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APRIL 11, 2020 | PUBLICATION

Bankruptcy Preference Alert: Score Two Touchdowns for Chapter 11 Preference Defendants

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The "Small Business Reorganization Act of 2019" (SBRA) signed into law on August 23, 2019 contains two amendments to Chapter 11 preference laws, which are NOT limited to small business reorganizations.

1. Debtors' Burden of Proof.

- As creditors who have been on the wrong end of preference claims under Section 547 of the Bankruptcy Code know all too well, debtors' burden to assert preference claims is minimal, a lay-up. The burden quickly shifts to the creditor to establish its defenses under Section 547(c) of the Bankruptcy Code.
- With SBRA, debtors now have an additional hurdle before asserting preference claims. A debtor/trustee may avoid a preference payment "based on reasonable due diligence in the circumstances of the case and taking into account a party's known or reasonably knowable affirmative defenses . . .."
    - Debtors now should analyze a preference defendant's defenses of: "subsequent new value", "ordinary course of business", and "contemporaneous exchange for value".
    - This should effectively eliminate the normal "shotgun" approach by debtors to file preference complaints based on all payments made to creditors within 90 days prior to the Chapter 11 filing, without regard to potential defenses. Otherwise, debtors' claims may be subject to dismissal, and possibly claims for bad faith filing.
    - No doubt, debtors will challenge the meaning of "reasonable due diligence".
    - Over the years, many Bankruptcy Courts have issued creditor-friendly rulings in preference cases, within the bounds of the current statute. This indicates a judicial dislike of the cottage industry of attacking suppliers who supported a debtor prior to the Chapter 11 filing, particularly when preference recoveries do not serve the stated purpose of materially increasing the value of

the estate, for the benefit of creditors (not the under-secured lender).

We hope this will translate to creditor-friendly rulings on the debtors' new "due diligence" requirement.

- The impact of this amendment will be a reduction in the value of preference claims, which should alter debtors' incentive for pursuing claims.

2. Venue of Small Preference Claims.

- Any preference claims for $25,000 or less must be filed in the venue where the defendant is located.
- Given the impracticability of filing small claims in multiple jurisdictions, this change may effectively eliminate claims under $25,000.
- Given the trustee's new burden of evaluating preferential defenses, preference defendants should consider a motion to dismiss or transfer venue of preference claims that are under $25,000, after application of the preference defenses.

The effective date for these changes is February 19, 2020.

We hope you found this useful and informative. Please contact us if you have any questions about this or any other matter.

David H. Conaway, Shumaker 2019©

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