



Lowenstein Bankruptcy Lowdown Video 39 – When Preference Complaints Fall Short: Due Diligence as a Condition Precedent

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Gianfranco Finizio: Today, we're breaking down a recent Delaware Bankruptcy Court decision in the *Christmas Tree Shops* bankruptcy case, where a Chapter 7 trustees' preference complaint against Prestige Patio was dismissed without prejudice.

In this case, the trustees sued to avoid and recover more than \$736,000 in alleged preferential transfers under Section 547 and 550 of the Code. The Defendant moved to dismiss and argued that the Trustee failed to plead the due diligence requirement regarding potential defenses that was added to Section 547(b). The court agreed.

Collen M. Restel: As a quick reminder, amendments to Section 547(b) became effective in 2020, adding the requirement that the Trustee may avoid transfers only after reasonable due diligence and taking into account known or reasonably knowable defenses under Section 547(c).

Courts in Delaware treat that language as a condition precedent governed by Federal Rule of Civil Procedure 9(c). In practice, that means the Complaint must at least allege the Trustee conducted due diligence on potential affirmative defenses before suing. The Trustees' complaint here didn't do that—it merely said the Defendant bears the burden of proving defenses, which is always true but doesn't show any diligence.

Gianfranco Finizio: The Court contrasted this fact pattern with a recent case, *Pack Liquidating*, where the Plaintiff explained it reviewed books and records, analyzed new value, and still determined that some of the transfers were avoidable even after accounting for those potential defenses. This satisfied the condition precedent; the facts in this complaint did not.

The Trustee also pointed to the *Randolph Hospital* case, but there the Complaint explicitly alleged that the Plaintiff reviewed books and records and performed some due diligence on reasonably knowable defenses—again, a concrete allegation that was missing from the facts here.

Colleen M. Restel: In the *Christmas Tree Shops* case, the Court dismissed the Complaint without prejudice, signaling the Trustee might replead and satisfy the due diligence requirement. The Trustee did ask for leave to amend, but the Court denied that request without prejudice because in the Third Circuit,

you must attach proposed amended complaint to a request for leave to amend. That way, the court can assess futility. The Trustee didn't attach one, but has 14 days to move to amend with a draft.

Gianfranco Finizio: Bottom line: Section 547(b) is real, and preference complaints in Delaware must expressly allege presuit diligence on reasonably knowable defenses. Failure to do so risks the Complaint being dismissed.

Thanks for joining us on this edition of the [Lowenstein Bankruptcy Lowdown](#).