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

SOUTH COLLEGE STREET, LLC, Plaintiff, - against - ARES CAPITAL CORPORATION, Defendant.	Index No. 655045/2019 **Motion Seq. No. 002** **Hon. Jennifer G. Schecter** **ORAL ARGUMENT REQUESTED**

MEMORANDUM OF LAW IN SUPPORT OF DEFENDANT ARES CAPITAL CORPORATION'S MOTION TO DISMISS THE COMPLAINT

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Defendant Ares Capital Corporation ("ARCC") respectfully submits this brief in support of its motion, under CPLR 3211(a)(1), 3211(a)(7) and 3016(b), to dismiss the complaint ("Complaint," NYSCEF No. 25) filed by Plaintiff South College Street, LLC.

PRELIMINARY STATEMENT

Plaintiff, an unsecured creditor of non-party InfiLaw Corporation ("Debtor"), and not even a creditor of Debtor's parent, InfiLaw Holding, LLC ("HoldCo"), seeks to avoid, as alleged fraudulent conveyances, 19 payments, totaling $34,225,114.00, that were made to ARCC by either Debtor or HoldCo between June 2015 and August 2016.[1] The payments were either made: (1) by Debtor on account of Debtor's secured debt owed to ARCC (the "Secured Debt Payments"), totaling $21,268,304.00, or (2) by HoldCo for obligations it owed to ARCC under a pre-existing preferred equity agreement (the "HoldCo Payments"), totaling $12,956,810.00.[2]

Plaintiff is the former landlord of one of Debtor's subsidiaries, Charlotte School of Law, LLC ("CSL"). In October 2017, fourteen months *after* the last alleged conveyance was paid to ARCC, CSL defaulted on its $500,000-a-month rental payments. On February 6, 2019, Plaintiff obtained a $24,550,000 consent judgment against CSL and its guarantor, Debtor (but *not* against HoldCo) for unpaid rent through the expiration of the lease on July 31, 2026.[3] Now, having failed to collect on this judgment, Plaintiff is suing ARCC to try and grab for itself the payments made to ARCC by Debtor and HoldCo between June 2015 and August 2016, even

[1] Plaintiff merges Debtor and HoldCo into a single defined term, "InfiLaw," in the Complaint (Complaint ¶ 5). This is wrong and misleading.

[2] *See* footnote 6, *infra*, respecting the calculation of each of these amounts.

[3] Although CSL abandoned the premises back in 2017 (*see* p. 7, *infra*), and Plaintiff alleges that it has a judgment for unpaid rent through July 31, 2026, Plaintiff does not disclose whether and how much rent it has received from tenants leasing the same space that CSL vacated two years ago.

though Plaintiff received and retained *every* monthly rental payment during this timeframe (~$6.5 million), and Plaintiff continued to receive and retain these monthly rental payments for *fourteen months after* the last conveyance was made (~$7 million, for a total of ~$13.5 million received and retained by Plaintiff after Debtor and HoldCo allegedly became insolvent).

While Plaintiff claims that Debtor and HoldCo were insolvent when each of their payments was made to ARCC, Plaintiff provides no balance sheet or other data supporting this claim. Indeed, when Plaintiff filed a declaration by Debtor's and HoldCo's CFO from another case as Exhibit 5 to its Complaint, Plaintiff *deliberately removed* balance sheets—originally attached as exhibits to that declaration—which showed that as late as December 2017 (sixteen months *after* the last payment was made to ARCC), each of CSL, Debtor and HoldCo was *not* insolvent because the value of their respective assets exceeded their respective liabilities (*see* p. 8, *infra*).

The Complaint should be dismissed, with prejudice, for the following reasons:

First, Plaintiff's actual fraudulent conveyance claim should be dismissed because Plaintiff (1) fails to allege how any conveyance could have been made with intent to prevent Plaintiff from collecting its judgment, when each conveyance was made at least a year *before* CSL defaulted and two years *before* Plaintiff obtained its judgment; and (2) fails in any event to allege, much less with the required particularity, facts or badges of fraud sufficient to support an inference of fraudulent intent.

Second, because the Secured Debt Payments were made to satisfy antecedent secured debt that Debtor owed to ARCC, such payments are *not* fraudulent transfers as a matter of law. *See Englander Capital Corp. v. Zises*, 60 Misc. 3d 659, 664 (Sup. Ct. N.Y. Cty. 2018).

Third, the HoldCo Payments cannot be avoided as constructive fraudulent conveyances because they were payments made pursuant to a contractual obligation that non-debtor HoldCo owed to ARCC. Plaintiff does *not* have a judgment against HoldCo.

Finally, Plaintiff has failed to plead that any of the three bases of insolvency—balance sheet insolvency (DCL § 273); unreasonably small capital (DCL § 274); or Debtor's or HoldCo's belief that it would not be able to pay debts as they became due (DCL § 275)—existed *at the time any conveyance was made*. Allegations of net losses, or of challenges faced by Debtor's business, are insufficient if unaccompanied by balance sheet data showing Debtor's assets were worth less than its liabilities *at the time of each conveyance*. Plaintiff not only fails to allege any such contemporaneous balance sheet or other data, but it deleted from Exhibit 5 to its Complaint the balance sheets indicating CSL's, Debtor's and HoldCo's solvency sixteen months after the last payment was made to ARCC. There is no excuse for Plaintiff's conduct. Any insolvency allegation is also refuted by the fact that, after Debtor allegedly became insolvent in June 2015, Plaintiff continued to receive and retain about $13,500,000—*i.e.*, $500,000 in monthly rent payments for the next twenty-seven months. Plaintiff fails to adequately plead HoldCo's insolvency for the same reasons, but, of course, since HoldCo owed no money to Plaintiff, the issue of HoldCo's solvency is *irrelevant* to Plaintiff's claims.[4]

[4] If this Motion is denied, ARCC intends to vigorously contest Plaintiff's allegations, and ARCC reserves all of its rights, claims and defenses, including, *inter alia*, to recover every payment that Plaintiff received and retained after Debtor first allegedly became insolvent.

ALLEGED FACTS[5]

Plaintiff seeks to recover nineteen "debt and equity payments" made to ARCC between June 2015 and August 2016, totaling $34,225,114.00: the Secured Debt Payments of $21,268.304.00 and the HoldCo Payments of $12,956,810.00.[6]

HoldCo and Debtor were affiliates of CSL and two other for-profit law schools. Complaint ¶¶ 5-6. Plaintiff—CSL's former landlord—has a judgment against CSL and Debtor, but *not* against HoldCo, the non-CSL law schools or any of their other affiliates. *Id.* ¶ 1. Despite this fact, the Complaint unjustifiably and misleadingly lumps Debtor and non-debtor HoldCo together, collectively referring to the two entities as "InfiLaw." *See, e.g.*, *id.* ¶ 5, 15.

1. The Secured Debt Payments ($21,268,304.00[7])

The Secured Debt Payments were made to ARCC in its capacity as a secured creditor of CSL and Debtor, among others. On or about August 25, 2011, Debtor, CSL, HoldCo and certain of their affiliates entered into a Credit Agreement (the "Credit Agreement") with

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[5] These facts are drawn from (1) the Complaint and its exhibits; (2) documents incorporated by reference; and (3) sources from which the Court may take judicial notice. Documents not attached to the Complaint are provided as exhibits to the accompanying Affirmation of Stan Chiueh ("Chiueh Affirmation"). A copy of the unredacted Complaint is attached as Exhibit K to the Chiueh Affirmation.

[6] *See* Complaint ¶¶ 12-13, 15-16. There is an ambiguity in these amounts due to Plaintiff's failure to identify which payments are Secured Debt Payments, and which are HoldCo Payments. Guided by the dates of the payments, it appears that three of the four alleged HoldCo Payments can be identified: July 2015 ($3,396,204.00), October 2015 ($3,396,204.00); and April 2016 ($3,145,819.00). *Id.* ¶¶ 15-16. The fourth HoldCo Payment, in January 2016, appears to be one of two alleged payments—either $3,196,764.00 or $3,018,583.00—but it is impossible to confirm on the face of the Complaint which one is the HoldCo Payment. Thus, the alleged amount of the HoldCo Payments is either $13,134,991.00 or $12,956,810.00, and the alleged amount of the Secured Debt Payments is the remainder—$21,090,123.00 or $21,268,304.00. For ease of review, and with this footnote as reference, this brief will refer to the Secured Debt Payments as being $21,268,304.00, and the HoldCo Payments as $12,956,810.00.

[7] *See* footnote 6, *supra*.

ARCC. Complaint ¶ 10, *id.* Ex. 2.[8] Debtor and CSL were borrowers under the Credit Agreement. *Id.* Ex. 2 at 1. Non-debtor HoldCo was *not* a borrower, but was a guarantor. *Id.* Ex. 2 at 19. Plaintiff admits this debt was secured by "a lien on substantially all of the assets" of, *inter alia*, Debtor and CSL. *Id.* ¶ 10; *see also id.* Ex. 3 (Security Pledge Agreement).

2. The HoldCo Payments ($12,956,810.00[9])

"Contemporaneously" with the Credit Agreement, non-debtor HoldCo entered into a "Preferred Unit Purchase Agreement" ("PUPA") with ARCC. Complaint ¶ 9-10. Under the PUPA, ARCC paid $131 million to acquire preferred stock of non-debtor HoldCo (the "HoldCo Preferred Stock"), and HoldCo "bec[ame] contractually obligated" to pay dividends on the HoldCo Preferred Stock. *Id.* ¶ 9.[10] Debtor was a guarantor of HoldCo's obligations under the PUPA (Chiueh Affirmation, Ex. C (PUPA), at 90), and Debtor did *not* issue any preferred stock to ARCC. Four of the dividends paid by HoldCo—in July 2015, October 2015, January 2016 and April 2016—are the HoldCo Payments alleged to be fraudulent conveyances (Complaint ¶¶ 15-16).

[8] The Complaint attaches the Credit Agreement as Exhibit 2, but does not attach the schedules attached thereto. A copy of the Credit Agreement, with schedules, is attached as Exhibit B to the Chiueh Affirmation. The Court can consider these schedules as incorporated by reference in the Complaint. *See Alliance Network, LLC v. Sidley Austin LLP*, 43 Misc. 3d 848, 852 n.1 (Sup. Ct. N.Y. Cty. 2014) ("On a motion to dismiss, the court may consider documents referenced in a complaint, even if the pleading fails to attach them."); *see also Deer Consumer Prods., Inc. v. Little*, 2011 WL 4346674, at *4 (Sup. Ct. N.Y. Cty. Aug. 31, 2011).

[9] *See* footnote 6, *supra*.

[10] A copy of the PUPA, with schedules, is attached as Exhibit C to the Chiueh Affirmation, and the PUPA is incorporated by reference in the Complaint (*see* Complaint ¶ 9).

3. Plaintiff's Judgment Against CSL and Debtor Only

On October 11, 2012, over a year *after* the Credit Agreement and the PUPA were executed, CSL entered into a lease (the "Lease") with Plaintiff's predecessor-in-interest. Complaint Ex. 1, ¶ 2.[11] Exhibit P to the Lease, a Landlord Subordination Agreement, expressly acknowledged the Credit Agreement and ARCC's lien on Debtor's assets. Chiueh Affirmation Ex. E (Lease), at Ex. P, §§ 2-4. On the same day the Lease was executed, Debtor executed a Guaranty guaranteeing CSL's obligations under the Lease (the "Guaranty"). Complaint Ex. 1 (Consent Judgment) ¶ 2.[12] Non-debtor HoldCo was *not* a party to the Lease, did *not* guaranty the Lease, and Plaintiff has *not* alleged (and cannot allege) that it has any judgment against HoldCo. *See id.*

On April 20, 2015, over two years after the Lease was executed (and just two months before Plaintiff alleges Debtor became insolvent, *see* Complaint ¶ 14), Plaintiff purchased the property subject to the Lease and "assumed all rights and obligations" of CSL's landlord under the Lease and Guaranty. *Id.* Ex. 1 (Consent Judgment), ¶ 4. According to a sworn statement filed by Plaintiff's member manager in the North Carolina Case, CSL "paid its

[11] A copy of the Lease is attached as Exhibit E to the Chiueh Affirmation. Exhibit 1 to the Complaint refers to the Lease (*see* Complaint Ex. 1 (Consent Judgment) ¶ 2) and thus the Lease is incorporated by reference. The Lease was also attached to a complaint that Plaintiff filed against CSL and Debtor (the "North Carolina Complaint") in a North Carolina state court action captioned *S. Coll. St., LLC v. Charlotte School of Law, et al.*, No. 18-cvs-787 (the "North Carolina Case"). A copy of the North Carolina Complaint is attached as Exhibit D to the Chiueh Affirmation. The Court can take judicial notice of the Lease and the North Carolina Complaint because they are "undisputed court records and files." *Alliance Network*, 43 Misc. 3d at 852, n.1.

[12] A copy of the Guaranty, which was attached to the North Carolina Complaint and thus subject to judicial notice, is attached as Exhibit F to the Chiueh Affirmation.

rent, on a monthly basis," to Plaintiff until October 1, 2017.[13] Each monthly payment was roughly $500,000.[14] Thus, although Plaintiff alleges that Debtor was insolvent by June 2015 (Complaint ¶ 14), Plaintiff continued to receive and retain about $13,500,000 in total monthly rental payments over the next *twenty-seven months*, including for *fourteen months* (~$7,000,000) *after* the last alleged fraudulent conveyance was made to ARCC.

Starting October 1, 2017, CSL stopped paying rent to Plaintiff, and later abandoned the premises. Complaint, Ex. 1 (Consent Judgment) ¶ 5. Debtor also failed to make any payment to Plaintiff under the Guaranty. *Id.* On January 12, 2018, Plaintiff filed the North Carolina Complaint against CSL and Debtor alleging breach of the Lease and Guaranty. Plaintiff took discovery from CSL and Debtor (*see* Chiueh Affirmation, Ex. I (Plaintiff's brief in support of summary judgment in North Carolina Case) at 4), and filed and prevailed on a summary judgment motion against them (*see S. Coll. St., LLC v. Charlotte Sch. of Law, LLC*, 2018 WL 3830008 (N.C. Super. Aug. 10, 2018)). On February 6, 2019, over 29 months *after* the last conveyance was made to ARCC, Plaintiff obtained a judgment against each of Debtor and CSL (*not* HoldCo), which remains unpaid. Complaint ¶ 1.

4. Allegations as to Debtor's and HoldCo's Purported Insolvency

To support its claim that the 2015 and 2016 payments to ARCC were fraudulent conveyances (effectively making ARCC, Debtor's secured creditor, a retroactive guarantor of

[13] Affidavit of Maidad Rabina ("Rabina Aff."), ¶ 9, attached as Exhibit G to the Chiueh Affirmation. The Rabina Aff. was filed in the North Carolina Case to support Plaintiff's motion for summary judgment against Debtor and CSL, and thus is subject to judicial notice.

[14] *See* Amendment to Lease dated November 11, 2013, attached as Exhibit H to the Chiueh Affirmation, § 5; *see also* Plaintiff's brief in support of summary judgment in the North Carolina Case, attached as Exhibit I to the Chiueh Affirmation, at 1. Each of these documents was filed in the North Carolina Case, and thus is subject to judicial notice.

CSL's rent payments), Plaintiff alleges, upon information and belief, that Debtor and HoldCo (again, misleadingly lumping the two entities as a single defined term, "InfiLaw") were "insolvent" as far back as "June 2015." Complaint ¶ 14. This is just two months after Plaintiff took over as CSL's landlord, and *twenty-seven months before* Plaintiff stopped receiving CSL's roughly $500,000-a-month payments.

Other than this conclusory allegation of insolvency, Plaintiff makes *no* factual allegation that the value of Debtor's or non-debtor HoldCo's assets was less than that entity's liabilities. Worse still, as purported support for Plaintiff's insolvency allegation, Plaintiff cites to a September 11, 2018 declaration filed by Debtor's and HoldCo's CFO in another case (the "Thompson Declaration," *see* Complaint ¶ 14(a)), and purports to attach that declaration as Exhibit 5 to the Complaint. Plaintiff's exhibit, however, *omitted* copies of balance sheets for each of CSL, Debtor and HoldCo that were attached as exhibits to the originally-filed Thompson Declaration.[15] And these omitted balance sheets showed that, as late as December 31, 2017 (sixteen months *after* the last alleged conveyance), each of Debtor and HoldCo reported a positive "Total Members' Equity" on their balance sheets—that is, the value of their assets *exceeded* the amount of their liabilities.[16]

Plaintiff has no excuse for filing an exhibit with the Court that omitted the balance sheets indicating Debtor's solvency as late as December 2017. By Plaintiff's own admission,

[15] The Thompson Declaration, originally filed with exhibits in the case *Barchiesi v. Charlotte School of Law, LLC and InfiLaw Corp.*, No. 3:16-CV-00861-GCM, Dkt. 98-7 (W.D.N.C.), is attached in its entirety as Exhibit J to the Chiueh Affirmation, and is incorporated by reference in the Complaint. For ease of reference, the balance sheets as of December 31, 2017 for each of CSL, Debtor, and HoldCo (Exhibits 3, 7, and 11, respectively to the Thompson Declaration) are separately provided as Exhibit A to the Chiueh Affirmation.

[16] Chiueh Affirmation, Ex. A (December 31, 2017 balance sheets for CSL, Debtor and HoldCo).

Plaintiff obtained Debtor's financial information in discovery in the North Carolina Case, relied on this data in alleging, *inter alia*, the timing and amount of the conveyances (Complaint ¶ 16), and then moved to seal the Complaint because these allegations were derived from "confidential documents . . . produced" by CSL and Debtor to Plaintiff in the North Carolina Case. *See* NYSCEF Doc. No. 12, at 4.[17]

Instead of pleading any balance sheet information showing that Debtor or HoldCo was insolvent—as it is required to do—Plaintiff alleges a series of events, only *two* of which took place *before* June 2015, and none of which actually addresses the issue of whether Debtor was insolvent: (1) in January 2015, the American Bar Association ("ABA") found "reason to believe" that CSL did not comply with accreditation standards (Complaint ¶ 14(b)); and (2) in March 2015, the Department of Justice ("DOJ") sent a "Civil Investigative Demand" to Debtor and/or HoldCo (*id.* ¶ 14(c)). The remaining alleged events—net losses in tax years 2015 and 2016, covenant waivers and amendments under the secured Credit Agreement, ABA findings concerning CSL's noncompliance with educational standards, and a DOJ investigation—all took place *after* June 2015, including as late as May 2016, and likewise fail to directly address insolvency. *Id.* ¶¶ 14 (a), (d)-(g).

Given Plaintiff's conclusory and irrelevant allegations—not to mention its failure to submit to the Court the balance sheets showing Debtor's and HoldCo's *solvency*—Plaintiff has presented no evidence to support its claim that Debtor or HoldCo was insolvent as early as June 2015 (and has failed to explain why non-debtor HoldCo's solvency or insolvency is even relevant to Plaintiff's claims). Plaintiff's further allegations of insolvency-by-affiliation and insolvency-by-hindsight are not legally proper, and are undercut by the fact that Plaintiff

[17] The Court denied Plaintiff's motion to seal.

continued to receive and retain roughly $500,000 a month for twenty-seven months *after* Debtor allegedly became insolvent, and by the fact that the balance sheets that Plaintiff omitted from Exhibit 5 show Debtor's and HoldCo's solvency as late as December 2017, sixteen months after the last payment was made to ARCC.

STANDARD OF REVIEW

This Motion is made pursuant to CPLR 3211(a)(1), 3211(a)(7) and 3016(b). Dismissal under CPLR 3211(a)(1) is appropriate where "documentary evidence and undisputed facts negate or dispose of claims in the complaint or conclusively establish a defense." *Zanett Lombardier, Ltd. v. Maslow*, 29 A.D.3d 495, 495 (1st Dep't 2006). Further, dismissal under CPLR 3211(a)(7) is appropriate if the "facts as alleged" fail to "fit within any cognizable legal theory." *Leon v. Martinez*, 84 N.Y.2d 83, 87-88 (1994). Even on a motion to dismiss, the Court need not accept as true "factual allegations that are contradicted by documentary evidence or legal conclusions that are unsupportable in the face of undisputed facts." *Zanett*, 29 A.D.3d at 495; *see also Mamoon v. Dot Net Inc.*, 135 A.D.3d 656, 658 (1st Dep't 2016). Where "key allegations" are pled upon information and belief, failing to "identify[] the source of the information" justifies dismissal as well. *Carlyle, LLC v. Quik Park 1633 Garage LLC*, 160 A.D.3d 476, 477 (1st Dep't 2018); *RTN Networks, LLC v. Telco Grp., Inc.*, 126 A.D.3d 477, 478 (1st Dep't 2015). Plaintiff's fourth cause of action is one for actual fraudulent conveyance under DCL § 276, and thus the elements of this cause of action must be pled with particularity under CPLR 3016(b). *Carlyle*, 160 A.D.3d at 477; *see also RTN Networks*, 126 A.D.3d at 478.

ARGUMENT

I.
PLAINTIFF FAILS TO STATE A CLAIM FOR ACTUAL FRAUDULENT CONVEYANCE, MUCH LESS WITH PARTICULARITY

Plaintiff's claim for actual fraudulent conveyance under DCL § 276 should be dismissed because it fails to allege, much less with the required particularity, facts showing that Debtor or HoldCo made any payment to ARCC with actual intent to "hinder, delay, or defraud" Plaintiff.

First, Plaintiff's actual-fraud claim fails as a matter of timing. Numerous courts have dismissed actual fraudulent conveyance claims alleged by judgment creditors where, as here, "the judgment had not yet been obtained at the time" of the conveyance. *RTN*, 126 A.D.3d at 478; *see also Carlyle*, 160 A.D. 3d at 477 ("[T]he timing of the allegedly fraudulent transfers—beginning two years before the judgment debtors incurred the subject debts—undermines the claim of fraudulent intent."). Here, the alleged conveyances were made between June 2015 and August 2016. During this time, CSL was making its monthly payments of roughly $500,000 to Plaintiff, and continued doing so until its default in October 2017, fourteen months *after* the last alleged conveyance was made (an additional $7,000,000). Plaintiff did not file suit against CSL and Debtor until January 2018; Plaintiff did not obtain the Consent Judgment against them until February 2019; and Plaintiff alleges nothing to show that the 2015 and 2016 payments were made with actual intent to prevent Plaintiff from collecting on a judgment it did not even obtain *until over two years later.* Moreover, Plaintiff did not ever sue HoldCo or obtain a judgment against HoldCo. Dismissal is warranted on this basis alone.[18]

[18] Plaintiff does not allege that either the Credit Agreement or the PUPA (each executed over a year before CSL executed the Lease) was fraudulent when each was initially executed.

Second, since Plaintiff's allegations as to Debtor's and HoldCo's purported intent are conclusory and/or based upon unsourced information or belief, such allegations fail to satisfy CPLR 3016(b)'s requirement of alleging fraud with particularity. *See Carlyle*, 160 A.D.3d at 477; *RTN*, 126 A.D.3d at 478. Plaintiff alleges, for instance, that "[u]pon information and belief, [CSL] and its affiliated entities knew such a business model was not sustainable and that the financial drain would result in [Debtor and/or non-debtor HoldCo] being unable to pay its debts and obligations as they became due." Complaint ¶ 13. But this fails to meet 3016(b)'s particularity requirements because it (1) does not identify the *source* for Plaintiff's "information and belief," *see Carlyle*, 160 A.D.3d at 477; (2) does not identify *which affiliated entities* (*i.e.*, Debtor, non-debtor HoldCo, or other non-debtors) "knew" of the negative information; (3) does not identify *when* such knowledge was acquired (*i.e.,* before, contemporaneous with or after each conveyance); and (4) does not identify *which* "debts and obligations" would not be paid "as they became due." Plaintiff's other allegations are similarly lacking in the requisite particularity. *See* Complaint ¶¶ 33(a)-(e).[19]

Finally, Plaintiff has *not* alleged, with the required particularity, "badges of fraud." *Wall St. Assocs. v. Brodsky*, 257 A.D.2d 526, 529 (1st Dep't 1999). The Complaint does not allege that ARCC had a "close" relationship with Debtor or non-debtor HoldCo (*i.e.*., that ARCC ran or controlled Debtor or HoldCo) (*see id.*); that any of the Secured Debt Payments or

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See 3 E. 54th St. New York, LLC v. Patriarch Partners, LLC, 90 A.D.3d 418, 419 (1st Dep't 2011).

[19] The Complaint intermittently alleges that CSL or another affiliated law school had engaged in "fraudulent practices" against its students, *see* Complaint ¶ 33(b), which were being investigated. *Id.* ¶¶ 14(c), 14(g). These are conclusory allegations and do not plead fraud with particularity; but even if true, Plaintiff conflates alleged fraud against *students* (which is *not* the claim asserted here) with alleged fraud against Plaintiff, CSL's landlord.

the HoldCo Payments were not made "in the usual course of business" (*see id.*); that ARCC knew, in 2015 or 2016, that CSL was going to default on the Lease in late 2017 (*see id.*); or that either Debtor or non-debtor HoldCo retained control of any of the payments after they were made to ARCC. These failures also warrant dismissal. *See id.*; *see also Brennan v. 3250 Rawlins Ave. Partners, LLC*, 171 A.D.3d 603, 605 (1st Dep't 2019).

II.
PLAINTIFF CANNOT AVOID OR RECOVER THE SECURED DEBT PAYMENTS BECAUSE THEY WERE PAYMENTS TO ARCC FOR A SECURED ANTECEDENT DEBT

Plaintiff's constructive fraudulent conveyance claims under DCL §§ 273, 274 and 275 (Plaintiff's first, second and third causes of action) also fail. First, as Plaintiff admits, the Secured Debt Payments were payments made to satisfy an antecedent secured debt owed by Debtor to ARCC. Such payments, as a matter of black-letter law, are for fair consideration, in good faith, and therefore *not* fraudulent conveyances.

Each of the DCL's three constructive fraudulent conveyance statutes requires Plaintiff to adequately plead that the conveyance was made without "fair consideration." DCL §§ 273, 274, 275; *see also Matter of American Inv. Bank v. Marine Midland Bank*, 191 A.D.2d 690, 691 (2d Dep't 1993) ("inadequacy of consideration" is a "prerequisite to a finding of constructive fraud"). The DCL further explains that "[f]air consideration is given for property . . . [w]hen in exchange for such property . . . an antecedent debt is satisfied." DCL § 272. Therefore, under New York law, "a conveyance which satisfies an antecedent debt," even if made by an insolvent debtor, "is neither fraudulent nor otherwise improper," although "its effect is to prefer one creditor over another." *Ultramar Energy Ltd. v. Chase Manhattan Bank, N.A.*, 191 A.D.2d 86, 91 (1st Dep't 1993); *see also RDLF Financial Services, LLC v. Esquire Capital Corp.*, 34 Misc. 3d 1235(A), 2012 WL 695488, at *8-9 (Sup. Ct. N.Y. Cty. Feb. 27, 2012)

(dismissing cause of action alleging that payment under prior loan agreement was fraudulent conveyance); *In re Sharp Int'l Corp.*, 403 F.3d 43, 54 (2d Cir. 2005) ("[T]he basic object of fraudulent conveyance law is to see that the debtor uses his limited assets to satisfy some of his creditors; it normally does not try to choose among them.") (internal quotations and citations omitted).

Dismissal is particularly warranted here because, as Plaintiff admits, the Secured Debt Payments were made to satisfy Debtor's *secured* debts owed to ARCC. *See* Complaint ¶ 10 ("In connection with these loans, [ARCC] acquired a lien on substantially all of the assets of InfiLaw."); *id.* Ex. 3 (Security Agreement); Chiueh Affirmation Ex. E (Lease), at Ex. P, §§ 2-4 (Landlord subordination agreement acknowledging Credit Agreement and ARCC's security interest). As a secured creditor of Debtor, ARCC was entitled to satisfaction of its secured debt, in full, *before* Plaintiff could recover anything. *See Englander*, 79 N.Y.S.3d at 506. Indeed, this Court in *Englander* held that even the repayment of an *insider's* debt—which ordinarily could be presumed to be in bad faith—is *not* a fraudulent conveyance if the debt was secured. *Id.* Plaintiff, of course, does not, and cannot, allege that ARCC is an insider, *i.e.*, a "controlling shareholder, officer or director" of Debtor, *see UBS Securities LLC v Highland Capital Management, L.P.*, 2017 WL 1103879, at *14 (N.Y. Sup. Ct. Mar. 13, 2017), meaning that Plaintiff's claim here is even weaker than the one rejected by this Court in *Englander*. All of Plaintiff's claims as against the Secured Debt Payments should be dismissed.

III.
PLAINTIFF HAS NOT ALLEGED ANY LEGAL BASIS TO AVOID A CONVEYANCE BY NON-DEBTOR HOLDCO TO ARCC

As for the HoldCo Payments, Plaintiff fails to satisfy a different requirement under the fraudulent conveyance laws—that the challenged transfer be made by a debtor of *Plaintiff*. "It is well settled that in order to set aside a fraudulent conveyance [under DCL §§

273-275], one must be a creditor *of the transferor*; those who are not injured by the transfer lack standing to challenge it." *Eberhard v. Marcu*, 530 F.3d 122, 129 (2d Cir. 2008) (emphasis added); *see also Drenis v. Haligiannis*, 452 F. Supp. 2d 418, 428 (S.D.N.Y. 2006). Plaintiff admits that the HoldCo Payments were dividends that were "contractually obligated" to be paid to ARCC by HoldCo under the PUPA, *see* Complaint ¶ 9, and per the plain terms of the PUPA, HoldCo—*not* Debtor—is the obligor under the PUPA. *See supra* pp. 5-6; *see also* Chiueh Affirmation Ex. C (PUPA) at 1. But HoldCo could not have made a transfer to defraud Plaintiff because, as Plaintiff admits, Plaintiff was *not* a judgment creditor, or, for that matter, *any* creditor, of HoldCo. Complaint ¶ 1; *id.* Ex. 1 (Consent Judgment) ¶ 1.

To try and cure this fatal defect, Plaintiff relies on a misleading pleading technique: the Complaint lumps Debtor and non-debtor HoldCo into a single definition called "InfiLaw," (*see* Complaint ¶ 5), and then claims that "InfiLaw" made all the purported fraudulent conveyances (*see* Complaint ¶¶ 15-16). The problem with this defined-term sleight-of-hand is that documents attached to the Complaint or incorporated by reference therein refute Plaintiff's attempts to ignore distinctions between these entities. *See Zanett*, 29 A.D.3d at 495 (Court need not accept as true any "factual allegations that are contradicted by documentary evidence"). The PUPA establishes that *only* non-debtor HoldCo, and *not* Debtor, issued HoldCo Preferred Stock to ARCC. *See supra* p. 5.

IV.
PLAINTIFF FAILS TO PLEAD DEBTOR'S OR HOLDCO'S INSOLVENCY, UNREASONABLY SMALL CAPITAL, OR BELIEF THAT EITHER OF THEM WOULD FAIL TO PAY ITS DEBTS AS THEY BECAME DUE

Plaintiff's three constructive fraudulent conveyance claims can all be dismissed on a second ground: each of them fails to allege that, when any alleged conveyance took place, (1) Debtor or HoldCo was insolvent; (2) Debtor or HoldCo had unreasonably small capital; or

(3) Debtor or HoldCo intended or believed it would incur debts it would not be able to repay. *See* DCL §§ 273-275. For each analysis, the "operative reference point for determining insolvency is *the time at which the transfer took place*." *In re Trinsum Grp., Inc.*, 460 B.R. 379, 392 (Bankr. S.D.N.Y. 2011) (emphasis added). Insolvency "cannot be presumed from subsequent insolvency at a later point in time." *Id.*; *see also Bleru Realty Corp. v. 158 E. 23rd St. Rest. Corp.*, 200 A.D.2d 547, 547 (1st Dep't 1994) (allegations of "current financial hardship" and "inability to pay certain bills" insufficient to "demonstrate insolvency 8 months earlier," when alleged conveyance was made). In evaluating Plaintiff's allegations, the Court should keep in mind that the Complaint was filed only *after* Plaintiff took discovery from each of CSL and Debtor, including obtaining their confidential financial information. *See* p. 9, *supra.*

1. Plaintiff fails to plead that Debtor was insolvent at any time between June 2015 and August 2016

Plaintiff's first cause of action, under DCL § 273, requires Plaintiff to plead that Debtor was insolvent when each conveyance was made to ARCC—*i.e.*, that Debtor's assets had a "present fair salable value… less than the amount that [would] be required to pay [its] probable liability on [its] existing debts as they [became] absolute and matured." DCL § 271(1). Courts applying New York law have held that "[a]n adequate pleading of insolvency requires some sort of balance sheet information that the Court can use to infer that the corporation's liabilities exceeded [its] assets *at the time the transfers took place*." *Innovative Custom Brands, Inc. v. Minor*, 2016 WL 308805, *3 (S.D.N.Y. January 25, 2016) (internal quotations omitted, citing *Trinsum*, 460 B.R. at 392) (emphasis in original). Failure to allege such balance sheet data warrants dismissal. *Innovative Custom Brands*, 2016 WL 308805, at *3.

The Complaint alleges *no* balance sheet data whatsoever. Nor does it allege any fact respecting the value of Debtor's assets or the amount of its liabilities at any point. Indeed,

Plaintiff *deliberately omitted* balance sheets from the Thompson Declaration that Plaintiff filed as Exhibit 5 to its Complaint. These balance sheets, from December 31, 2017—sixteen months *after* the last alleged conveyance in August 2016—*still* reported a positive total equity value (*i.e.*, value of assets in excess of amount of liabilities) for each of Debtor and non-debtor HoldCo. *See* p. 8, *supra*; Chiueh Affirmation Ex. A (CSL, Debtor, HoldCo balance sheets).

Plaintiff's failure to allege any balance sheet data, coupled with its blatant attempt to hide from the Court the balance sheet data showing Debtor's solvency after the conveyances were made, warrants dismissal of Plaintiff's first cause of action for failing to plead insolvency. This fatal flaw cannot be cured by merely pleading that Debtor incurred a "net loss" sometime in 2015-2016, or that there were setbacks (mostly after June 2015) in Debtor's or its subsidiaries' businesses. *See* Complaint ¶ 14. Courts have rejected similar efforts to plead insolvency merely by alleging challenges in a debtor's business while failing and refusing to provide the requisite balance sheet data. *See Innovative Custom Brands*, 2016 WL 308805, at *3 (allegation of "serious financial distress" failed to plead insolvency); *Trinsum*, 460 B.R. at 392-93 (allegations of decreasing income and cash flow figures failed to plead insolvency); *Ray v. Ray*, 2019 WL 1649981, at *7 (S.D.N.Y. Mar. 28, 2019) (allegations that transferor had "no work assignment and no income" and was "depleted of assets" failed to plead insolvency).

Nor is the allegation that CSL went out of business in 2017—well after the last conveyance to ARCC was made—sufficient. Not only is CSL only one of Debtor's three law school subsidiaries, but this again is an improper allegation of insolvency by hindsight. *See, e.g.*, *Bleru*, 200 A.D.2d at 547; *Trinsum*, 460 B.R. at 392; *FSP, Inc. v. Societe Generale*, 2005 WL 475986, at *15 (S.D.N.Y. Feb. 28, 2005) ("Whether the [debtor] is deemed to have sufficient assets *must* be gauged at the time of the transfer and not with the benefit of hindsight.")

(emphasis added); *Am. Inv. Bank*, 191 A.D.2d at 692 (reliance on financial statement made two years after transfer "insufficient to establish" insolvency on date of transfer).

2. Plaintiff fails to plead that Debtor had unreasonably small capital at any time between June 2015 and August 2016

Plaintiff's second cause of action, under DCL § 274, requires an allegation that Debtor was left with "unreasonably small capital" after each conveyance. This denotes "a financial condition short of equitable insolvency, and is aimed at transferees that leave the transferor technically solvent but doomed to fail." *In re Operations NY LLC.*, 490 B.R. 84, 98 (Bankr. S.D.N.Y. 2013) (internal quotations and citations omitted). The types of relevant facts that could be alleged to satisfy this element include, *inter alia*, the transferor's "debt to equity ratio, historical capital cushion, and the need for working capital in the transferor's industry." *Id.*

None of these facts is alleged in the Complaint. Instead, Plaintiff merely parrots the legal elements of the cause of action—that the conveyances were made "at a time when" Debtor "had unreasonably small capital, or was put in that position as a result" of these conveyances. Complaint ¶ 25. This is insufficient. Plaintiff alleges no instance in which Debtor lacked sufficient capital between June 2015 and August 2016 to run its ongoing business operations, and indeed, Plaintiff fails to explain how, if Debtor purportedly had insufficient capital as of June 2016, Plaintiff could have subsequently received and retained *twenty-seven* consecutive monthly payments of half-a-million dollars each ($13,500,000), including for fourteen months *after* the last alleged conveyance was made to ARCC. *See In re Operations*, 490 B.R. at 98 (dismissing claim where debtor "continued to operate… ten months after the transfer" and plaintiff "d[id] not allege that the Debtor failed to pay any other debts or that it lacked the capital to do so"); *Innovative Custom Brands*, 2016 WL 308805 at *3 (dismissing

claim where "Company had sufficient assets to pay its creditors during the relevant period"). Dismissal of this cause of action is appropriate as well.

3. Plaintiff fails to plead that Debtor intended or believed it would incur debts it would not be able to repay at any time between June 2015 and August 2016

Finally, Plaintiff's third cause of action, under DCL § 275, requires an allegation that Debtor intended or believed, at any time when a conveyance was made, that Debtor would "incur debts beyond [its] ability to pay as they mature." Failure to plead Debtor's "subjective intent or belief" as to this element warrants dismissal. *Ray*, 2019 WL 1649981, at *8 (*citing Innovative Custom Brands*, 2016 WL 308805, at *3); *see also Swartz v. Swartz,* 145 A.D.3d 818, 828 (2d Dep't 2016) (dismissing claim where "the facts alleged in the complaint do not support any inference that [debtor] . . . intended or believed that he would incur debts beyond his ability to pay as a result of the transfers").

Once again, the Complaint alleges no fact to support this element. It alleges, upon "information and belief," that CSL "and its affiliated entities" knew (but fails to specify which entities or when) that CSL's "business model was not sustainable" and that "the financial drain would result in [Debtor and/or non-debtor HoldCo] being unable to pay its debts and obligations as they became due." Complaint ¶ 13. As discussed at page 12, *supra*, not only is this allegation conclusory, but Plaintiff's failure to provide a source for its information and belief itself justifies dismissal. *See Carlyle*, 160 A.D.3d at 477.[20] In any event, this allegation fails to present any fact to suggest that the belief that Debtor would not pay its debts had been formed *at*

[20] Requiring Plaintiff to identify such sources is particularly salient here, given (1) the numerous allegations that improperly attempt to allege insolvency by hindsight (*see* pp. 9-10, 17-18, *supra*); and (2) Plaintiff's inexcusable omission from its own exhibit of critical information that was unhelpful to its case (*see* p. 8, *supra*). Plaintiff cannot avoid dismissal by violating its obligation to provide sources for its allegations based on information and belief.

the time the alleged conveyances were made, *see Trinsum*, 460 B.R. at 392, and is, as with the other causes of action, completely undercut by the fact that monthly payments totaling roughly $13,500,000 were made to Plaintiff in the twenty-seven months after June 2015. *See Operations NY*, 490 B.R. at 98-99 (dismissing claim where other debts were being paid while the alleged conveyances were being made).[21]

4. The issue of HoldCo's solvency is irrelevant because HoldCo owed no money to Plaintiff, but in any event Plaintiff fails to allege HoldCo's insolvency

Because the Complaint misleadingly lumps Debtor and HoldCo into a single defined term called "InfiLaw," *see* p. 15, *supra*, the Complaint alleges that HoldCo was insolvent under each of DCL §§ 273, 274 and 275 for exactly the same reasons why Debtor was purportedly insolvent under those provisions (Complaint ¶ 14). But, since Plaintiff was *not* a creditor of HoldCo, the issue of whether HoldCo was insolvent is simply *irrelevant* to any of Plaintiff's causes of action. *See* p. 15, *supra*. In any event, Plaintiff's allegations of insolvency against HoldCo fail for exactly the same reasons why these allegations fail against Debtor, including, *inter alia*, Plaintiff's omission, from Exhibit 5 of its Complaint, of the December 31, 2017 balance sheet showing that HoldCo was *not* insolvent.

CONCLUSION

For the foregoing reasons, the Court should dismiss the Complaint, with prejudice, and grant ARCC such other, different and further relief as is just and proper.

[21] Insofar as Plaintiff is later found to have adequately alleged Debtor's insolvency, ARCC reserves its right to raise a defense, under CPLR 3211(a)(3), as to whether there would have been any unencumbered asset available to the hypothetically insolvent Debtor to satisfy Plaintiff's claim. *See, e.g.*, *Chemtex, LLC v. St. Anthony Enters., Inc.*, 490 F.Supp.2d 536, 542 (S.D.N.Y. 2007) ("[A] complaining creditor must first plead . . . that it had an equity stake in the debtor's assets. . . . Absent any such equity in the assets conveyed, an unsecured creditor lacks standing to challenge the conveyance as fraudulent.") (internal citations omitted). Since Plaintiff has *not* adequately pled insolvency, this issue need not be considered at this time.

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Respectfully Submitted,

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