The following constitutes the ruling of the court and has the force and effect therein described.

Signed August 1, 2007 **United States Bankruptcy Judge**

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§	
	§	
BROOK MAYS MUSIC COMPANY,	§	CASE NO. 06-32816-SGJ-11
	§	
DEBTOR.	§	

ORDER ACCEPTING TRUSTEE'S PRELIMINARY REPORT REGARDING POTENTIAL PREFERENCE ACTIONS AND SETTING SPECIFIC PARAMETERS ON THE PURSUIT OF PREFERENCE ACTIONS

CAME ON FOR CONSIDERATION by this court the Trustee's Preliminary Report Regarding Potential Preference Actions [doc. no. 879], which was presented at a Section 105(d) Status Conference held on July 30, 2007. By way of background, this court entered an order, at the request of the Debtor, converting the above-referenced case to Chapter 7 on March 29, 2007.[1] In

[1] The Debtor proceeded first in a Chapter 11 case for over eight months, eventually selling most of its assets to third parties in a Section 363 auction and sales.

such conversion order, the court specifically mandated that the statutory trustee appointed in this case, within 60 days after his appointment, seek a status conference and present at such time a preliminary report regarding: (a) his analysis of the potential chapter 5 causes of action in this case; and (b) his assessment of other administrative tasks that may need to be completed in this case to exercise his fiduciary duties to the estate. The court required the preliminary report to contain, among other things, a list of transfers made by Brook Mays Music Company ("Brook Mays" or the "Debtor") to creditors within 90 days of the Petition Date (the "90-Day Preference Period"); a list of transfers made by Brook Mays to insiders within one year of the Petition Date (the "Insider Preference Period"); a designation of which recipients of transfers during the 90-Day Preference Period possess already-allowed or potential Section 503(b)(9) administrative expense claims; and other useful information regarding likely defenses that might be asserted by recipients of transfers (which the court would, if requested, consider *in camera* or under seal). The court ordered this preliminary report because of a concern that there should be an expeditious and economical resolution of the case, and that the trustee should cautiously and properly exercise fiduciary duties in this regard.

The court notes that pursuit of chapter 5 avoidance actions is not mandatory in any bankruptcy case. *See, e.g.*, 11 U.S.C. § 547(b) ("the trustee *may* avoid any [preferential] transfer of an interest of the debtor in property"); 11 U.S.C. § 548(a)(1) ("The trustee *may* avoid any [fraudulent] transfer"); 11 U.S.C. § 549(a) ("the trustee *may* avoid a [postpetition] transfer of property of the estate") (all emphases added). *See also* 11 U.S.C. § 704 (listing the duties of a trustee, with no mention of any duty to pursue chapter 5 causes of action). The decision whether to pursue chapter 5 avoidance actions is simply a matter of what is a proper exercise of fiduciary duties in any particular case, and what is in the best interests of the beneficiaries of the trust/res. This court considers fundamental fairness to the beneficiaries of the trust/res to be of paramount importance, too. Every bankruptcy case is different—what makes economic sense in one case may not make economic sense in another. But this court is troubled by a trend in large bankruptcy cases, in particular, of "preference litigation run amok" (*i.e.*, trustees and plan agents suing, with reckless abandon, every recipient of a transfer of property of the debtor that occurred within 90 days of the bankruptcy filing, with no consideration of obvious defenses, what makes economic sense, or the underlying policies of the preference laws which, since Elizabethan times, have always been about promoting equality of distribution among similarly situated creditors and deterring overreaching). This court will never tolerate abusive preference litigation or extortion of unsecured creditors on its watch. This court wanted to set some "ground rules" before any trustee in this case commenced[2] chapter 5 avoidance actions—where presumably there could be thousands of recipients of transfers from the Debtor in the 90 days leading up to the bankruptcy filing.

The Trustee's Preliminary Report is thorough, thoughtful and helpful. It is exactly what the court had hoped for. It provides exhibits containing the information required by the court and ultimately proposes that the Trustee will not sue: (a) any party who has entered into a court-approved settlement agreement that provided for a release of mutual claims (*e.g.*, such as the so-called "Print Vendors," who were previously the subject of court-approved settlements); (b) any party in respect of payments received on an executory contract that was ultimately

[2] This court, obviously, had no idea who might be appointed trustee in this case at the time of the conversion order.

assumed;[3] (c) certain taxing authorities who received payments in the 90-Day Preference Period in respect of claims that would have Section 507 priority status in the case had they gone unpaid;[4] (d) any vendors who were fully secured or who only received payments during the 90-Day Preference Period from a trust or other third-party funds; and (e) any vendors who received transfers totaling less than $10,000 during the 90-Day Preference Period.[5] The court notes that the Trustee started with a list of more than 1,400 entities who had received transfers in either the 90-Day Preference Period or during the Insider Preference Period, which transfers totaled more than $20 million. By eliminating

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[3] Presumably under the theory that, in the event of a successful preference suit and recovery against any such party, the suit would prove fruitless, since the party would then have an additional default-arrearage in respect of the executory contract, that it would be entitled to have cured in order for the executory contract to be considered validly assumed under Section 365.

[4] Presumably under the theory that there is a cogent argument that these folks might have been paid in full, even if not for the payment to them in the 90-Day Preference Period, in a hypothetical chapter 7.

[5] The court notes that many of these under-$10,000 vendors shown in the Trustee's Preliminary Report received payments of less than $5,000 in the 90-Day Preference Period, so they would be immune from suit by operation of law, due to changes made in BAPCPA. *See* 11 U.S.C. § 547(c)(9). However, there were still several dozen creditors who received transfers in the $5,000-$10,000 range and, thus, could be sued under BAPCPA–albeit in the home venue of the defendant. *See* 28 U.S.C. § 1409(b).

the parties identified in categories (a)-(e) above, the list of potential preference defendants decreased to 189 entities and roughly $12.6 million (approximately $2 million of which related to four insiders).

This court accepts and approves the Preliminary Report of the Trustee and so ORDERS that he will not sue any of the parties identified in categories (a)-(e) above.[6]

In addition, this court orders that the Trustee will not sue any vendor in respect of a payment made on account of goods shipped in the 20-day period before the Petition Date, which, if unpaid, would have given rise to a Section 503(b)(9) claim in this case.

Additionally, this court orders that the Trustee will not sue any school, school district, or other non-profit entity that may have done business with Brook Mays without coming back and

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[6] If this court felt it could exercise more discretion in this context, it probably would have set the threshold for suing parties slightly higher than the $10,000 proposed by the Trustee. However, the court feels somewhat constrained by 11 U.S.C. § 547(c)(9) and 28 U.S.C. § 1409(b). Congress has expressed its views on preference thresholds. Setting a threshold at, say $15,000 to $20,000, would become somewhat arbitrary. In a different context, such as in provisions of a Chapter 11 plan—where parties have the ability to vote—there would perhaps be more flexibility. However, in this context, the court can only hope that the Trustee uses good situation-by-situation discretion, and only sues parties when it makes economic sense and is fundamentally fair.

obtaining leave of court.

Finally, this court orders that the Trustee must, at least 45 days prior to filing any preference action against any party, serve a demand letter on such party, describing the payments that might be subject to a preference claim, and giving the party 20 days to respond to the Trustee with information that might be relevant to a good faith defense. <u>The letter shall conspicuously show the name of a contact person working for the Trustee with whom parties should correspond regarding the potential preference. Such contact person shall be available and responsive to the calls/communications of potential preference defendants.</u>

This court is optimistic that this Order and process will strike a fair balance and approach to preference litigation in this case. Ultimately, this or any other court can always address inappropriately-waged preference litigation in either a fee application context (when considering the "results obtained" factor; *see Johnson v. Georgia Hwy. Express, Inc.,* 488 F.2d 714 (5th Cir. 1974)) or, perhaps in certain extreme contexts, with the tool of Rule 11. This court has the tools of Rule 11 and the *Johnson*-factors and is not afraid to use them. However, the court hopes that this order will serve as a template for trustees and plan agents to consider in the future in cases before this judge.

The court addresses one last point. This court has some consternation about preference litigation being waged in a context, such as in this case, *in which there is little chance that unsecured creditors are going to realize any benefit*. This is because of a large unsecured deficiency claim of the secured lenders in this case, some or all of which may have a chapter 11 "super priority" administrative expense claim status—due to certain adequate protection that was given to the secured lenders in connection with postpetition debtor-in-possession financing that was extended to the Debtor and due to cash collateral usage that was permitted postpetition. This court does not have a record before it of: (a) exactly how much the remaining deficiency claim of the secured lenders is (one lawyer speculated at the July 30, 2007 hearing that it might be in the neighborhood of $6 million) or (b) if *all* of the deficiency claim, in fact, enjoys "super priority" administrative expense status (the court notes, without opining, that such status may be tied to the issue of whether there was genuinely diminution in the lenders' collateral position during the case). In any event, there is a significant possibility that, after payment of chapter 7 and 11 administrative expense claims in this case, there will be no distribution to unsecured creditors—even if there are large recoveries in preference litigation. This court has grave concern whether it makes sense (or is consistent with preference policy) to pursue preference litigation in such a context. However, the fact is that nothing in the Bankruptcy Code explicitly requires that a preference action benefit the unsecured creditors. Section 550 contemplates that a trustee may recover "for the benefit of the estate" property in respect of transfers avoided under Section 547 and other Code sections. But there is no reference to the unsecured creditor pool *per se*. As earlier alluded to, the appropriate strategy for a case is more subtle than anything explicitly stated in the Bankruptcy Code—it is more a matter of what is a proper exercise of fiduciary duties. This court is not prepared to make a blanket ruling that preference litigation should never be pursued by a bankruptcy fiduciary if the only parties who benefit are professionals and a secured or undersecured lender. Such a blanket ruling is not only not explicitly supported by the Bankruptcy Code, but might result in mischief in certain cases. For example, if there were such a blanket ruling, what if, on the eve of a bankruptcy, a debtor who happened to be obligated to an obviously under-water lender with a lien on all assets, decided to prefer certain vendors, or even insider creditors, with lucrative payments, based on an assumption that preference litigation would likely never be pursued, because there could never be a benefit to the general unsecured creditor pool? Or what if, even without such plotting, there simply were some eve-of-bankruptcy payments to creditors that clearly suggested some overreaching? It would seem contrary to fundamental bankruptcy policies, fairness, and the notions of there being transparency and scrutiny of transactions in connection with bankruptcy to simply ignore such payments because the professionals and secured lenders would be the only parties to benefit from avoidance actions. In the case at bar, the court could not help but notice that there were certain large payments on the eve of bankruptcy. These payments, in many cases, are possibly 100% defensible. However, to blanketly rule that they are beyond all scrutiny does not seem to be the right result.

As previously noted, every case is different, but this court hopes that the process outlined herein will go far toward eliminating concerns about improper preference litigation.

IT IS SO ORDERED.

* * * END OF ORDER * * *