MASS PREFERENCE LITIGATION
STRATEGIES AND PITFALLS
(INCLUDING THE USE OF STREAMLINED PROCEDURES AND MEDIATION)

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As preference cases become more and more commoditized, brought in large batches, and with procedures orders entered well before any defendant knows that they have been sued, the potential for abuses increases. Several articles appeared in the ABI Journal bemoaning the lack of oversight and conflicts of interest that arise in mass preference litigation. Those articles call for legislative changes to address the issues. For example, Karen Cordry suggests that the cure for a "blunderbuss" of preference litigation brought with too little investigation is to shift the burden of proof on ordinary course to the estate. Karen Cordry, "*Some Modest Proposals on Preferences*," ABI JOURNAL, June 2008.

Zach Mosner proposes that estates that are administratively insolvent be precluded from bringing preferences and that the Bankruptcy Code be amended to prohibit assignment of preference actions under 363. Zach Mosner, "'*Churn' Noble: Rethinking Preference Suits*," ABI JOURNAL, July/August 2011. Until these legislative suggestions are adopted, the rank and file bankruptcy lawyer will have to create their own solutions to the problem of preference litigation run amok.

This article attempts to highlight where procedures orders, dismissal decisions and mediation orders get it wrong or could be vastly improved. It also suggests creative strategies (some untested) to change the balance of power between plaintiffs and defendants: pre-judgment interest, fee-shifting, jury trial rights, discovery sanctions and similar slings and arrows to favorably move the settlement needle. This article is not a primer on preference elements and defenses as those matters are routinely known or discussed elsewhere.

When faced with a mass preference complaint, a defendant has the choice between attempting to distinguish itself from the hordes to reach an early settlement or to play along like a prisoner in the Bataan Death March, where attrition and time will eventually wear down both plaintiff and defendant making settlement cheaper than going forward. Whether the typical dance of attrition in mass preference actions achieves justice is another matter. Defendants face unnecessary costs in the form of local counsel, travel, and attorneys' fees when the complaint against them was based solely on the fact that a check was written during a 90-day period. Some procedures orders do not require any precision or verification by the plaintiff that a plausible preference claim exists and usually stay discovery "to avoid administrative costs." A review of procedures orders reveals that certain of these provisions are efficient and workable, and others are simply over-reaching, slovenly or both. Most preferences are settled over the phone after informal document exchange if both sides are settlement-minded. Mediation early in the case streamlines the adversary proceeding significantly. This is particularly true if the parties exchange documents and position statements before the mediation.

PART A--PLAINTIFF ISSUES

Preference litigation can be lucrative for estate counsel, but it also can be unjustifiably expensive for the estate. There is a natural bias against spending too much time investigating claims before they are brought because it is easier to let the defendants identify the weaknesses in the trustee's case. Still, a trustee or estate representative can get caught in a situation where he has brought too many weak cases and the ensuing perception of weakness can embolden both the court and defendants. For both ethical and strategic reasons, the estate representative is well-advised to choose battles that are winnable and to avoid obviously unsupportable cases.

Efficiency should not prevail over counsel's goal of reasonable investigation and meritorious pleadings. With respect to winnable cases, the estate is best-served when advancing every possible avenue of recovery and pleading the case with a full understanding of the facts. We begin with a juxtaposition of various pleading standards and grounds for dismissal.

I. APPLICATION OF THE *TWOMBLY/IQBAL* TO PREFERENCE ACTIONS

The first step in the mass preference march of attrition is the filing of the complaint. Often the preference complaint will be mass produced, sometimes simply using the debtor's check register to identify defendants. The result is a complaint that merely recites the elements of 11 U.S.C. § 547(a) without pleading specific facts as to what was the antecedent debt (or if there was one), whether the transfer was of property of the debtor or someone else, or facts showing that the transfer enabled the creditor to receive more than in a chapter 7 case.

Cases addressing what must be in a preference complaint can be divided into four overlapping constructs: before and after *Twombly/Iqbal* and for or against Judge Walsh's opinion in *Valley Media.* The short explanation of the *Twombly/Iqbal* shift is that these two Supreme Court opinions changed the level of pleading required under FED. R. CIV. P. 8 to withstand a motion to dismiss under FED. R. CIV. P. 12. The old standard was that a complaint should not be dismissed for failure to state a claim unless it appeared "beyond doubt" that the plaintiff could prove *no* set of facts in support of its claims. *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957). *Twombly/Iqbal* changed that standard to whether the complaint is "plausible" based on the pleading of "enough factual matter to state a cognizable claim." *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 127 S.Ct. 1955 (2007), and *Ashcroft v. Iqbal*, 129 S.Ct. 1937 (2009). Federal Rules of Civil Procedure 8 and 9 apply to bankruptcy proceedings by operation of Federal Rules of Bankruptcy Procedure 7008 and 7009 with 7008 being applicable to preferences and 7009 also applicable to fraudulent transfers based on actual fraud.[1]

"A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal*, 129 S.Ct. at 949 (citing *Twombly*, 550 U.S. at 556). "The plausibility standard is not akin to a 'probability requirement,' but it asks for more than a sheer possibility that a defendant has acted unlawfully." *Id.*

A. Rule 12(b)(6) Decisions Pre-*Twombly/Iqbal*

Rule 12(b)(6) decisions on avoidance actions prior to 2007 run the gamut between a very liberal "notice pleading" standard and opinions that presaged the heightened pleading standards in *Twombly/Iqbal*. Judge Walsh's opinion in *In re Valley Media, Inc.*, 288 B.R. 189 (Bankr. D. Del. 2003), set forth the "minimum standard" that preference complaints must contain:

> (a) an identification of the nature and amount of each antecedent debt and (b) an identification of each alleged preference transfer by

[1] Fraudulent transfer are generally subject to the heightened pleading standard of FED. RULE CIV. PROC. 9, although claims of constructively fraudulent transfers are subject to the FED. RULE CIV. PROC. 8. *See, e.g., In re Saba Enterprises Inc.*, 2009 WL 3049651 at *9 (Bankr. S.D.N.Y.) (Sept. 19, 2009) (citations omitted).

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