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LITIGATING BANKRUPTCY PREFERENCES WHEN NOTHING IS "ORDINARY"

The ordinary-course of business defense is intended to encourage creditors to continue to do business with debtors by shielding ordinary-course payments from avoidance and recovery. In this article, the author discusses the limits of what is defined as "ordinary" in the cases, and the disconnect it creates between bankruptcy policy and practice. She concludes with a note on the Consolidated Appropriations Act of 2021, which she finds is a partial and temporary fix.

By Deborah Kovsky-Apap *

WHAT IS A PREFERENCE? (OR, HOW THE BANKRUPTCY CODE RUBS SALT IN CREDITORS' WOUNDS)

The avoidance and recovery of preferences are statutory causes of action that are — at least theoretically — designed to keep the debtor from preferring certain creditors over others and to ensure that similarly situated creditors are given equal treatment. In practice, the existence of the preference provisions in the Bankruptcy Code means that bankruptcy lawyers spend a great deal of time explaining to incredulous clients that not only are the clients *not* going to get paid what they are owed by the debtor, they are likely to have to return what little they did receive before the bankruptcy filing.

Section 547(b) of the Bankruptcy Code provides that a trustee[1] "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"[2] that was made to or for the benefit of a creditor on account of an antecedent debt, while the debtor was insolvent, on or within 90

[1] Subject to certain limitations not relevant here, the debtor in possession in a chapter 11 case has essentially all of the rights and powers of a trustee under the Bankruptcy Code, including the power to avoid and recover preferences. *See* 11 U.S.C. § 1107(a).

[2] The trustee's obligation to perform reasonable due diligence and take into account a creditor's potential affirmative defenses is a relatively recent amendment to the Bankruptcy Code, having been added by Sec. 3 of the Small Business Reorganization Act of 2019. At least one court has found that "this condition precedent, i.e., due diligence and consideration of affirmative defenses, is an element of the trustee's prima facie case," and suggested that the trustee's failure to meet such condition "may defeat jurisdiction." *In re ECS Ref., Inc.*, 625 B.R. 425, 453–54 (Bankr. E.D. Cal. 2020).

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