

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

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SOUTH COLLEGE STREET, LLC,	:	
	:	COMPLAINT
Plaintiff,	:	
	:	Index No.:
-against-	:	
ARES CAPITAL CORPORATION,	:	
	:	
Defendant.	:	
	:	
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Plaintiff South College Street, LLC, by its attorneys, Troutman Sanders LLP, as and for its Complaint against Defendant Ares Capital Corporation (“Defendant” or “Ares”), alleges as follows:

PARTIES

1. Plaintiff South College Street, LLC is a Delaware limited liability company. Plaintiff’s principal place of business is in New York, New York. South College Street, LLC holds a judgment (Exhibit 1) against Debtor InfiLaw Corporation in the amount of \$24,550,000 (not including interest that is continuing to accrue).

2. Upon information and belief, Defendant Ares Capital Corporation is a corporation organized and existing under the laws of the State of Maryland with its principal place of business in New York, New York. The registered principal executive office of Ares, as currently on file with the New York Secretary of State is 245 Park Avenue, 44th Floor, New York, New York 10167. Ares’ registered agent in the State of New York is Corporation Service Company, 80 State Street, Albany, New York, 12207-2543.

JURISDICTION AND VENUE

3. The Court has jurisdiction over Defendant pursuant to CPLR 301 and 302.
4. Venue is proper in New York County pursuant to CPLR 503.

FACTUAL BACKGROUND

5. Debtor InfiLaw Corporation is wholly owned by InfiLaw Holding, LLC. Upon information and belief, InfiLaw Corporation and InfiLaw Holding, LLC (collectively “InfiLaw”) have consistently had overlapping officers and prepared consolidated financial returns with the profits and losses of InfiLaw Corporation being passed through to InfiLaw Holding, LLC. Upon information and belief, InfiLaw Holding, LLC engages in no business activities separate and apart from that of InfiLaw Corporation.

6. InfiLaw Corporation owned and operated three for-profit law schools: (1) Charlotte School of Law, (2) Arizona Summit School of Law, and (3) Florida Coastal School of Law. The Charlotte School of Law went out of business – leaving creditors unpaid in 2017. Arizona Summit School of Law went out of business in 2018. Although Florida Coastal School of Law remains in existence, its enrollment has declined by 93% over the last eight years.

7. The demise of these law schools was a result of their for-profit status and the debt and capital structure imposed on InfiLaw by Ares.

8. Upon information and belief, from 2004 to 2011, the principal equity interests in InfiLaw Holding, LLC were owned by Sterling Capital, L.P. and Sterling Capital Partners GmbH & Co. KG – private equity funds managed by Sterling Fund Management LLC (doing business as “Sterling Partners”).

9. In August 2011, Ares served as lead arranger, administrative agent and collateral agent in a private equity tranche that resulted in Ares acquiring a substantial ownership interest

in InfiLaw. Pursuant to a Preferred Unit Purchase Agreement between Ares and InfiLaw, Ares acquired 131,000 units of InfiLaw’s Series A Redeemable Nonvoting Preferred Units (“Series A Preferred Units”) for \$131 million. Ares’ restructuring of InfiLaw resulted in InfiLaw becoming contractually obligated to pay over \$12 million per year to Ares in preferred dividends – with these payments increasing to more than [REDACTED] in 2016.

10. Contemporaneously with the execution of the Preferred Unit Purchase Agreement, Ares and InfiLaw entered into a Credit Agreement by which Ares agreed to provide a \$30,000,000 term loan, a \$15,000,000 delayed term loan and \$25,000,000 revolving line of credit. InfiLaw was charged 9.5% interest on these loans which increased to 11% in 2016. (Exhibit 2). In connection with these loans, Ares acquired a lien on substantially all of the assets of InfiLaw. (Exhibit 3).

11. Additionally, on October 19, 2012, Ares and ABRY Partners (“ABRY”) acquired Series B Preferred shares in InfiLaw for the sum of \$138,678,000. The proceeds for the sale of Series B Preferred shares were used to fund distributions to InfiLaw’s existing investors.

[REDACTED]

12. The effect of these agreements was to saddle InfiLaw with payment obligations to Ares that was unsustainable. The multi-million-dollar debt and equity payments that InfiLaw was required to make to Ares each year was compounded by the Series B Preferred shares. InfiLaw received virtually no financial benefit from the Series B shares because the funds raised

from Ares and ABRY were essentially used to replace the existing shareholder equity of Sterling Capital, L.P. and Sterling Capital Partners GmbH & Co. KG. [REDACTED]

[REDACTED] In short, the Ares transactions were structured to milk cash from InfiLaw and its students as quickly as possible.

13. As a result of the incredible debt and equity payments that Ares required of InfiLaw, InfiLaw experienced liquidity and operational difficulties. In order to continue funding its payments to Ares, InfiLaw (through Rick Inatome and others) caused the three law schools owned by InfiLaw to lower their admission standards. This resulted in a death spiral for these law schools in that these lower standards resulted in lower student performance, lower bar passage rates and lower placement of the graduates from these schools in legal employment. For example, the Dean of the Charlotte School of Law acknowledged that the Law School's "management systematically lowered the school's admission standards over the objections of CSL faculty." (Exhibit 4). As a result of lowering its admissions criteria, the Law School's bar passage rate declined precipitously, thereby causing the Law School to further lower admissions criteria in order to have a sufficient number of students for InfiLaw to fulfill its payment obligations to Ares. This "self-inflicted reputational damage" resulted in Charlotte School of Law being in "tenuous financial condition." *Id.* Upon information and belief, Charlotte School of Law and its affiliated entities knew such a business model was not sustainable and that the financial drain would result in InfiLaw being unable to pay its debts and obligations as they became due. The University of North Carolina Board of Governors ultimately terminated Charlotte School of Law's license as a result of these issues.

14. Upon information and belief, InfiLaw was insolvent as of June 2015. InfiLaw’s insolvency is reflected by the following facts:

a. As set out in the testimony of InfiLaw’s Chief Financial Officer, InfiLaw “suffer[ed] a net loss of approximately \$10-12 million in tax years 2015-16.” (Exhibit 5) (Affidavit of Scott Thompson, p. 8 ¶ 28).

b. In January 2015, the American Bar Association concluded that it had reason to believe that one of InfiLaw’s law schools (Charlotte School of Law) was not in compliance with law school accreditation standards.

c. [REDACTED]

d. [REDACTED]

e. [REDACTED]

f. In February 2016, the American Bar Association concluded that it had reason to believe that the Charlotte School of Law had not demonstrated that it maintains a rigorous program of legal education that prepares its students for admission to the bar.

g. [REDACTED]

FIRST CAUSE OF ACTION

Fraudulent Conveyance – New York Debtor and Creditor Law §§ 273 and 278 to set aside and disregard a conveyance made without fair consideration by a person who is or was thereby rendered insolvent

17. Plaintiff repeats and re-alleges each and every allegation above as if fully set forth herein.

18. Plaintiff is the holder of a mature claim against Infilaw.

19. At the time of the Conveyances, InfiLaw was “insolvent” as that term is used in New York Debtor and Creditor Law § 271 in that the present fair salable value of InfiLaw’s assets was less than the amount required to pay InfiLaw’s probable liability on existing debts as they become absolute and matured.

20. Because the Conveyances were payments to a shareholder, the Conveyances were not a transfer in exchange for “fair consideration” as that term is used in New York Debtor and Creditor Law § 272.

21. The Conveyances were made at a time when InfiLaw was insolvent or would be rendered insolvent as a result of the Conveyances.

22. The Conveyances stand as fraudulent conveyances pursuant to New York Debtor and Creditor Law § 273 in that they were made without fair consideration by a person who is or was thereby rendered insolvent.

23. As a result, Plaintiff is entitled to: (a) have the Conveyances set aside to the extent necessary to satisfy its claim; or (b) disregard the Conveyances and attach or levy execution upon the property conveyed; or (c) in the alternative, a money judgment against Defendant in the amount of the Conveyances.

SECOND CAUSE OF ACTION

Fraudulent Conveyance – New York Debtor and Creditor law §§ 274 and 278 to set aside a conveyance made without fair consideration by a person engaged in a business or transaction for which the property remaining in his hands after the conveyance is an unreasonably small capital

24. Plaintiff repeats and re-alleges each and every allegation above as if fully set forth herein.

25. The Conveyances were made without fair consideration and at a time when InfiLaw had unreasonably small capital, or was put in that position as a result of the Conveyances.

26. The Conveyances stand as fraudulent conveyances pursuant to New York Debtor and Creditor Law § 274 in that they were made without fair consideration and resulted in InfiLaw having unreasonably small capital in light of the nature of its business.

27. As a result, Plaintiff is entitled to: (a) have the Conveyances set aside to the extent necessary to satisfy its claim; or (b) disregard the Conveyances and attach or levy execution upon the property conveyed; or (c) in the alternative, a money judgment against Defendant in the amount of the Conveyances.

THIRD CAUSE OF ACTION

Fraudulent Conveyance – New York Debtor and Creditor law §§ 275 and 278 to set aside and disregard a conveyance made without fair consideration by a person intending or believing that he will incur debts beyond his ability to pay as they mature

28. Plaintiff repeats and re-alleges each and every allegation above as if fully set forth herein.

29. The Conveyances were made without fair consideration and at a time when InfiLaw was intending to incur, or believed it would incur, debts beyond its ability to pay them as the debts matured.

30. The Conveyances stand as fraudulent conveyances pursuant to New York Debtor and Creditor Law § 275 in that they were made without fair consideration by a person intending or believing that he will incur debts beyond his ability to pay as they mature.

31. As a result, Plaintiff is entitled to: (a) have the Conveyances set aside to the extent necessary to satisfy its claim; or (b) disregard the Conveyances and attach or levy execution upon the property conveyed; or (c) in the alternative, a money judgment against Ares in the amount of the Conveyances it received.

FOURTH CAUSE OF ACTION

Fraudulent Conveyance – New York Debtor Creditor Law §§ 276, 276-a 278 to set aside a conveyance made with actual intent to hinder, delay or defraud either present or future creditors

32. Plaintiff repeats and re-alleges each and every allegation above as if fully set forth herein.

33. The Conveyances were made with actual intent to hinder, delay or defraud present or future creditors and therefore stand as fraudulent conveyances pursuant to New York Debtor and Creditor Law § 276. This actual intent is reflected by the nature of the Conveyances, as well as the following facts:

- (a) Despite the liquidity issues faced by InfiLaw in June 2015, the Conveyances were not disclosed to creditors.
- (b) Prior to the Conveyances, numerous creditors had sued the law schools that make up InfiLaw, including class actions brought by students alleging that these law schools had engaged in fraudulent practices.
- (c) InfiLaw essentially received no value for the Conveyances.
- (d) InfiLaw became or was insolvent at the time of the Conveyances.

- (e) The Conveyances occurred shortly after a substantial debt was incurred by InfiLaw.

34. As a result, Plaintiff is entitled to: (a) have the Conveyances set aside to the extent necessary to satisfy its claims; (b) disregard the Conveyances and attach or levy execution upon the property conveyed; (c) in the alternative, a money judgment against Defendant in the amount of the Conveyances; and (d) recover judgment for its reasonable attorneys' fees incurred in this action pursuant to New York Debtor and Creditor Law § 276-a.

WHEREFORE, Plaintiff respectfully requests the Court to enter judgment against Defendant as follows:

- a) Setting aside the Conveyances;
- b) In the alternative, awarding Plaintiff a money judgment against Defendant in the amount of the Conveyances up to the amount of the debt owed to Plaintiff;
- b) Awarding Plaintiff its reasonable attorneys' fees and expenses; and
- c) Awarding Plaintiff such other and further relief as the Court deems just and proper.

Dated: New York, New York
September 3, 2019

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