ETHICS FOR THE BUSINESS PRACTITIONER: EVALUATION OF POTENTIAL PREFERENCE ACTIONS

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Analysis of potentially avoidable preferential transfers is among the necessary duties of counsel in a business bankruptcy case. Any operating business is likely to have paid hundreds, if not thousands, of bills within the 90 days before the bankruptcy filing. However, most of these payments probably do not qualify as preferences under 11 U.S.C. § 547(b), even assuming the debtor's insolvency. This article discusses the ethical implications of the exercise of "prosecutorial discretion" with respect to preference actions.

The prima facie preference case requires a showing that, within the 90 days before the bankruptcy filing, an insolvent debtor made a payment to a creditor on account of an antecedent debt, thereby enabling that creditor to receive more than it otherwise would under a Chapter 11 plan or a Chapter 7 liquidation. Even if these elements are present, however, most preference period payments will not be avoidable because of the protections of §547(c): they will turn out to have been made in ordinary course of business, as part of a contemporaneous exchange for new value, or as part of a continuing relationship in which the non-debtor counterparty has continued to provide "new value" in the form of goods or services after receiving payment. Although creditors ultimately bear the burden of proof as to the §547(c) defenses, even a cursory review of the debtor's books and records is likely to establish that regular monthly payments to utilities, taxes, employees and regular suppliers are presumptively ordinary course payments.

Accordingly, the ethical question arising in this context concerns the degree to which debtor's counsel is obligated to investigate readily identifiable defenses and take them into account in deciding whether to prosecute preference claims. Answering this question requires consideration of three types of obligations: (1) the attorney's ethical and legal obligation to file only well-founded complaints pursuant to the standards of the Federal Rules of Bankruptcy Procedure Rule 9011; (2) the attorney's ethical obligation to the client not to churn cases to generate fees disproportionate to probable benefit; and (3) the attorney's professional and ethical obligation as an officer of the court not to bring the bankruptcy system into disrespect by filing meritless preference actions for the purpose

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of extracting settlements for the estate's benefit. In addition, special ethical problems of conflict of interest arise when the potential preference claim to be prosecuted is against the bankruptcy counsel's firm.

1. Failure to Consider Preference Defenses as Sanctionable Misconduct

Rule 9011 provides that, by signing and filing a pleading with the court, the attorney "is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances, . . . [the pleading] is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation," while also certifying that the legal and factual assertions are warranted. As a general proposition of the law of federal pleading, plaintiff's counsel does not have an obligation to take into account an affirmative defense that is waivable if not pled. That is, in the words of one commentator on Fed.R.Civ.P. Rule 11, a federal complaint could be filed "with plaintiff's fingers crossed, hoping that the defendant would not raise the defense, whether by choice or neglect."[2] However, for preference actions, inadvertent waiver of affirmative defenses is rare, as the standard ones are so conveniently listed in the statute itself.

Courts have applied a variety of standards in determining whether to impose sanctions for filing a preference complaint in the face of a dispositive affirmative defense. Two different considerations appear to drive the case law. First, the affirmative defense must be "obvious" and clear cut. Second, the plaintiff's counsel must either know or should known facts sufficient to establish the defense. Both are necessary elements to any sanction award, but they generally must rise to the level of "bad faith" for sanctions to be imposed. The most notable pattern in the case law is that bankruptcy courts are far more willing to impose sanctions than appellate courts are to affirm them.

The emerging rule seems to be that plaintiffs and their counsel have a duty to investigate "obvious" affirmative defenses. In *In re Excello Press, Inc.*, 967 F.2d 1109, 1115 (7th Cir. 1992), defendant's summary judgment motion was initially granted with respect to two of the three transfers at issue on the ground that they were ordinary course transfers, and later as to the third transfer, on the ground that the defendant was not a transferee of that transfer within the meaning of § 550 of the Bankruptcy Code. Thereafter, the bankruptcy judge granted defendant's motion for sanctions against debtor's counsel with respect to the entire matter. The district court affirmed sanctions only as to the first two transfers, holding that the failure to dismiss the third count based upon post-filing facts could not rise to the level of a Rule 9011 filing sanction. The Seventh Circuit reversed the award of sanctions because plaintiff had investigated various possible affirmative defenses. Moreover, reliance by debtor's counsel upon a minority view of the ordinary course defense as the justification for pursuing the action could not constitute bad faith in the absence of controlling contrary precedent.

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[2] David H. Taylor, "Filing with Your Fingers Crossed: Should a Party be Sanctioned for Filing a Claim to Which There is a Dispositive, Yet Waivable, Affirmative Defense?" 47 Syracuse L.Rev. 1037, 1038 (1997).

The *Excello* standard was recently invoked in *In re Berger Industries, Inc.*, 298 B.R. 37 (Bankr. E.D.N.Y. 2003), in which the bankruptcy court endorsed the view that, in appropriate cases, an attorney may have the obligation to investigate "whether any obvious affirmative defenses bar the case." However, under the facts presented, the bankruptcy court declined to impose sanctions under Rule 9011 for the debtor's preference complaint against a supplier to recover a payment of about $177,000, that resulted in six and a half years of litigation regarding the defendant's new value and ordinary course defenses. The debtor eventually conceded that over $120,000 in new value had been provided. The matter went to trial solely upon the ordinary course defense, and resulted in dismissal of the complaint on that ground. Four months later, the defendant sought to reopen the adversary proceeding to seek imposition of sanctions. The sanctions motion squarely presented the issue of whether the plaintiff was required to consider the availability of the affirmative defenses before filing the complaint. The court held that Rule 9011 does not require investigation into whether affirmative defenses were available to prevent recovery. The court noted the general view that requiring counsel to conduct such investigations in every case "reorders traditional burdens of pleading and would, in effect, impermissibly change the requirement for a reasonable pre-filing inquiry into pre-filing discovery." *Id.* at 41. However, it cited *Excello* with approval, stating that "[a] *per se* rule negating any requirement for a pre-filing investigation of affirmative defenses" would be unacceptable. *Id.* at 42. Had the new value defense been "obvious," sanctions would have been appropriate.

Other courts frame the issue in terms of "bad faith" but seem to be talking about essentially the same standard of conduct as the "obvious" affirmative defense cases. For example, in *In re Mroz*, 65 F.3d 1567 (11th Cir. 1995), the trustee filed a preference complaint against the debtor's ex-wife based solely upon the debtor's uncorroborated statements that he transferred part of a $39,000 payment to her. The ex-wife provided an affidavit denying receipt of such funds and seeking sanctions for the failure of the trustee and his lawyer to conduct an adequate investigation before filing the complaint. The bankruptcy court dismissed the complaint and imposed sanctions upon the trustee, the appearing attorney and his law firm, expressing its outrage that the trustee would prosecute the case armed solely with the debtor's affidavit that failed to specify the date, amount of transfer, antecedent debt that was supposedly repaid, or the manner of transfer. The district court summarily affirmed, but the Eleventh Circuit reversed and remanded for further factual determinations. While concluding that the debtor's affidavit was a sufficient basis to hold that the filing of the complaint met the good faith test of Rule 9011, the trustee's total failure to take discovery, gather supporting evidence, or otherwise prepare for trial justified a further review by the bankruptcy court to determine whether sanctions would be appropriate under the court's inherent powers to regulate the conduct of counsel and parties. Imposition of sanctions would be appropriate if the trustee, the attorney or the law firm acted in "bad faith, vexatiously, wantonly, or for oppressive reasons." *Id.* at 1575 (citing *Chambers v. NASCO, Inc.*, 501 U.S. 32 (1991).

The Eleventh Circuit's directive to examine counsel's litigation conduct in light of the court's inherent equitable powers to curb abuse might have caused reconsideration of the result in *In re Leeds Building Products, Inc.*, 181 B.R. 1006 (Bankr. N.D. Ga.

1995), which predated *Mroz* by six months. In *Leeds Building Products*, the bankruptcy court refused to impose sanctions even though plaintiff virtually stipulated to summary judgment when confronted with defendant's spreadsheet analysis supporting its ordinary course defense. The court concluded that Rule 9011 "places no prefiling duty upon a plaintiff to conduct an inquiry into possible affirmative defenses, except in those unusual or extreme circumstances where such a defense is obvious and needs no discovery to establish." *Id.* at 1010. Although defendant had informed plaintiff of its intention to assert an ordinary course defense, it did not provide plaintiff with the detailed basis for that defense until summary judgment. The court apparently concluded that, absent discovery, plaintiff could not verify the defense. This analysis suggests that, had the defendant provided its spreadsheet analysis initially, the court might well have imposed sanctions if the complaint was filed in the face of such evidence.

Courts do not consider haste to be an acceptable excuse – usually arising from the impending expiration of the statute of limitations – for filing meritless preference claims. In evaluating the reasonableness of counsel's prefiling conduct and whether sufficient investigation was conducted with diligence, courts refuse to give any weight to the common excuse that the preference complaint in question urgently required filing due to the two-year statute of limitations. As one bankruptcy court explained in the earliest case addressing this question, "[e]ven though the Complaint may have been prepared and filed in haste, to prevent the running of the statute, the necessity for that haste was caused by the Trustee's own delay. For that reason, the resulting press of time should not excuse or mitigate the Trustee's obligations under Bankruptcy Rule 9011." *In re Western Die Casting Co.,* 106 B.R. 645, 648 (Bankr. N.D. Cal. 1989). While rejecting this excuse, the court nonetheless denied the requested sanctions, holding that Rule 9011 does not impose upon plaintiff the obligation to investigate or consider affirmative defenses. Even though the trustee and counsel were chargeable with actual knowledge of substantial evidence supporting a "new value" defense and eventually stipulated to dismissal of the complaint with prejudice, allegedly because it was uneconomic to litigate the defense, the court accepted representations by plaintiff's counsel that material issues of fact existed with respect to certain aspects of that defense, thereby (sort of) justifying the filing of the complaint. Like the bankruptcy courts in *Mroz* and *Leeds Building Products*, the *Western Die Casting* court did not consider the possible imposition of equitable sanctions as directed by the Eleventh Circuit in *Mroz*.

Warnings of equitable sanctions are popping up in other preference cases as well. In *In re Hechinger Inv. Co. of Delaware, Inc.*, 298 B.R. 240 (Bankr. D. Del. 2003), the bankruptcy court denied a *pro se* defendant's summary judgment motion because of its reliance on hearsay evidence about ordinary course in the relevant industry. In reserving the issue of sanctions against special counsel hired to handle mass preference actions, however, the court noted, "I am constrained to comment on the effort and activity in this case to date which certainly appears far out of proportion to the amount at issue. The vast majority of preference actions of this magnitude are resolved by compromise solutions after limited discovery activity." *Id.* at 240. Counsel had made a relatively high settlement demand, unacceptable to defendant who argued that he was not getting credit for his strong ordinary course defense. After the bankruptcy judge's "hint," this matter has surely settled at a modest price or been dismissed entirely.

Of course, counsel cannot reasonably be sanctioned for failing to anticipate future evolution of the case law that appears to be in the process of liberalizing preference defenses. For example, the Ninth Circuit recently issued an opinion that is generally regarded as having expanded the scope of the "ordinary course" defense, and shows the uncertainty about applicable standards for some kinds of transactions. *In re Jan Weilert RV, Inc.*, 315 F.3d 1192 (9th Cir. 2003), involved preference period payments by a recreational vehicle dealer to certain secured creditors in full satisfaction of their liens on RVs sold by the dealership. One creditor received payments as to various trade-ins from 21 to 45 days after the sale. The bankruptcy court determined that, because the industry average was 20 days, the payments in question were later than the "industry standard," and therefore not "ordinary course." The Court of Appeals reversed, holding that ordinary business terms cannot be limited to the average transactions in the industry, but instead include "the broad range of terms that encompasses the practices employed by similarly situated debtors and creditors facing the same or similar problems." *Id.* at 1200. Occasionally, an established line of preference case law is overruled by the circuit courts, as happened in *In re Finance Federated*, 309 F.3d 1325 (11th Cir. 2002) (preference defendant is not barred as a matter of law from asserting an affirmative defense that the transfers were received in good faith and for value, despite prior precedent holding such defenses unavailable in alleged ponzi scheme cases). Together these cases appear to reflect an emerging trend favoring a more expansive view of affirmative defense to preferences, and cutting back on the aggressiveness of preference prosecutions.

The practical rule that can be derived from the developing trend in the case law is that a preference plaintiff's counsel should be able to avoid sanctions except where the affirmative defense in question is "obvious" and not subject to material issues of disputed fact or law, unless the court determines that the complaint is being prosecuted in bad faith or for an improper purpose. Whichever standard is employed, a number of bankruptcy courts have taken offense at plaintiff's conduct that the appellate courts have found at least not definitively beyond the range of acceptable conduct. For the practitioner, however, the imposition of sanctions at the bankruptcy court level, often affirmed by the district court, should be of concern, even if the appellate court eventually excuses the conduct in question. The bankruptcy courts appear to be taking an increasingly hard look at pre-filing practices, which may result either in improved diligence by counsel or an increasing likelihood of reported sanctions.

2. Ethical Obligation to Assure Probable Benefit to the Unsecured Creditors of the Estate in Recommending Filing of Preference Actions

The right to recover preferential transfers is a non-assignable cause of action by created solely for the benefit of the general unsecured creditors of the estate. *See, e.g,, Grass v.* Osborn, 39 F.2d 461 (9th Cir. 1930); *In re S&D Foods, Inc.*, 110 B.R. 34, 36 (Bankr. D. Colo. 1990) (dismissing preference action by asset purchaser where creditors would not benefit); *accord, In re Texas General Petroleum Corp.*, 58 B.R. 357 (Bankr. S.D.Tex. 1986). Thus, in preference actions, the actual "client" is the class of unsecured creditors, regardless of whether preference action is being prosecuted by a debtor, a

trustee, a creditors' committee, or some other representative of the estate. The potential preference defendants are usually also members of that class of creditors. This odd inherent conflict is tolerated out of necessity, but imposes the obligation upon any counsel evaluating potential preference actions to be mindful that recovery of preferences is supposed to serve the overall fundamental bankruptcy goal of equality of distribution: similarly situated creditors should be paid pro rata the same distribution from the estate. Moreover, the transactional cost of recovering preferences – in the form of attorneys' fees, litigation costs, and sometimes delays in distribution – deplete the very pool of assets from which the unsecured creditors can be paid.

An additional consideration for counsel is the fact that preference causes of action are unique to bankruptcy. While trustees and turnaround managers are familiar with the process of evaluating the merits of pursuing preferences, a debtor's regular management and members of the creditors committee may be encountering the issue for the first time. The novices usually defer to their attorney's recommendations about how to conduct the preference analysis, and what standards to use in determining whether to file preference actions. Counsel thus has the duty to explain both the mechanics and the principles of preference actions, as well as the role that recovery of preferences is supposed to play in the bankruptcy process.

The professional ethical standards governing attorney conduct in most states are based upon the American Bar Association's Model Rules of Professional Conduct ("MRPC"), adopted in 1993. However, none of the rules addresses the kinds of inherent conflicts built into the bankruptcy system, such as the statutory obligation of the estate's representative to evaluate preference claims and decide whether to sue entities that are members of the class whose interests are supposed to be protected and advanced by that same representative. Even the experts despair of reconciling general rules and case law relating to conflicts of interest to the peculiarities of the bankruptcy context.[3] At a minimum, however, the evaluation of potential preference claims generally implicates MRPC Rule 1.1 requiring competent representation, MRPC Rule 1.3 requiring diligence and promptness, and MRPC Rule 2.1 requiring the exercise of independent judgment.

In the context of evaluation of preference actions, satisfying the MRPC Rule 1.1 requirement that lawyers provide "competent" representation to the client[4] requires attention to the need to educate the client about the purposes and limitations of preference actions, and to remind the estate representative – who is formally directing the attorney's efforts – of the actual identity of the intended beneficiaries of those efforts, that is, the

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[3] Comments by Professor Geoffrey Hazard regarding bankruptcy judges' request that the American Law Institute undertake to address conflicts issues in bankruptcy cases at Federal Judicial Center educational program in the mid-1990s.

[4] MRPC Rule 1.1 provides, "A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation." In elaborating on "thoroughness and preparation," Comment 5 to this rule notes that "Competent handling of a particular matter includes inquiry into and analysis of the factual and legal elements of the problem, and use of methods and procedures meeting the standards of competent practitioners."

unsecured creditors. As set forth in Section 1 above, with respect to the evaluation of potential preference actions, the "thoroughness and preparation reasonably necessary for the representation" requires adequate inquiry into the both the prima facie elements for the preference action *and* potential defenses to ensure that sufficient evidence exists to prevail upon the preference claim – which necessarily includes overcoming any affirmative defenses.

Waiting until the statute of limitations is about to expire before attempting serious preference analysis would appear to run afoul of MRPC Rule 1.3's requirement of "reasonable diligence and promptness" in representing clients.[5] Other conduct exhibited in the sanctions cases would also violate that rule: delaying five months before serving a complaint, waiting two years after notice of defenses before dismissing a complaint, and in many of the cases, lack of any investigation before the filing of the complaint. Just because a cause of action has an outside chance of success does not mean that it is worth prosecuting to the bitter end.

MRPC Rule 2.1, requiring the exercise of independent judgment,[6] specifically directs lawyers to consider factors in addition to the narrow question of *prima facie* evidence of a preference, in advising the client whether to pursue a particular potential preference claim. For typical litigation, an attorney would ordinarily be obligated to provide an assessment of the probability of success, including the strength of potential affirmative defenses; the probable cost of prosecuting the claim; and the likelihood of recovery upon any judgment. In the preference arena, the attorney should also analyze how well the prosecution of the claim will serve the bankruptcy principle of equality of treatment, in light of the possibly countervailing principle of maximizing overall recovery for the creditors. Even an indisputable preference may not be worth pursuing if, after taking account of the costs of prosecution, the replacement claim that the defendant will hold if the preference is repaid, and the overall distributions contemplated for the case, prevailing in the preference action is likely to add but a penny's worth of value to each creditor.

Defense of even small preference actions is expensive. The defendant has to incur the costs to retain counsel (often both general counsel and local counsel are required), investigate and produce documentation in defense of the action, and travel to the bankruptcy home court for hearings and trial. Defending even a small preference action is likely to cost upwards of $5,000 to $10,000. MRPC Rule 2.1 suggests that attorneys evaluating preference actions are obligated to take into account the costs to

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[5] MRPC Rule 1.3 provides that, "[a] lawyer shall act with reasonable diligence and promptness in representing a client." Comment 1 to this rule notes the need to balance "commitment and dedication to the interests of the client and with zeal in advocacy upon the client's behalf" against the obligation to exercise professional discretion in determining the means to be used and the fact that "a lawyer is not bound to press for every advantage that might be realized for a client."

[6] MRPC Rule 2.1 provides that, "[i]n representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation."

preference defendants in assessing the overall benefit to be gained from the prosecution, because most potential preference defendants are members of the class of creditors for whose benefit the preference actions are supposed to be prosecuted. No case law exists on this precise issue, so far as can be determined, but the existence of such an ethical obligation flows directly from purpose and nature of this Rule.

3. Ethical Obligations as Officer of the Court

Increasingly, preference actions are being filed by the hundreds, especially in liquidating cases in which the debtor has no need to preserve relationships with vendors. These kinds of mass filings are usually based upon rote formulas for average payment delays from date of invoice. For example, in August 2003, 861 preference actions were filed by the joint debtors in the *In re Ames Department Stores* cases in Delaware against a wide variety of creditors. The 35 largest claims, ranging from $1 million to $11 million, are being handled by the debtors' major bankruptcy firms, including Weil Gotshal & Manges LLP at the same hourly rates as their general representation. The rest have been farmed out to special litigation counsel, retained on a 21% contingency fee basis.[7] Many other bankruptcy cases similarly have hundreds of pending preference actions.

These massive filings have been encouraged by the development of computerized programs to search computerized accounting records for discrepancies and patterns in the debtor's prefiling payments. They have also been fueled by and have spurred the emergence of mass preference prosecution as a legal specialization for contingency fee attorneys. Often these attorneys do not otherwise regularly appear before the bankruptcy courts in any other capacity. Most are concerned about demonstrating their value to the estate in raw numerical terms: how much in the way of net proceeds they deliver to the debtor. Because of the contingency fee arrangement, debtors are often relatively oblivious to the costs imposed both upon the preference defendants and upon the court from the numerous marginal claims being filed, and the inadequacy of the information provided in the form complaints. Indeed, many form complaints used in mass preference filings fail to identify the allegedly preferential transfers in sufficient detail for the defendants to identify the checks, payments or other transfers at issue. Occasionally, in trying to cut their own costs, contingency fee counsel have reportedly even resorted to such improper tactics as lumping multiple preference claims against multiple, unrelated defendants together in a single complaint to save filing fees.

High volume filings of preference adversaries present logistical problems for clerical management by the courts. Many courts now require counsel to prepare and update hearing calendars, agendas and other papers to ease the clerk's office burdens for

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[7] Application of the Debtors for an Order Authorizing the Retention and Employment of Storch Amini & Munves, P.C. as Special Counsel to Analyze and Litigate Preference Claims, dated July 1, 2003, *In re Ames Department Stores, Inc.*, Case Nos. 01-42217 – 01-42221 (REG) (Bankr. S.D.N.Y.). Revealingly, but perhaps unintentionally, paragraph 15 of the Application only provides for a 21% fee based upon amounts "realized on the settlement or compromise" of preference actions. It does not specify what, if any, fee is due from collections of judgments. This implies the lack of intention to litigate preference claims to finality.

such dockets. If the particular court does not have such procedures in effect, then plaintiff's counsel should offer to provide it to relieve the court and clerk of the special burdens posed by such mass filings.

Plaintiff's counsel risk damaging their own credibility before the court by filing poorly founded, poorly documented complaints that result in high volumes of dismissals once defendants document their defenses. Other cases settle for "nuisance" value because the cost of defense is higher than the amount of the preference. Patterns of meritless or nuisance value complaints generate outrage among preference defendants which is sometimes then echoed by court sanctions. Abusive filings of preference actions can fly under the radar screen of the court, particularly if very broad settlement discretion is given to counsel without notice or court review. Defendants simply have no effective way in smaller preference actions of bringing their defenses and their resistance to settlement demands effectively before the court, where such "no hearing, no approval required" procedures are in effect. Query whether the bankruptcy judges actually have any sense as to whether the high volume preference filings in their cases are well-founded or abusive filings. Courts should consider whether the due process requirements for standard federal litigation are being shunted aside in the service of "efficiency" and lack of judge time to deal with so much litigation. Under these circumstances, both the preference defendants and courts are highly dependent upon the ethical exercise of discretion by attorneys for the estate.

4. Ethical Obligations of Law Firms as Potential Preference Defendants

Some of the most difficult ethical issues arising with respect to preference representation concern potentially preferential payments received by debtor's counsel on the eve of the bankruptcy filing. This problem raises professional conflict of interest issues that are unique to the bankruptcy arena, since outside of bankruptcy, clients are free to prefer paying their lawyers to other creditors.

This thorny issue was recently addressed in *In re Pillowtex Corp.*, 304 F.3d 246 (3rd Cir. 2002). As disclosed in the firm's retention application, Jones, Day, Reavis & Pogue had received $1,000,000 during the preference period as payment for prepetition services provided to Pillowtex. The U.S. Trustee objected to Jones Day's retention as debtor's bankruptcy counsel on the grounds that the firm had received preference payments and thus did not meet the § 327(a) requirement of disinterestedness. Instead of litigating the preference issue before retention, Jones Day proposed that it be authorized to represent Pillowtex and if it was later determined to have received a preference payment as a result of an action brought by a party in interest, Jones Day would return such "preference amount" and waive any claims it had against the estate. On appeal by the U.S. Trustee, the Third Circuit reversed, ruling that the preference issue must be *resolved* before retention. In determining whether proposed counsel is disinterested under the Bankruptcy Code, the bankruptcy court must determine whether a firm has a conflict of interest because it holds a potential preference.

Consequently, a "facially plausible" claim that a firm received a "substantial" preference payment will disqualify the firm from representing the debtor or at least

require the issue to be resolved first (and thus delay the bankruptcy proceedings and require the potential firm to allocate its resources solely to resolution of the preference issue instead of the debtor's case). The Third Circuit did not clarify in *Pillowtex* whether it meant that resolution required a complete adversary proceeding or adjudication as a contested matter. Moreover, its use of the modifier "substantial" leaves room for prospective counsel to argue, based on § 327 cases involving other professionals, that if the amount paid to a firm is not substantial (certainly less than the $1 million at issue in *Pillowtex*) only a de minimis conflict may exist and thus resolution of the preference matter may not be required before the firm can represent the debtor. *Cf., In re Howard Smith, Inc.*, 207 B.R. 236 (Bankr. W.D. Okla. 1997) ("*de minimus*" prepetition claim did not disqualify accountant from retention under the § 327 disinterestedness test**)**. In practice, returning any *de minimus* preference might be deemed sufficient to resolve any conflict of interest, but this has not yet been tested in reported cases.

5. "Best Practices" Recommendations

As discussed above, plaintiff's counsel in preference cases have ultimately avoided final sanction judgments according to reported cases. Echoing through these opinions, however, are very strong hints, if not outright warnings, by bankruptcy judges that they disapprove of some of the bar's practices in filing and prosecuting preference actions in their courts. Merely avoiding sanctions is not the true measure of compliance with the standards of ethical practice. More is required. Thus, the following "best practices" can be derived from the cases and from the ABA Model Rules of Professional Conduct:

- Investigate debtor's books and records to identify obvious defenses.

- Conduct the investigation early; write inquiry letters to potential defendants, identifying the potentially preferential transfers and requesting any evidence of affirmative defenses.

- Assess the probability of success and the potential net amount of recovery in light of the evidence of affirmative defenses. Provide appropriate cost-benefit analysis to the client.

- Resist the temptation to justify filing massive numbers of preference complaints just because you have the complaint template on your computer and just have to fill in the defendant's name and amount. The weaker claims are likely to be harder to prosecute and likely to reduce the overall return.

- File any preference complaint only where the amount at issue and the probability of recovery justify the cost of proceeding. They are not actually cheaper by the dozen.

- Even as contingency counsel, be selective in prosecution, to assure that prosecution of the claim can be well justified in terms of benefit to the unsecured creditors of the estate.

- Focus on the 20% of potential preferences that are most likely to yield substantial net recoveries.

- Dismiss or settle promptly and cheaply all claims that, despite prefiling investigation, turn out post-filing to be of marginal value.

- Be mindful of the costs imposed upon the defendant and the court.

- Do your part to dispel the perception of many creditors that mass preference actions with little or no investigation are merely some form of legalized "extortion" that primarily generates money to pay professional fees, not prepetition creditors.

By adhering to these kinds of "best practices," you can avoid being the subject of reported cases about sanctions of the type discussed in this memorandum. You will also contribute to the proper functioning and effectiveness of the entire bankruptcy system.

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