution among creditors, such that those unsecured creditors who are paid just before bankruptcy are not made better off than those unsecured creditors who are not paid—in effect all share in the pain of the bankruptcy discharge equally.[11] There is no requirement that either the debtor or the creditor intended to cheat other creditors or to benefit the preferred creditor; in this way, preference law is fundamentally different from the law of fraudulent conveyances.[12] Congressional record indicates that preference liability is also intended to deter creditors from rushing to collect from a struggling debtor, thereby making the slide into bankruptcy inevitable.[13] However, there is good reason to be skeptical that preference law has any real deterrent effect.[14]

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[8] Preference liability comes up with some frequency in the context of a secured transactions, a topic that is tested on the bar exam of all fifty states.

[9] Insolvency is presumed for transfers that occur within the ninety-day period, although a creditor may rebut this presumption. *See* 11 U.S.C. § 547(f) (2018).

[10] *See id.* § 547(b).

[11] *See* H.R. REP. NO. 95-595, at 177–78 (1977) *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6138 ("The purpose of the preference section is two-fold. First, by permitting the trustee to avoid prebankruptcy transfers that occur within a short period before bankruptcy, creditors are discouraged from racing to the courthouse to dismember the debtor during his slide into bankruptcy. . . . Second, and more important, the preference provisions facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor."); Lawrence Ponoroff, *Evil Intentions and an Irresolute Endorsement for Scientific Rationalism: Bankruptcy Preferences One More Time*, 1993 WIS. L. REV. 1439, 1447, 1479; Robert Weisberg, *Commercial Morality, the Merchant Character, and the History of the Voidable Preference*, 39 STAN. L. REV. 3, 3 (1986); Richard B. Levin, *An Introduction to the Trustee's Avoiding Powers*, 53 AM. BANKR. L.J. 173, 184 (1979).

[12] *Compare* 11 U.S.C. § 547, *with id.* § 548 (delineating fraudulent conveyance law, which allows a trustee to avoid any transfer if the debtor "made such transfer or incurred such obligation with intent to hinder, delay, or defraud any entity").

[13] *See* H.R. REP. NO. 95-595, at 177–78; REPORT OF THE COMMISSION ON THE BANKRUPTCY LAW OF THE UNITED STATES, H.R. DOC. NO. 93-137, at 202 (1973) [hereinafter COMMISSION REPORT ON BANKRUPTCY LAW] (listing "three distinct goals" for preference in the Bankruptcy Act of 1898: "First, it lessens the possibility of a scramble among creditors for advantage; second, it promotes equality; and third, it eliminates the incentive to make unwise loans in order to obtain a preferential payment or security").

[14] *See generally* Brook E. Gotberg, *Optimal Deterrence and the Preference Gap*, 2018 B.Y.U. L. REV. 559, 559 (2019) ("[D]eterrence theory suggests that the low likelihood of punishment and the cap on punishment

There are some defenses to preference liability in the form of statutory exceptions.[15] Defendants typically must employ legal professionals to use these defenses because applicability may be difficult to prove. For example, there have been entire books written on how to effectively prove the "ordinary course of business" exception found in section 547(c)(2), which requires a demonstration that the underlying debt was "incurred by the debtor in the ordinary course of business or financial affairs" and that payments were "made in the ordinary course of business" or "made according to ordinary business terms."[16] There is no additional guidance, outside of case law, as to what constitutes "ordinary" in these contexts. Therefore, it comes down to legal argument, which most defendants have neither the time nor the skills to present *pro se*.

More intuitive defenses are generally not available. For example, it is no defense that the payment was due and owing, that the creditor accepted the payment in good faith, or even that repaying the preference would inflict an overwhelming hardship on the creditor. In general, preference law is one of strict liability:[17] there is no need to show wrongdoing, only to show that the transfer took place within the relevant window of time.

On the other hand, preference liability is not necessarily automatic. The language of the statute indicates that "the trustee *may* avoid any transfer of an interest of the debtor,"[18] which most have interpreted to mean that the trustee need not pursue every avoidable preference.[19] A bankruptcy trustee is appointed in every liquidation case pursuant to chapter 7 of the Code,[20] and also in every chapter 13 case.[21] Trustees are

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associated with preference law make it a very poor deterrence."); *see also* David Gray Carlson, *Security Interests in the Crucible of Voidable Preference Law*, 1995 U. ILL. L. REV. 211, 216 (1995); Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 748 (1985); Lawrence Ponoroff, *Bankruptcy Preferences: Recalcitrant Passengers Aboard the Flight from Creditor Equality*, 90 AM. BANKR. L.J. 329, 344–45 (2016).

[15] *See* 11 U.S.C. § 547(c).

[16] *See, e.g.*, NEIL STEINKAMP, UNDERSTANDING ORDINARY: A PRIMER ON FINANCIAL AND ECONOMIC CONSIDERATIONS FOR THE ORDINARY COURSE DEFENSES TO BANKRUPTCY PREFERENCE ACTIONS (2d ed. 2016); *see also* HON. DEBORAH THORNE, IAN FOLLANSBEE & JOHN H. ANDREASEN, PREFERENCE DEFENSE HANDBOOK: THE CIRCUITS COMPARED (3d ed. 2019).

[17] Although early preference laws did require a finding of intent on either the debtor or the creditor's side, the enactment of the Bankruptcy Code in 1978 removed any intent requirements on account of the difficultly of proving intent. *See* COMMISSION REPORT ON BANKRUPTCY LAW, *supra* note 13, at 203–04 ("That [intent] requirement, more than any other, has rendered ineffective the preference section of the present Act."); *see also* Lissa Lamkin Broome, *Payments on Long-Term Debt as Voidable Preferences: The Impact of the 1984 Bankruptcy Amendments*, 1987 DUKE L.J. 78, 115 (1987) ("After Congress removed the 'reasonable cause to believe' requirement in 1978, the main goal of the preference provision was to preserve equality of distribution; the prevention of unusual pressure or action by the creditor became only an incidental objective.").

[18] 11 U.S.C. § 547(b) (emphasis added).

[19] Not all practitioners agree that the statute should be read permissively. *See, e.g.*, Brook E. Gotberg, *Relational Preferences in Chapter 11 Proceedings*, 71 OKLA. L. REV. 1013, 1052 (2019) (reporting on a difference of opinion among attorneys interviewed).

[20] *See* 11 U.S.C. §§ 701, 702, 704.

[21] *See id.* § 1302. Typically, the trustee in chapter 13 is a "standing trustee," appointed to oversee all chapter 13 cases filed in the district. The standing trustee in chapter 13 has slightly different obligations than fall to a chapter 7 trustee.

only rarely appointed in chapter 11, as explained in greater depth below.[22] The bankruptcy trustee has fiduciary duties towards the bankruptcy estate, and in chapter 7, also has a financial incentive to maximize the estate for the benefit of creditors.[23] Accordingly, in chapter 7 liquidations it is expected that the bankruptcy trustee will pursue most, if not all, identifiable preference actions.[24] That said, bringing a preference suit is a potentially costly endeavor, particularly where the opposing party is well-represented and can make a case for an exception to preference liability. Accordingly, a bankruptcy trustee acting in the best interests of the bankruptcy estate may choose to forgo bringing the suit in such a scenario, if costs could eat away at any potential benefit to the estate, and by extension any compensation for the bankruptcy trustee.[25]

In fact, most preference actions are settled at a very early stage. Typically, a trustee will begin with a low-cost letter writing campaign, identifying transferees in the ninety days before filing from the debtor's records and contacting them via letter to inform them of their potential liability.[26] These letters are likely to be followed with a phone call, at which point most transferees who have a credible defense to the preference can explain their position and settlement negotiations can commence. Often, transferees are not aware of their own legal defenses, and will either repay the trustee on demand or negotiate to pay out some portion of what the trustee claims in order to avoid being sued. Indeed, both the trustee and the transferees are typically better off avoiding the hassle and expense of a lawsuit, and accordingly, they will usually be amenable to a settlement agreement that will discount the total amount owed. This is especially true when the lawsuit is to be filed in the venue where the debtor has filed for bankruptcy, rather than in the transferee's location, often creating an additional costly complication from the transferee's perspective.[27] A vanishingly

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[22] *See* Jonathan C. Lipson, *Understanding Failure: Examiners and the Bankruptcy Reorganization of Large Public Companies*, 84 AM. BANKR. L.J. 1, 23 (2010) (reporting that in a sample size of 576 cases, only twenty-four trustees were appointed); *see also* Richard M. Hynes et al., *National Study of Individual Chapter 11 Bankruptcies*, 25 AM. BANKR. INST. L. REV. 61, 94 (2017) (reporting only six trustee appointments in a study of over 6,000 chapter 11 filings).

[23] *See* U.S. DEP'T OF JUSTICE, HANDBOOK FOR CHAPTER 7 TRUSTEES, 4-1 (2012), https://www.justice.gov/ust/file/Handbook_for_Chapter_7_Trustees.pdf/download (explaining the statutory and general duties of a trustee as a fiduciary to the estate and to the creditors).

[24] *See* U.S. DEP'T OF JUSTICE, HANDBOOK FOR CHAPTER 7 TRUSTEES (1998), https://www.justice.gov/ust/handbook-chapter-7-trustees ("To represent the estate, the trustee must secure for the estate all assets properly obtainable under applicable provisions of the Bankruptcy Code, object to the debtor's discharge where appropriate, defend the estate against improper claims or other adverse interests, and must liquidate the estate as expeditiously as possible.").

[25] Courts have censored trustees for pursuing preference actions that were unlikely to bring a recovery for the estate, thereby imposing disproportionate and unnecessary costs. *See, e.g., In re* Taxman Clothing Co., 49 F.3d 310, 315 (7th Cir. 1995); *In re* Minich, 386 B.R. 723, 729 (Bankr. C.D. Ill. 2008).

[26] *See, e.g.*, Thomas D. Goldberg, *Curbing Abusive Preference Actions: Rethinking Claims on Behalf of Administratively Insolvent Estates*, 23 AM. BANKR. INST. J., May 2004 at 14.

[27] Many chapter 11 cases are filed in the venue where the company has been incorporated, rather than the primary place of business, although both are permissible locations pursuant to 28 U.S.C. § 1408 (2018). *See, e.g.*, Stephen J. Lubben, *Delaware's Irrelevance*, 16 AM. BANKR. INST. L. REV. 267, 269 (2008) (noting Delaware's high rate of filing for large corporate bankruptcy cases, but arguing that Delaware cases are not significantly different than cases filed in other jurisdictions). Pursuant to the statute, a company operating out

small percentage of preference claims make it to trial and judgment, with the consequence that much of what is known about preference actions, settlement amounts, and the overall benefit to the bankruptcy estate is anecdotal, drawn from the experience of practitioners in the field.

For example, although it is generally understood that preference actions are one of the most commonly litigated issues in bankruptcy law, it is not known, nor is it easily calculable, exactly how often preference actions arise in the bankruptcy context. Certainly, many bankruptcy cases have no record of any preference avoidance activities on the docket. Other cases list hundreds of preference actions, many of which contain no record other than the initial filing of a complaint; these actions do not appear to be formally answered or prosecuted. A search for filed avoidance actions pursuant to section 547 on Bloomberg Law for any given 30-day period raises hundreds of hits, but this number alone says very little about the extent to which preference liability is used. It may be an overcount, including preference filings that ultimately go nowhere, or more likely an undercount, excluding preference claims that are never formalized. As noted above, a preference claim may be simply made by letter or call, and payment may be obtained without the need to file anything with the court.[28]

Because the overwhelming majority of preference actions are settled without trial, and often without any court record at all, it is also difficult to make generalizations regarding how much preference actions recover for a bankruptcy estate, and whether the costs associated with preference liability are justified. One survey of practitioners conducted in 1997 reported that the average settlement amount was 58.5% of the preferential transfer.[29] Interviews with practitioners indicate that settlement amounts in chapter 11 cases tend to be for less than half the actual preference, although reports vary widely and depend somewhat on the presence of applicable defenses, as well as the tenacity of both parties.[30] A study of twenty-one large chapter 11 cases filed between 2008 and 2010 found that the recovery was consistently below 20% of the total transfer amount, although information regarding settlement was only available in seven of the cases studied.[31] In contrast, a study of

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of Las Vegas, Nevada, can file for bankruptcy in Delaware, the location of its incorporation. *See* TABB, *supra* note 4, at 375 (explaining section 1408's reference to "domicile" and "residence"). Such a filing may be inconvenient for all local creditors to the extent they wish to participate in the bankruptcy, but it can be particularly difficult for defendants of a preference action to participate in litigation in a forum two time zones away. Similarly, many companies conduct business throughout the United States, accordingly, even bankruptcy filings in the debtor's place of business may be strikingly inconvenient forums for preference defendants, who may be located across the country.

[28] *See* 11 U.S.C. § 550 (2018).

[29] AM. BANKR. INST. TASK FORCE ON PREFERENCES, PREFERENCE SURVEY REPORT 8 (1997) (Charles J. Tabb, Reporter) [hereinafter TASK FORCE ON PREFERENCES]. Although the survey did not ask explicitly about the context for the preference actions, the survey was sent to practitioners who "stated that at least part of their practice involves business bankruptcy," suggesting that business bankruptcy, rather than consumer bankruptcy, was the focus of the study. *Id.* at 1.

[30] *See* Gotberg, *supra* note 19, at 1060 (reporting statements made by interviewees, including assertions that settlement amounts tend to be in the range of 40-60% and that settlements should be less than 10%).

[31] *See* Lander, *supra* note 6.

consumer chapter 7 cases, including sixteen preference avoidance actions, found that the mean recovery amount was 74% of the preferential transfer, although the range went from 100% of the transfer down to only 6%.[32] This study, which examined the final reports filed by chapter 7 trustees in these cases, also concluded that the percent of the total recovery[33] that went toward administrative expenses was an average of 32%,[34] with a range from 70% down to 13%.[35] Unfortunately, more extensive analysis of preference settlements, particularly in the business context, is simply unavailable at this point in time.

The lack of information regarding the administrative expenses associated with preference recovery and the limited information regarding the amount of recovery received makes it difficult to establish whether preference recovery is actually good for the estate (and therefore, the creditors) or simply bad for the transferee. There is no formal data regularly gathered on the extent to which preference avoidance actions recapture funds for the estate, and researchers' efforts to discover the efficiency of preference actions are limited due to lack of access to information.[36] The 1997 survey of practitioners referenced above reported—from the perspective of credit providers—preference recoveries "never or rarely" increased distributions to unsecured creditors; however, attorneys reported the opposite—that recoveries were frequently and significantly increased by preference actions.[37] In the recent study of twenty-one of the largest chapter 11 cases, the majority of cases in which preference actions had been brought provided less than a 10% payout to unsecured creditors, although it could not be determined from the evidence the extent to which the preference actions had increased this amount, if at all.[38]

It is noteworthy that there is no requirement in the Code that a trustee show that avoidance of a preferential transfer would result in a higher payout to unsecured creditors, only that the transferee had received more than it would have without the preference under a liquidation distribution.[39] Courts have permitted preference actions to go forward even when there is no payout to unsecured creditors, signaling

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[32] *See* Dalie Jimenez, *Reforming Preference Law*, 100 IOWA L. REV. BULL. 41, 46 (2015).

[33] In most cases, this included assets besides preferential transfers. *See id.* ("In seven cases (44%), the only asset recovered was the preferential transfer.").

[34] This number reflects the mean. The median percentage spent in administrative expenses was only 26%. *Id.*

[35] *Id.* It appears that the data was not precise enough to give an understanding of costs associated exclusively with preference recovery.

[36] *See* John C. McCoid, II, *Bankruptcy*, *Preferences*, *and Efficiency: An Expression of Doubt*, 67 VA. L. REV. 249, 262 (1981) ("There is little information regarding the extent of recapture. The Administrative Office of United States Courts, which annually published bankruptcy statistics, publishes no figures on this."); *Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the Comm. on the Judiciary*, 94th Cong. 396–97 (1975) (statement of Peter F. Coogan); *id.* at 479–80 (testimony of Patrick A. Murphy); *Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the Comm. on the Judiciary*, 94th Cong. 1668–70 (1976) (statement of Richard Kaufman); James Angell McLaughlin, *Defining a Preference in Bankruptcy*, 60 HARV. L. REV. 233, 235 (1946).

[37] *See* TASK FORCE ON PREFERENCES, *supra* note 29, at 5.

[38] *See* Lander, *supra* note 6.

[39] *See* 11 U.S.C. § 547(b)(5) (2018).

that the law seeks only to remove an unequal benefit from a preferred creditor, not necessarily to transfer this benefit to others.[40] Under this interpretation, preference avoidance may be value destroying; a preference action can be brought where it imposes costs upon the estate and the defendant but results in no corresponding benefit to the estate or its creditors. Such a result is difficult to defend from a policy perspective, as it is the antithesis of the overarching bankruptcy policy goals of value preservation and efficient disposition. Perhaps this is why the law also allows a trustee to exercise discretion in determining which transfers should be avoided under section 547. Presumably, based on the trustee's fiduciary duty and personal motivations,[41] the trustee would not pursue a preference when the recovery would not benefit the estate.

II. PREFERENCE ACTIONS IN BUSINESS REORGANIZATIONS

When there is no trustee appointed, as in most chapter 11 business reorganizations, the calculation of when and where to bring preference actions may be very different and informed by even more factors than have already been discussed. In chapter 11 cases, the estate is managed by the Debtor in Possession ("DIP"), which takes on the role of the trustee and the discretion associated with pursuing preference actions.[42] It is generally accepted among bankruptcy practitioners that it is bad business for a debtor to bring lawsuits against business partners with whom it seeks to maintain a relationship.[43] Accordingly, good faith efforts to maximize the value of the estate, measured not just in cash on hand but also the goodwill of business partners, would argue against bringing preference actions against those business partners. In these situations, the "may" of section 547 appears to permit a DIP in chapter 11 to pick and choose which of its preferential transferees to target for a clawback,[44] much the way a DIP may designate critical vendors to be

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[40] These cases are generally constrained by the argument in 11 U.S.C. § 550 that a trustee may only recover property "for the benefit of the estate," but courts interpret this provision broadly. *See* Harstad v. First Am. Bank, 39 F.3d 898, 905 (8th Cir. 1994) (finding a trustee or DIP is not required to demonstrate a direct benefit to creditors from preference recovery); Mellon Bank, N.A. v. Dick Corp., 351 F.3d 290, 293 (7th Cir. 2003) (preference recovery that goes solely to secured creditors is permitted under the statute because there is still a benefit to the estate under section 550); *In re* Furrs, 294 B.R. 763, 773 (Bankr. D. N.M. 2003) (finding a benefit to the estate when preference recovery would go exclusively to paying chapter 7 administrative fees); *In re* Payless Cashways, Inc., 290 B.R. 689, 697 (Bankr. W.D. Mo. 2003).

[41] Trustees are compensated based on the amount they recover for the estate, or more precisely, "moneys disbursed or turned over in the case by the trustee to parties in interest," including secured creditors. *See* 11 U.S.C. § 326.

[42] *See id.* § 1101.

[43] *See, e.g.*, Gotberg, *supra* note 19, at 1051–52 (quoting interviewed attorneys).

[44] *See In re* Adelphia Commc'ns Corp., 330 B.R. 364, 373 (Bankr. S.D.N.Y. 2005) ("Debtors sometimes lack the inclination, or the means, to bring actions that should be prosecuted. They sometimes have higher priorities, or are distracted by other things. They sometimes have a practical need to avoid confrontation with entities like their secured lenders, because they need those entities' continuing cooperation—as, for example, in connection with exit financing."); Nancy Haller, *Cybergenics II: Precedent and Policy vs. Plain Meaning*, 56 ME. L. REV. 365, 384–85 (2004) ("A debtor-in-possession . . . may use the trustee provisions to favor certain creditors; may be unwilling to avoid transactions with a supplier or lender with whom it hopes to

paid in full in a chapter 11 case.[45] If the debtor wants an ongoing relationship with a transferee, the preference is not pursued; in other cases, it is.

It follows from these observations that, as a group, transferees who are less essential to the debtor's business and less familiar with defenses to preference liability available under the Code end up paying higher settlement amounts in preference actions than their more essential, more sophisticated counterparts. This conclusion has some empirical support, although the number of observations is limited.[46] Transferees in small chapter 11 cases may be particularly vulnerable to discriminatory treatment at the hands of a DIP, insofar as transferees are also frequently small businesses. Small businesses targeted for preference liability have correspondingly small budgets and are consequently more likely to be underrepresented by counsel. Although reform of the preference statutes could take place in virtually any context, it is nevertheless particularly appropriate that concerns regarding the use of preferential transfers be addressed in a statute dealing with small business reorganizations, although the impact is likely to be greater on small businesses as creditors than on small businesses as debtors.

Concerns regarding the fairness of preference actions may be generally valid in whatever context they arise; however, fairness concerns are particularly at issue when decisions regarding preferences are made by a DIP, rather than a bankruptcy trustee. Although the SBRA introduces a standing trustee in small business chapter 11 cases, the standing trustee's duties do not include oversight of avoidance actions.[47] Rather, the DIP retains the ability to pick and choose from whom they will recover a preference under the SBRA, as the SBRA has done nothing to alter the discretionary language in section 547(b).

One obvious solution to concerns regarding the inequities of preference liability, and in particular its unequal enforcement, is for transferees to obtain legal advice regarding the particularities of preference law and to obtain legal representation when actions are brought against them. In truly egregious cases of cherry-picking preferential transfers for avoidance, transferees may be able to make a case before the court that the trustee or DIP bring actions against all preferred transferees.[48]

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continue a business relationship after a successful reorganization; or may have developed friendships that make it difficult to choose to pursue actions with severe economic impacts."); Alan R. Lepene & Sean A. Gordon, *The Case for Derivative Standing in Chapter 11: "It's the Plain Meaning, Stupid*", 11 AM. BANKR. INST. L. REV. 313, 317–18 (2003) ("DIPs frequently face conflicts where the duty to investigate and prosecute avoidance claims may involve family members, major shareholders whose support they may need post-reorganization, or current and past officers, directors, or other corporate insiders.").

[45] Critical vendors are certain creditors who are granted full repayment of prebankruptcy unsecured claims at the debtor's request, with the court's approval, on the basis that such payment is necessary to ensure the debtor's ongoing access to the goods or services provided by these creditors. Critical vendor motions are granted by virtue of the judicially-created doctrine of necessity; there is no statutory authorization for this rule. *See generally* Alan N. Resnick, *The Future of the Doctrine of Necessity*, 47 B.C. L. REV. 183, 183–84 (2005).

[46] *See* Gotberg, *supra* note 19, at 1050.

[47] *See* 11 U.S.C.A. §§ 1181, 1184 (West 2019).

[48] Generally speaking, creditors do not have standing to challenge a preference, and the ability to pursue a preference is reserved for the trustee or DIP. *See, e.g., In re* Bodenstein, 248 B.R. 808, 817 (Bankr. W.D. Ark. 2000). However, creditors may be permitted to pursue a preferential transfer if it is clear that the trustee cannot

Currently, transferees are understandably reluctant to obtain legal advice. Preference liability is strict liability, so defendants rightfully feel they have done nothing wrong in preference avoidance cases. What is more, these defendants frequently have outstanding accounts owed by the debtor—beyond what the defendants received as a preferential payment. These outstanding accounts, typically unsecured debt, will not be repaid in full through the bankruptcy and must be written off for a loss. Accordingly, transferees assume that hiring an attorney and engaging in motion practice would simply be throwing good money after bad. The entire process feels fundamentally unfair and unjust.[49] This is particularly true in cases where transferees correctly perceive that they have been targeted for liability when other recipients of transfers have not.

Given the reluctance to obtain legal counsel and the reality that even an excellent attorney cannot protect defendants from all the inequities of preference liability (indeed, the legal advice will be very costly), another compelling solution is to revise the law to ensure greater equity in the use of preference actions. Such a revision has proved elusive. Although the SBRA amendments were clearly intended to combat perceived inequities in preference actions, they have achieved little in the way of meaningful revision.

III. CRITIQUE OF THE AMENDMENTS

The SBRA amendments alter the current law relating to preference actions in two small, incremental ways. Both appear designed to restrict a trustee or DIP's ability to bring strategic preference actions that are likely to inflict disproportionate pain upon a defendant-transferee with marginal benefit to the estate. Put another way, the amendments attempt to protect transferees from the cost of defending against frivolous preference actions and from the hassle of defending small-dollar actions brought in an inconvenient venue. Although the thinking and motivation behind these amendments is admirable, the amendments fail to address the broader systemic issues surrounding preferential transfers. Accordingly, the amendments are unlikely to affect real change for most individuals and companies who are affected by preference actions. Furthermore, the amendments may be entirely ineffectual on their face, depending largely on the interpretation and enforcement by bankruptcy judges and bankruptcy courts.

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be relied upon to pursue the preference. *See* Nangle v. Lauer (*In re* Lauer), 98 F.3d 378, 388 (8th Cir. 1996); *In re* Feldhahn, 92 B.R. 834, 835 (Bankr. S.D. Iowa 1988) (observing although the Code specifies that only a trustee or DIP may pursue preference recoveries "many courts have allowed Chapter 11 creditors' committees to bring such actions by operation of 11 U.S.C. § 1103(c)"); Canadian Pac. Forest v. Irving (*In re* Gibson Grp., Inc.), 66 F.3d 1436, 1442 (6th Cir. 1995) ("[A] creditor may have standing to file an avoidance action if the bankruptcy court determines that certain conditions exist and certain prerequisites are met.").

[49] *See, e.g.*, Gotberg, *supra* note 19, at 1048 (quoting interviewed creditors who had been subject to a preference action).

A. Amendment to § 547

The first amendment affecting preference law in the SBRA is the change to section 547 itself. It inserts a clause after the phrase "the trustee may" and before "avoid any transfer" that appears to qualify the trustee's power to avoid a preference.[50] The inserted clause restricts a trustee from avoiding a preferential transfer without first conducting "reasonable due diligence" and taking into account a defendant's "known or reasonably knowable affirmative defenses."[51] Presumably, this would limit the trustee's filing of nuisance lawsuits, or lawsuits designed to extort a defendant out of a settlement amount, simply so the defendant can avoid the hassle and expense of raising a clear and knowable defense. On its face, this is a welcome development, insofar as nuisance lawsuits impose costs on defendants and may result in inefficient and inequitable outcomes.

However, there is little to suggest that this amendment will actually change any current practices or reduce the number of preference lawsuits brought. Bankruptcy trustees are already constrained, like all litigants in federal court, from filing claims that they know are not "warranted" or lack "evidentiary support" after "an inquiry reasonable under the circumstances."[52] Rule 11 of the Federal Rules of Civil Procedure, which imposes sanctions on parties who file frivolous or harassing papers with the court, is incorporated in bankruptcy proceedings with identical procedures for the imposition of sanctions on a violating party.[53] It is hard to imagine how the amendments to section 547 will meaningfully change a bankruptcy trustee's duty to avoid frivolous lawsuits, given the standard already in place.

It is possible, based on this signal from Congress, that the courts may impose additional requirements on bankruptcy trustees in preference cases beyond those already established by Rule 11. They may, for example, establish a standard for "reasonable due diligence" in preference cases that exceeds the "inquiry reasonable under the circumstances" standard in other cases covered by Rule 11. However, the statute itself does not require establishment of such a heightened standard and there is no additional direction to courts as to how they should interpret the amendment. It is just as possible that courts will interpret even very superficial due diligence into defenses to be sufficient (i.e., "reviewing the debtor's records").

Perhaps the amendment will have an influence on a trustee's letter-writing campaign, which ostensibly would be beyond the standard of Rule 11, as the letters

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[50] The inserted clause is: "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)." Small Business Reorganization Act of 2019, Pub. L. No. 116-54, § 3, 133 Stat. 1079, 1085 (codified at 11 U.S.C. §§ 1181-1195 and scattered sections of 11 U.S.C. and 28 U.S.C.).

[51] *See id.*

[52] FED. R. BANKR. P. 9011.

[53] *See, e.g.*, Grantham Bros. v. Needler (*In re* Grantham Bros.), 922 F.2d 1438, 1442 (9th Cir. 1991); *see also* Schaefer Salt Recovery, Inc. v. Segal (*In re* Schaefer Salt Recovery, Inc.), 542 F.3d 90, 97 (3d Cir. 2008) ("The purpose of Rule 11 is to deter litigation abuse that is the result of a particular 'pleading, written motion, or other paper' and, thus, streamline litigation.").

are not "present[ed] to the court."[54] On the other hand, it is not clear from the statute alone that the amendment to section 547 constrains the trustee in this way; again, the law depends on bankruptcy judges to interpret the provision.

Furthermore, the statute is silent as to the enforcement of this clause. If confronted with a trustee's demand that violates section 547's revised language, presumably a defendant would need to raise the issue with the bankruptcy court in order to obtain relief. But preference defendants currently resist going to court due to the costs and hassle involved. The law does not address this reality, nor mitigate the costs associated with raising a defense. It is hard to see why a defendant would attempt to obtain relief on the basis of section 547's revised language, because to prevail the defendant would need to show both that a valid defense exists and that the trustee should have reasonably known about it. This evidence could be more difficult to acquire and present than simply defending against the action itself, insofar as it would require proof of what the trustee knew and when he or she knew it. Instead of bringing the matter to the court and incurring the associated costs, defendants are still more likely to settle, as is consistent with current practice.

Based on this analysis, it is difficult to describe the amendment to section 547 as anything more than window dressing on protections that already exist for defendants, but which do very little work in practice. Again, it is possible that bankruptcy judges and bankruptcy courts will interpret section 547 in a way that will change behavior on the ground, but the scope and direction of that change is difficult to predict based on the plain language of the statute.

B. Amendment to § 1409

The second amendment to the SBRA believed to affect preference law is an amendment that increases the dollar amount cap at which a trustee may commence a proceeding arising in or related to a bankruptcy case outside of the venue where the defendant resides.[55] As noted above, creditors may incur significant costs when engaged in a bankruptcy case outside of the creditor's own venue. This statute acknowledges the difficulty of pursuing litigation in a foreign venue, and attempts to avoid these costs for parties when a relatively small amount is on the line.

Similarly, preference law already caps the minimum amount of the transfer required to bring a preference action.[56] Truly *de minimus* preferential transfers would not typically be pursued, simply because it would be contrary to the self-interest of a chapter 7 trustee or a DIP to spend the time and energy collecting such transfers. However, to guard against the risk of strategic motions to avoid a tiny transfer, or perhaps simply to signal to all parties what should be considered *de minimus*, the law

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[54] FED. R. BANKR. P. 9011(b).

[55] *See* Small Business Reorganization Act of 2019, Pub. L. No. 116-54, § 3, 133 Stat. 1079, 1085 (codified at 11 U.S.C. §§ 1181-1195 and scattered sections of 11 U.S.C. and 28 U.S.C.).

[56] *See* 11 U.S.C. 547(c)(9) (2018) (explaining a trustee may not avoid a transfer under this section "if, in a case filed by a debtor whose debts are not primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than $5,000").

has historically provided an exception to liability for transfers less than $600 in consumer cases, and, as of April 1, 2019, $6,825 in non-consumer cases.[57] Pursuant to the statute, the non-consumer floor is periodically adjusted for inflation.[58]

A separate provision in the law, found in 28 U.S.C. § 1409, required a trustee who sought to recover a debt from a non-insider arising in or related to a bankruptcy case to commence the action in the district court where the defendant resides if the action was for less than $13,650.[59] The SBRA amended that statute to increase the dollar amount to $25,000 (to be adjusted annually for inflation). As before, the restriction on bringing a suit in a foreign venue applies only to small recoveries; for larger amounts, the trustee may simply commence the action in the district of the bankruptcy case, wherever the defendant is located.

Many have presumed, with some justification, that the change to section 1409 on venue will affect preference avoidance actions, limiting the trustee's ability to bring an action against a non-insider in the bankruptcy venue if the amount to be recovered is less than $25,000.[60] However, it is not at all clear that section 1409 applies to preference actions.[61] Indeed, some courts have explicitly stated that it does not.

In re Sunbridge Capital, Inc. is a clear example.[62] There, the chapter 7 trustee sought to recover a preferential transfer in the amount of $7,794.38 from a defendant by filing an adversary proceeding in Kansas, where the bankruptcy case had been filed and where the chapter 7 trustee resided.[63] The defendant had no association with the State of Kansas, and instead resided in the Southern District of Alabama.[64] The defendant accordingly moved to dismiss the trustee's complaint for improper venue.[65] The bankruptcy court denied the motion on the grounds that the plain wording of the statute indicated that venue limitations in section 1409(b) do not apply to preference claims and other avoidance actions.[66]

The court, observing that the issue presented was a matter of first impression for the Tenth Circuit, began by acknowledging the "conventional wisdom" that section 1409(b) did apply to preference cases.[67] Nevertheless, the court ruled on the basis of

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[57] *See id.* § 547(c)(8), (9).

[58] *See id.* § 104(a).

[59] *See* 28 U.S.C. § 1409(b) (2018). This number began at $10,000 and is adjusted annually for inflation. *See* 11 U.S.C. § 104(a); Revision of Certain Dollar Amounts in the Bankr. Code Prescribed Under Section 104(a) of the Code, 84 Fed. Reg. 3,488 (Judicial Conference of the U.S. Feb. 12, 2019).

[60] *See, e.g.*, Charles J. Tabb, *The Brave New World of Bankruptcy Preferences*, 13 AM. BANKR. L. REV. 425, 427 (2005).

[61] *See* Bruce Nathan, *Is There a Small Preference Venue Limit? Yes and No!*, BUSINESS CREDIT Nov./Dec. 2011, at 1.

[62] *See generally In re* Sunbridge Capital, Inc., 454 B.R. 166 (Bankr. D. Kan. 2011).

[63] *Id.* at 167.

[64] *Id.*

[65] *See* FED. R. BANKR. P. 7012 (incorporating FED. R. CIV. P. 12(b)(3)).

[66] *In re* Sunbridge Capital, Inc., 454 B.R. at 168.

[67] *Id. See also* Tabb, *supra* note 60, at 426–27 (stating the American Bankruptcy Institute's Task Force on Preferences' assumption that the venue provision would "giv[e] preference defendants more protection from nuisance suits"); Bryan C. Starcher, *Second Thoughts on "Home Court Advantage" for Small-Dollar Preference Defendants*, 25 AM. BANKR. INST. J., Mar. 2006 at 10 ("Conventional wisdom seems to be that § 1409 now requires preference actions of less than $10,000 to be brought in the defendant's home court.");

the statutory language that the venue provision did not apply to preference cases.[68] Section 1409(b) refers to proceedings "arising in or related to" a bankruptcy case.[69] The court reasoned that this language, which omitted reference to proceedings "arising under" the bankruptcy case, excluded preference claims by negative inference.[70]

This "arising in/arising under" distinction gained significant prominence in the wake of the Supreme Court's decision in *Stern v. Marshall*,[71] where the Court grappled with Congress' use of the terms in defining the scope of the bankruptcy court's jurisdiction.[72] Although the Code does not explicitly define the parameters of the distinction, multiple Circuit Courts have established their own parameters.[73] The Tenth Circuit Bankruptcy Appellate Panel, which the court in *Sunbridge* followed, had previously ruled that "[a] proceeding 'arises under' the Bankruptcy Code if it asserts a cause of action created by the Code, such as . . . avoidance actions under 11 U.S.C. §§ 544, 547, 548, or 549[.]"[74] Accordingly, based on the plain language of the statute, the court in *Sunbridge* concluded that the venue provision in section 1409(b) does not apply in preference cases.[75] Some courts have agreed with this conclusion,[76] while others have disagreed.[77]

Unfortunately, the SBRA amendments do not clarify the law on this point. Although both the amendment to section 547 and the amendment to section 1409 are

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Paul R. Hage & Patrick R. Mohan, *Does BAPCPA's Small-Dollar Venue Restriction Apply to Preference Actions?*, 29 AM. BANKR. INST. J., Dec./Jan. 2010 at 26 ("The conventional wisdom among most commentators following the enactment of BAPCPA was that this amendment to the venue statute was primarily targeted at limiting so-called abusive preference litigation in business bankruptcy cases commenced in a foreign jurisdiction where the amount at issue was relatively small.").

[68] *In re* Sunbridge Capital, Inc., 454 B.R. at 169.

[69] *See* 28 U.S.C. § 1409(b) (2018).

[70] *In re* Sunbridge Capital, Inc., 454 B.R. at 169.

[71] 564 U.S. 462 (2011).

[72] *See id.* at 475; 28 U.S.C. § 157(b). *See also* 28 U.S.C. § 1334(c) (using the terms in reference to the district court's ability to abstain from hearing proceedings).

[73] *See, e.g.*, Bergstrom v. Dalkon Shield Claimants (*In re* A.H. Robins Co.), 86 F.3d 364, 372 (4th Cir. 1996) ("Proceedings 'arising in' Title 11 are those proceedings that 'are not based on any right expressly created by Title 11, but nevertheless would have no existence outside of the bankruptcy.'") (citations omitted); *In re* Wood, 825 F.2d 90, 96 (5th Cir. 1987) ("Congress used the phrase 'arising under title 11' to describe those proceedings that involve a cause of action created or determined by a statutory provision of title 11.") (citation omitted); Eastport Assoc. v. City of Los Angeles (*In re* Eastport Assoc.), 935 F.2d 1071, 1076 (9th Cir. 1991) (adopting the reasoning of *In re* Wood, 825 F.2d 90 (5th Cir. 1987)).

[74] *In re* Midgard Corp., 204 B.R. 764, 771 (10th Cir. B.A.P. 1997).

[75] *In re* Sunbridge Capital, Inc., 454 B.R. at 174 ("The claims alleged arose under title 11 and therefore are not within § 1409(b), which limits venue to the district where the defendant resides only for small-dollar claim 'arising in' and 'related to' the bankruptcy case.").

[76] *See, e.g., In re* J & J Chem., Inc., 596 B.R. 704, 714 (Bankr. D. Idaho 2019); *In re* Tadich Grill of Wash. D.C. LLC, 598 B.R. 65, 67 (Bankr. D.D.C. 2019).

[77] *See, e.g., In re* Little Lake Indus., Inc., 158 B.R. 478, 484 (9th Cir. B.A.P. 1993) ("Our inquiry leads us to the conclusion that the terms 'arising under' and 'arising in' cannot be interpreted as mutually exclusive, and their use in § 1409 as a whole does not indicate that the elliptical omission in subsection (b), whether intended or inadvertent, operates to exclude a class of cases thereunder."); *In re* Nukote Intern., Inc., 457 B.R. 668, 669 (Bankr. M.D. Tenn. 2011) (concluding that the phrases "arising under" and "arising in" are not mutually exclusive).

in the same section of the law, the section is titled "Preferences; Venue of Certain Proceedings."[78] On one hand, this title and the proximity of the two provisions could offer reassurance to those who view section 1409 as applicable to preference actions. On the other hand, the semicolon demarking the two sections could also serve as confirmation to those who view section 1409 as inapplicable to preference actions—that the two issues are fundamentally distinct. When given the opportunity, Congress did not alter the language appearing to limit the scope of section 1409 to cases "arising in or related to" a bankruptcy case. Accordingly, it is unclear that the amendment has any impact at all on the interpretation of the *Sunbridge* court and others like it.

Even in jurisdictions where section 1409 is considered applicable to preference actions, the amendment is incremental at best. The restriction on where a trustee can file a preference action is only likely to arise in cases where the trustee files and the defendant elects to respond in court, rather than simply settle. As noted above, this probably limits the influence of section 1409 to those cases where the defendant chooses to obtain legal counsel, as many *pro se* defendants are unlikely to be aware of the venue provision or know how to adequately raise the issue of venue before the court. Accordingly, it is unlikely that the most vulnerable transferees, those with the least amount of sophistication or access to legal counsel, will benefit from this change.

Furthermore, it should be noted that simply objecting to venue does not necessarily end the case. Although transfer of venue to the defendant's local district is likely to impose a greater cost on the trustee, who now must prosecute the action in a foreign venue, it neither eliminates the case altogether nor removes all the trustee's leverage for a settlement. Even in a local venue, there will be costs associated with defending against a preference—costs that most litigants will prefer to avoid. Furthermore, the ever-increasing ability of litigants to call into hearings and file documents remotely presents a relatively minor hurdle to an experienced litigant, such as those typically hired to conduct preference actions, even if it can be imposing to a less sophisticated defendant.

In sum, the SBRA amendment to section 1409 is fundamentally deficient at promoting meaningful change to the implementation of preference laws. In some courts, it will have no impact on preference cases because it has been interpreted not to apply. In other courts, when applicable, it will only have meaning when raised by a defendant who is aware of it and motivated to take the necessary steps to invoke it. Even then, it is less likely to impose a significant enough burden on the trustee to meaningfully alter the incentive structure to settle the case rather than litigate defenses. Furthermore, it does nothing to prevent a DIP's strategic use of preference actions.

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[78] Small Business Reorganization Act of 2019, Pub. L. No. 116-54, § 3, 133 Stat. 1079, 1085 (codified at 11 U.S.C. §§ 1181-1195 and scattered sections of 11 U.S.C. and 28 U.S.C.).

CONCLUSION: PROPOSALS TO PROMOTE MEANINGFUL AMENDMENTS

Complaints about preference law and calls for reform have been broadly documented.[79] There is no lack of well-considered proposals to amend preference law—some incremental and others more extensive.[80] However, all of them suffer from a fundamental lack of the information necessary to sufficiently evaluate both the problem of preferential transfers and the viability of proposed solutions.[81] Preference law remains an elusive area of study because of the difficulty of obtaining reliable empirical data regarding how preference law is being implemented. Without such data, all efforts to understand preference law are fundamentally handicapped, and all proposals for reform inherently theoretical.

Accordingly, the first step forward towards accomplishing meaningful reform of preference law is to obtain additional information about how it functions in practice. Historically, this has proved exceptionally difficult, even when studies are limited in scope. Time-consuming evaluation of court records is necessary to find even the most basic information, and much of the most vital information is simply unattainable from court records.

For example, the study of 2,500 consumer chapter 7 cases described above included only sixteen cases with observable preference recovery.[82] In that study, preference avoidance was "a truly low incidence event," occurring in only 0.64% of the sample studied.[83] The study concluded that preference avoidance enabled the trustee to recover a median amount of $2,086,[84] that the percentage of recovery was

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[79] *See, e.g.*, Daniel J. Bussel, *The Problem with Preferences*, 100 IOWA L. REV. BULL. 11, 12 (2014) ("When preference targets are those receiving payments within 90 days of bankruptcy in respect of goods or services, redistributing those preference recoveries to unsecured creditors ratably seems like rearranging the deck chairs on the *Titanic*."); Michael J. Herbert, *The Trustee Versus the Trade Creditor: A Critique of Section 547(c)(1), (2) & (4) of the Bankruptcy Code*, 17 U. RICH. L. REV. 667, 668 (1983); *See* McCoid, II, *supra* note 36, at 250; C. Robert Morris, Jr., *Bankruptcy Law Reform: Preferences*, *Secret Liens and Floating Liens*, 54 MINN. L. REV. 737, 737 (1970) ("The law is wrong . . . . [T]he law of preferences is not the appropriate vehicle for handling secret liens in bankruptcy."); Thomas J. Palazzolo, *New Value and Preference Avoidance in Bankruptcy*, 69 WASH. U. L.Q. 875, 876 (1991); *see also* Ponoroff, *supra* note 11, at 1446; Ponoroff, *supra* note 14, at 336; David A. Skeel, Jr., *The Empty Idea of "Equality of Creditors"*, 166 U. PA. L. REV. 699, 729 (2017) (arguing preference law should be limited to self-dealing transactions); Charles Jordan Tabb, *Rethinking Preferences*, 43 S.C. L. REV. 981, 984 (1992).

[80] *See, e.g.*, Bussel, *supra* note 79, at 13 (recommending raising the minimum amount of preferential transfer recoverable in a business case to $100,000); *see also* McCoid, II, *supra* note 36, at 250 (tentatively recommending the elimination of preference law); Lawrence Ponoroff & Julie C. Ashby, *Desperate Times and Desperate Measures: The Troubled State of the Ordinary Course of Business Defense—And What to Do About It*, 72 WASH. L. REV. 5, 9–10 (1997) (calling for a refining of the ordinary course of business defense); AM. BANKR. INST., COMMISSION TO STUDY THE REFORM OF CHAPTER 11, 2012-2014 FINAL REPORT AND RECOMMENDATIONS 148 (2014), https://abiworld.app.box.com/s/vvircv5xv83aavl4dp4h (recommending raising the floor for preference actions to $25,000 in business cases).

[81] *See* Jimenez, *supra* note 32, at 49 ("[W]e lack basic information about what happens to preferential transfers in business cases today.").

[82] *See id.* at 45 n.31; Dalie Jimenez, *The Distribution of Assets in Consumer Chapter 7 Bankruptcy Cases*, 83 AM. BANKR. L.J. 795, 821 (2009).

[83] Jimenez, *supra* note 32.

[84] *Id.*

high (reflecting favorable settlement terms for the trustee), and that administrative expenses for those cases overall were relatively reasonable.[85] Even so, these positive observations translated into comparatively small gains for unsecured creditors. Cases with preference recoveries provided a median of 8.7% repayment to unsecured creditors versus 7.9% repayment for unsecured creditors in other asset cases.[86]

A similar study of business cases, expanded to cover a higher number of cases and a greater number of observations, might reveal similar patterns of high recoveries and comparably low expenses, contrary to collective wisdom and the limited studies that have been conducted thus far. On the other hand, it might demonstrate that preference avoidance is, on the whole, a value-reducing proposition for bankruptcy estates and their creditors. The larger point is that we simply do not know; and until the evidence is gathered, any efforts to amend the law are shots in the dark.

If Congress is truly concerned about the impact of preference liability on small businesses, it should consider encouraging greater information-gathering about the extent to which preference law satisfies its intended goals. Further, Congress should also obtain information as to whether the goals of preference avoidance conflict with more general policy concerns of the bankruptcy system, such as efficiency and value-preservation. How effective are preference actions at recovering transfers, thereby equalizing distribution among creditors? How costly are preference recoveries to the estate? To defendants? Based on data obtained thus far, it seems highly plausible, if not probable, that preference law as written and implemented is not sufficiently tailored to promote an efficient recovery of funds for the estate, due to the breadth of its application. It also seems plausible, if not probable, that preference law as written and implemented is inequitably applied across defendants, imposing higher costs on those who are less sophisticated or less vital to the debtor's ongoing plan of reorganization. A statutory amendment that simply reaffirms that trustees should not bring frivolous lawsuits does not address these problems.

Generally, if preference actions are indeed value-destroying, then Congress should consider broader reforms that would scale back or eliminate preference liability altogether in the interests of preserving the estate. It is likely that some preference liability is desirable going forward, particularly for insiders and possibly for very large transfers that fundamentally affect how the estate is distributed. However, limiting preference liability to these sorts of situations calls for extensive amendment to the Code, not the incremental changes seen here.

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[85] *Id.*

[86] *Id.*; *see* Jimenez, *supra* note 82.