

# Christmas Tree Shops Preference Dismissal for Failure to Plead Pre-Lawsuit Due Diligence: An Early Holiday Gift for Trade Creditors

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Credit managers increasingly find themselves navigating preference exposure in bankruptcy cases—both as custodians of payment histories and as first-line recipients of pre-suit communications from trustees. Preference law is designed to prevent unequal treatment among creditors in the run-up to bankruptcy, but it has long imposed substantial costs on trade creditors who received routine payments in the ordinary course. The Small Business Reorganization Act of 2019 amended 11 U.S.C. § 547(b) in an attempt to rebalance these dynamics by requiring trustees to conduct and plead “reasonable due diligence” and to take into account a creditor’s known or reasonably knowable affirmative defenses before suing.

On December 5, 2025, the Delaware bankruptcy court dismissed a Chapter 7 trustee’s preference complaint in the *Christmas Tree Shops* bankruptcy case for failing to adequately plead Section 547(b)’s “reasonable due diligence” requirement. The opinion is a practical road map for what preference plaintiffs must allege—and, by implication, what trade creditors and defendants should expect to see—in a properly pled preference complaint. It also frames an open question for the market: whether this due diligence obligation has implications for pre litigation preference demand letters (as opposed to filed preference complaints).

## Small Business Reorganization Act Revisions to Section 547(b)

The Small Business Reorganization Act of 2019 added a new introductory clause to Section 547(b). Under the current language, a trustee “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 . . . .” This clause became effective on February 19, 2020.

Courts have treated this added clause as a condition precedent that plaintiffs must satisfy and plead. Practically, this means a trustee’s complaint should not merely recite the statutory elements of a preference. It should also state, at least in general terms, what due diligence was performed and how affirmative defenses were evaluated based on information available before filing the suit, such as debtor records and any information the creditor provided pre-suit. Courts have recognized that alleging proper due diligence can be done concisely, but it must be more than a bare assertion that the defendant “might” have defenses.

## The *Christmas Tree Shops* Decision

In *Miller v. Prestige Patio Co., Ltd.*, an adversary proceeding brought in connection with the *Christmas Tree Shops* bankruptcy case, the Chapter 7 trustee sued a trade vendor to avoid \$736,820.85 as alleged preferences. The complaint did not state whether any due diligence was performed pre-suit. In fact, the complaint did not mention the words “due diligence” at all. Instead, the trustee alleged that the defendant bears the burden to prove any affirmative defenses it may have.

The defendant moved to dismiss, arguing the complaint failed to plead the threshold due diligence condition required by Section 547(b). The Bankruptcy Court for the District of Delaware agreed and dismissed the complaint without prejudice, noting that the defendant always bears the burden of proving its defenses but that Section 547(b) now requires the trustee to plead that it performed diligence and has taken into account known or reasonably knowable affirmative defenses (which the trustee had not done).

The court contrasted this complaint with a preference complaint filed in connection with the *Pack Liquidat-*

ing bankruptcy case. There, sufficient allegations included that the plaintiff reviewed books and records, identified potential subsequent new value by invoice, acknowledged that shipping or service dates may alter those amounts, and nevertheless concluded the transfers remained avoidable even after accounting for the defense. The court found this kind of articulation demonstrated both the diligence performed and the consideration of reasonably knowable defenses.

The *Christmas Tree Shops* decision emphasized that the court is not imposing “magic words” but does expect language that plausibly indicates the trustee undertook an inquiry into potential Section 547(c) defenses based on the circumstances and information at hand. In this case, the absence of the term “due diligence” or any equivalent description of an inquiry into known or reasonably knowable defenses proved fatal at the pleading stage.

As the dismissal was without prejudice, the trustee had the opportunity to file a motion for leave to amend the complaint, attaching a copy of the proposed amended complaint, which he did on December 19, 2025. The proposed amended complaint adds allegations that the trustee reviewed the debtor’s books and records to identify any invoices that may qualify for the subsequent new value or ordinary course of business defenses. However, the trustee reiterated that he has no direct knowledge of or involvement in the prepetition business operations of the debtors, and therefore certain information relating to potential defenses may only be in the defendant’s possession. The defendant trade creditor opposed the request to amend the complaint, and the parties are currently awaiting a decision from the bankruptcy court. Therefore, it remains to be seen whether the trustee’s proposed amended complaint meets the “reasonable due diligence” requirement.

Regardless of the ultimate outcome, the *Christmas Tree Shops* opinion provides pleading benchmarks that, in turn, spotlight the diligence workstreams trustees should complete before filing a preference complaint. A trustee must be prepared to allege—at least generally—that it performed a pre filing inquiry into the trade relationship and considered defenses that were known or reasonably knowable from available information. Complaints that simply recite the statutory elements or shift attention to the creditor’s ultimate burden under Section 547(g) will not suffice.

### **Implications and Action Points for Trade Creditors**

For trade creditors frequently on the receiving end of preference actions, this decision fortifies a front end screening defense focused on the trustee’s pre suit diligence. Creditors should read complaints for clear allegations that the trustee did, in fact, both conduct reasonable due diligence and consider defenses—such as that the transfer(s) in question were made in the ordinary course of business or were a contemporaneous exchange for new value, and/or that new value was provided to the debtor after the transfer—based on records and information reasonably available before filing. If such allegations are missing, a motion to dismiss targeting the Section 547(b) condition precedent may be warranted.

In terms of practical defense posture, the *Christmas Tree Shops* court’s reliance on the *Pack Liquidating* opinion illustrates what trustees may start including in complaints—namely, tailored allegations about the dataset reviewed and the way potential defenses were considered. Creditors can anticipate more specific pleadings and should organize their records so they can promptly compare the complaint’s pre filing diligence narrative against vendor histories, invoice and shipping data, and communications.

### **Does Section 547(b)’s Due Diligence Requirement Apply to Preference Demand Letters?**

In reality, most preference actions do not begin with a complaint. Rather, trade creditors often receive a “demand letter” sent in advance of a lawsuit that invites the creditor to set forth any affirmative defenses. The *Christmas Tree Shops* opinion addresses pleading requirements in a filed adversary complaint and a subsequent motion to dismiss; it does not weigh in on what, if any, diligence needs to be done in advance

of pre litigation demand letters. So whether the Section 547(b) due diligence condition precedent has any legal effect on demand practices remains an open question.

While the *Christmas Tree Shops* opinion does not extend its reasoning to demand letters, trustees would be prudent to incorporate diligence into their pre suit process, and creditors can reasonably ask that any demand reflect the trustee's assessment of readily knowable defenses.

From a practical standpoint, when a creditor receives a demand it is sensible to respond with organized, targeted information bearing on any potentially applicable defenses—both to educate the trustee's diligence and to set up a record that the defenses were "reasonably knowable." Although the opinion does not adjudicate demand letter sufficiency, creditors who raise defenses early may position themselves favorably if litigation ensues and the complaint lacks adequate diligence allegations.

## Conclusion

This decision reinforces that Section 547(b)'s due diligence clause has teeth and must be pled, at least generally, in every preference complaint. For trade creditors and other preference defendants, it creates a threshold filter to challenge bare bones pleadings and incentivizes robust pre suit dialogue about potential defenses. While the ruling does not address demand letters (and therefore may still require that a creditor retain counsel early), aligning demand practices with the statute's diligence ethos—and responding to demands with evidence of applicable defenses—will likely reduce litigation risk and improve outcomes if a lawsuit follows.

## About the Authors



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