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 (Hon. Jennifer G. Schecter) (Motion Seq. 002)

MEMORANDUM OF LAW IN OPPOSITION
TO MOTION TO DISMISS

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Plaintiff South College Street, LLC ("SCS"), by its attorneys, Troutman Sanders LLP, respectfully submits this memorandum of law in opposition to Defendant Ares Capital Corporation's ("Ares") motion to dismiss, dated November 8, 2019.

PRELIMINARY STATEMENT

This is a complex fraudulent conveyance action brought under the New York Debtor and Creditor Law §§ 273-276 ("DCL"), premised on fraudulent conveyances made to Ares by InfiLaw Corporation ("InfiLaw Corporation") and InfiLaw Holding, LLC (individually "InfiLaw Holding" and collectively with InfiLaw Corporation "InfiLaw").[1]

SCS seeks to recover amounts due and owing pursuant to a $24,550,000 judgment it obtained in North Carolina on February 6, 2019 against InfiLaw Corporation and its wholly owned subsidiary, Charlotte School of Law ("CSL") (the "Judgment") following CSL's default under a lease between SCS and CSL, which was guaranteed by InfiLaw Corporation. The lease default was caused by the numerous fraudulent conveyances made by InfiLaw to Ares, as part of a scheme by Ares to defraud InfiLaw's creditors. Ares fails to acknowledge or address most of the pertinent allegations, and grossly mischaracterizes those that it does acknowledge, in order to cobble together its dismissal arguments. However, as discussed below, there is no merit to Ares's motion.

The Complaint adequately alleges three constructive fraudulent conveyance causes of action against Ares under DCL §§ 273-275 by setting forth that InfiLaw was rendered insolvent by Ares's fraudulent scheme (DCL § 273); had unreasonably small capital (DCL § 274); and was unable to pay its debts as they became due (DCL § 275). Ares's motion demonstrates a

[1] As discussed in Section I, *infra*, Ares's assertion that InfiLaw Corporation and InfiLaw Holding cannot be referred to collectively as InfiLaw ignores SCS's explicit allegations that the two were alter-egos of one another, as permitted under New York law.

fundamental misunderstanding of New York Debtor and Creditor Law. First, SCS is undeniably a creditor with standing to pursue fraudulent conveyances as to debts owed by both InfiLaw Corporation and InfiLaw Holding, who are alter egos of one another. Second, the Complaint meets the requisite pleading standard for insolvency and SCS is not required to plead "balance sheets insolvency." Finally, the dividend payments and other conveyances from InfiLaw to Ares were not made in good faith in connection with an "antecedent debt." Ares was a majority shareholder of InfiLaw and improperly preferred itself in a fraudulent scheme, rendering InfiLaw insolvent.

The Complaint also adequately states a cause of action for actual fraudulent conveyance under DCL § 276 by alleging "badges of fraud" to demonstrate that the conveyances were part of a scheme made with actual intent to hinder, delay or defraud creditors. Complaint, ¶ 33.

The Complaint more than adequately alleges the necessary elements of the four causes of action and Ares's motion should be denied in its entirety.[2]

FACTUAL BACKGROUND[3]

The Parties

InfiLaw Corporation, which is wholly owned by InfiLaw Holding, owned and operated three for-profit law schools, including CSL, which went out of business in 2017. Complaint, ¶¶ 5-6. Upon information and belief, InfiLaw Corporation and InfiLaw Holding have consistently had overlapping officers and prepared consolidated financial returns with the profits and losses of InfiLaw Corporation being passed through to InfiLaw Holding. *Id.*, ¶ 5. Further, upon information

[2] Alternatively, SCS is entitled to amend the Complaint to assert additional allegations, including those to support the fact that Ares's fraudulent scheme rendered InfiLaw insolvent.

[3] A full recitation of the relevant facts is set forth at length in the Complaint (annexed as Exhibit K to the 11/8/19 Affirmation of Stan Chiueh ("Chiueh Affirmation")) and are incorporated herein by reference.

and belief, InfiLaw Holding engages in no business activities separate from that of InfiLaw Corporation. *Id.*

SCS was CSL's landlord. *See* Consent Judgment, dated February 6, 2019, ¶¶ 2-3, attached to the Complaint as Exhibit 1. After CSL defaulted on its monthly rental payments, SCS obtained the Judgment against CSL and InfiLaw Corporation in the amount of $24,550,000. Complaint, ¶ 1. As alter-egos, InfiLaw Corporation and InfiLaw Holding both owe a debt to SCS.

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 in August 2011. *Id.*, ¶ 9. The demise of InfiLaw's schools, including CSL, was a result of their for-profit statuses and the debt and the capital structure imposed on InfiLaw by Ares. *Id.*, ¶¶ 7, 10-12.

Ares's Fraudulent Scheme

In August 2011, Ares acquired 131,000 units of InfiLaw Holding's Series A Redeemable Nonvoting Preferred Units for $131 million under a Preferred Unit Purchase Agreement ("PUPA") between Ares and InfiLaw Holding, under which InfiLaw Corporation was a guarantor. *Id.*, ¶ 9. Ares's restructuring of InfiLaw resulted in InfiLaw becoming obligated to pay over $12 million per year to Ares in preferred dividends – with these payments increasing to more than $15 million per year in 2016. *Id.* Contemporaneously with the execution of the PUPA, Ares and InfiLaw Corporation entered into a Credit Agreement by which Ares agreed to provide, amongst other terms, a $30,000,000 term loan, a $15,000,000 delayed term loan and a $25,000,000 revolving line of credit, under which InfiLaw Holding was a guarantor. *Id.*, ¶ 10. InfiLaw Corporation was allegedly charged 9.5% interest on these loans which increased to 11% in 2016. *Id.*

On October 19, 2012, as part of Ares's scheme, Ares and ABRY Partners ("ABRY") acquired Series B Preferred Shares in InfiLaw for the sum of $138,678,000. *Id.*, ¶ 11. The

proceeds for the sale of the Series B Preferred Shares were used to fund distributions to InfiLaw's existing investors. *Id.* Although the Series B Preferred Shares do not pay dividends or interest, InfiLaw was contractually obligated to redeem the investment of Ares and ABRY in October 2018 at a price of 2.5 times the investment (i.e., a redemption price of approximately $347 million). *Id.* Thus, the effect of the Series B Preferred Shares was to replace InfiLaw's existing shareholder equity with an obligation for InfiLaw to pay Ares and ABRY $347 million in 2018. *Id.*

As a result of the incredible debt and equity payments that Ares required of InfiLaw, InfiLaw experienced liquidity and operational difficulties. *Id.*, ¶ 13. In order to continue funding its payments to Ares, InfiLaw caused the three law schools owned by InfiLaw, including CSL, to lower their admission standards, against objections from the faculty. *Id.* 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. *Id.* As a result of lowering its admissions criteria, the law schools' bar passage rate declined precipitously, thereby causing the law schools to further lower admissions criteria in order to have a sufficient number of students for InfiLaw to fulfill its payment obligations to Ares. *Id.* The University of North Carolina Board of Governors ultimately terminated CSL's license. *Id.*

A detailed chronology evidences Ares's stranglehold and that preferred fraudulent transfers rendered InfiLaw insolvent. First, in March 2015, InfiLaw received a Civil Investigative Demand from the United States Department of Justice in connection with potential fraudulent practices. *Id.*, ¶ 14. By July 2015, InfiLaw was in violation of its covenants in its contractual agreements with Ares. *Id.* In January 2016, due to InfiLaw's liquidity issues, Ares amended the Credit Agreement to extend the maturity date. *Id.* In February 2016, the American Bar Association concluded that it had reason to believe that CSL had not demonstrated that it maintains a rigorous

program of legal education. *Id.* In May 2016, the United States Department of Justice informed InfiLaw that it was investigating possible fraudulent conduct. *Id.*

Ares's Scheme Rendered InfiLaw Insolvent

The effect of the agreements between InfiLaw and Ares was to saddle InfiLaw with payment obligations to Ares that were unsustainable. *Id.*, ¶ 12. 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 – which InfiLaw received virtually no financial benefit from – because the funds raised were essentially used to replace the existing shareholder equity. *Id.* Moreover, it required InfiLaw to essentially double the value of CSL within six years or face default. *Id.* Thus, the Ares transactions were "structured to milk cash from InfiLaw" and its students. *Id.*

Despite the fact that Ares's financial stranglehold rendered InfiLaw insolvent, Ares continued to extract preferred dividends from InfiLaw – including quarterly in July 2015, October 2015, January 2016 and April 2016 of several million dollars each. *Id.*, ¶ 15. In addition, InfiLaw made millions of dollars of additional payments to Ares without reasonably equivalent value after InfiLaw became insolvent. *Id.* Between June 2015 and August 2016, InfiLaw made fraudulent conveyances of $34,225,114.00 to Ares. *Id.*, ¶¶ 16, 21-22.

LEGAL STANDARDS

CPLR 3211(a)(1)

Dismissal under CPLR 3211(a)(1) is only warranted if the documentary evidence "dispositively refuted plaintiffs' allegations, as a matter of law." *See Landes v. Provident Realty Partners II, L.P.*, 137 A.D.3d 694 (1st Dep't 2016); *U.S. Tr. Co. v. Gill & Duffus, Inc.*, 189 A.D.2d 655, 655 (1st Dep't 1993) (denying tenant's motion to dismiss because its financial statement did not "definitively dispose of the plaintiff's claim"). Ares's reliance on a December 2017

"Draft/Unaudited" Balance Sheet is not sufficient to warrant dismissal. *See 1424-1428 Realty LLC v. Liu*, 169 A.D.3d 586, 586–87 (1st Dep't 2019) ("[Documentary evidence [of the alleged fraudulent transaction] does not utterly refute plaintiff's factual allegations, conclusively establishing a defense as a matter of law"); *U.S. Tr. Co.*, 189 A.D.2d at 655.

CPLR 3211(a)(7)

The scope of the Court's inquiry on a motion to dismiss under CPLR 3211(a)(7) is narrowly circumscribed. *See P.T. Bank Cent. Asia v. ABN AMRO Bank N.V.*, 301 A.D.2d 373, 375 (1st Dep't 2003). The Court does not assess the merits of the Complaint or any of its factual allegations, and the motion should be denied if, within the four corners of the Complaint, factual allegations are discerned which, taken together, manifest a claim cognizable at law. *See 511 West 232nd Owners Corp. v. Jennifer Realty Co.*, 98 N.Y.2d 144, 151-152 (2002). The Complaint should be liberally construed, and the Court should accept as true all facts in the Complaint. *Id*. at 152.

SCS is not required to plead facts that are "likely exclusively in the knowledge of [Defendant]." *1424-1428 Realty LLC*, 169 A.D.3d at 587.

CPLR 3016(b)

The heightened specificity requirement of CPLR 3016(b) only applies to DCL § 276 and "requires only that a claim of fraud be pleaded in sufficient detail to give adequate notice." *DaPuzzo v. Reznick Fedder & Silverman,* 14 A.D.3d 302, 302 (1st Dep't 2005). "[T]he Court of Appeals has acknowledged that it is virtually impossible to [allege in detail] where the facts surrounding the fraud are peculiarly within the knowledge of the other party." *See Ambassador Factors v. Kandel & Co.,* 215 A.D.2d 305, 308 (1st Dep't 1995) (citation omitted).

Fraudulent intent may be inferred from allegations of details of a fraudulent scheme. *See Marine Midland Bank v. Zurich Ins. Co.*, 263 A.D.2d 382, 382–83 (1st Dep't 1999). To satisfy

the particularity requirement of CPLR 3016(b), plaintiff may "rel[y] on various 'badges of fraud' to show actual intent to defraud or hinder present or future creditors." *Uni-Rty Corp. v. New York Guangdong Fin., Inc.*, 117 A.D.3d 427, 428 (1st Dep't 2014).

ARGUMENT

I. SCS Is A Creditor Under DCL §§ 270 and 278 And Has Standing To Pursue Fraudulent Conveyances Made By InfiLaw Corporation and InfiLaw Holding as Alter Egos

DCL § 270 broadly defines "Creditor," for purposes of fraudulent conveyance claims under DCL §§ 273-276, as a person having "any claim, whether matured or unmatured, liquidated or unliquidated, absolute, fixed or contingent" and "Debt" as "any legal liability, whether matured or unmatured, liquidated or unliquidated, absolute, fixed or contingent." The DCL does not otherwise limit a party who has standing to bring a claim, and Ares's disingenuous claim that SCS is not a creditor with standing, because it does not have a judgment against InfiLaw Holding, ignores the plain language of the DCL and binding case law. (Ares MOL, p. 3, 14-15).

All that SCS must allege at this early stage, to have standing to remedy fraudulent conveyances made by InfliLaw Corporation and InfiLaw Holding, is that it is a "Creditor" under DCL, and that it is owed a "Debt." *See Z Worldwide, Inc. v. Worldwide Links, Inc.*, No. 09-CV-023807, 2011 WL 934503 (N.Y. Sup. Ct. Feb. 24, 2011) (rejecting defendants' contention that plaintiff lacks standing under DCL because he is not a judgment creditor, explaining that "these sections by their very terms permit 'creditors whose rights have not matured' to institute an action under the Debtor and Creditor Law. Therefore, these sections do not require that a creditor obtain a judgment before proceeding with a valid claim under these sections"). As relevant here, future rent owed to a landlord under a lease is considered a "debt" under the DCL. *See Sunrise Indus. Joint Venture v. Ditric Optics, Inc.*, 873 F. Supp. 765, 771 (E.D.N.Y. 1995) (holding landlord

adequately pleaded causes of action against parent company to set aside fraudulent conveyances where outstanding rent payments were considered a debt).

New York courts routinely recognize an alter ego theory of recovery where fraudulent conveyance schemes are alleged. *See Toledo v. Sabharwal*, No. 17-CV-653234, 2019 WL 495801, at *2 (N.Y. Sup. Ct. Feb. 04, 2019) (on leave to reargue, upholding decision which denied motion to dismiss fraudulent conveyance causes of action based on alter ego theory); *see also 2406-12 Amsterdam Assocs. LLC v. Alianza LLC*, 136 A.D.3d 512, 513 (1st Dep't 2016) (construing plaintiff's allegation liberally and affirming the denial of defendants motion to dismiss claims for alter ego liability and fraudulent conveyances under DCL §§ 273-276); *888 7th Ave. Assocs. Ltd. P'ship v. Arlen Corp.*, 172 A.D.2d 445, 445 (1st Dep't 1991); *Oltchim S.A. v. Zebulon Indus.*, 26 Misc. 3d 1209(A) (Sup. Ct. Westchester Cty. 2009).

SCS has adequately pled that it is a creditor and owed a debt from CSL and InfiLaw Corporation/InfiLaw Holding (which are alter egos of one another). Complaint, ¶ 5. SCS also specifically pled that fraudulent conveyances were made by and through these interchangeable InfiLaw entities to Ares. *Id.*, ¶¶ 15-16 ("InfiLaw made millions of dollars of additional payments to Ares without reasonably equivalent value after InfiLaw had become insolvent."). Like in *Amsterdam Assocs.* where the Court found the elements of alter ego liability were adequately pled, SCS has also pled that InfiLaw Corporation was wholly owned by InfiLaw Holding, but also, upon information and belief, had consistently overlapping officers and prepared consolidated financial returns with the profits and losses of InfiLaw Corporation being passed through to InfiLaw Holding. Complaint, ¶ 5; 136 A.D.3d at 512. Similarly, SCS also pled that InfiLaw Holding engages in no business activities separate from InfiLaw Corporation. *Id.*

In fact, the documents that Ares attaches to the Chiueh Affirmation demonstrate factors

sufficient to conclude that InfiLaw Holding is the alter ego of InfiLaw Corporation. *See* Credit Agreement (Inatome signing as President and CEO of both InfiLaw Corporation and InfiLaw Holding) (*Chiueh Aff.*, Exhibit B); Preferred Unit Purchase Agreement (Inatome signing as President and CEO of both InfiLaw Corporation and InfiLaw Holding) (*Id.*, Exhibit C); Declaration of Scott Thompson in Support of Joint Motion for Preliminary Approval (Thompson served as CFO and Treasurer of both InfiLaw Corporation and InfiLaw Holding) (*Id.*, Exhibit J); Security Pledge Agreement (Inatome signing as President and CEO of both InfiLaw Corporation and InfiLaw Holding) (*Id.*, attached as Exhibit 2 to Exhibit J); Insurance Policies (reflecting that InfiLaw Corporation and InfiLaw Holding have the same corporate office) (*Id.*, attached as Exhibit 19 to Exhibit J); Balance Sheet (consolidating financial information of InfiLaw Corporation and InfiLaw Holding) (*Id.*, Exhibit A).

SCS is undeniably a creditor of InfiLaw prior to the Judgment vis-à-vis the debt it was owed under the lease. SCS's standing as a creditor depends upon the relationship between InfiLaw Corporation and InfiLaw Holding (which SCS has sufficiently alleged are alter egos), and the interpretation and effect of the Judgment under which SCS is owed a debt. The fact that the Judgment is nominally against InfiLaw Corporation is irrelevant under DCL's broad definition of "creditor," and New York case law is clear that a creditor may proceed on alter ego theories. Thus, at this stage of the litigation, it is not necessary to make a distinction between these entities. *See Toledo*, 2019 WL 495801, at *2; *2406-12 Amsterdam Assocs. LLC*, 136 A.D.3d at 512.

II. SCS Has Adequately Pled The First Cause Of Action For Fraudulent Conveyance Under DCL § 273

DCL § 273 provides that: "Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to

his actual intent if the conveyance is made or the obligation is incurred without a fair consideration." (emphasis added).

SCS easily satisfies the pleading requirements of DCL § 273 by alleging that: (A) InfiLaw made the conveyances "at a time when InfiLaw was insolvent or would be rendered insolvent as a result of the conveyances", and (B) the conveyances were "made without fair consideration." Complaint, ¶¶ 21-22.

A. SCS Has Adequately Plead That Ares's Fraudulent Scheme Rendered InfiLaw Insolvent

The standard for pleading insolvency is a low bar and "ultimately a question of fact." *See Sullivan v. Kodsi*, 373 F. Supp. 2d 302, 308 (S.D.N.Y. 2005) ("[P]laintiff alleges insolvency on the face of the Complaint: '[Defendant] was insolvent or became insolvent at the time of the transfers.'"); *see also Bd. of Managers Of Be@William Condominium v. 90 William St. Dev. Grp. LLC*, No. 11-CV-105137, 2019 WL 1170871, at *4 (N.Y. Sup. Ct. Mar. 13, 2019).

In similar circumstances, New York courts have routinely held that a plaintiff adequately pled insolvency by alleging that payments made under a scheme rendered a debtor insolvent. *See ABN AMRO Bank, N.V. v. MBIA Inc.*, 17 N.Y.3d 208, 228 (2011) (holding that plaintiffs adequately pled insolvency under DCL by describing "a series of fraudulent transactions made in bad faith" which they ultimately asserted stripped the debtor of assets and rendered it insolvent and unable to meet its obligations); *see also Abbas Corp. (Pvt) Ltd. v. Michael Aziz Oriental Rugs, Inc.*, No. 14 CIV. 6771, 2018 WL 1779380, at *7 (S.D.N.Y. Apr. 3, 2018) (finding conveyance was not made in good faith as part of the "repayment" of a supposed loan, where such "repayment" was part of a fraudulent scheme).

Under this standard, no formal evidence, such as testimony or balance sheets, is required to plead insolvency. *See Ostashko v. Ostashko*, No. 00-CV-7162, 2002 WL 32068357, at *25

(E.D.N.Y. Dec. 12, 2002) ("To establish that a person 'is or will be thereby rendered insolvent,' a plaintiff does not need to adduce formal evidence such as testimony from bankruptcy proceedings or balance sheets to demonstrate a defendant's financial distress."); *see also Uni-Rty Corp.*, 117 A.D.3d at 428–29.

Ares's assertion to the contrary, that "balance sheet information" is "required" to plead insolvency (Ares MOL, p. 3), misrepresents the law by misquoting *Innovative Custom Brands, Inc. v. Minor*, No. 15-2955, 2016 WL 308805, *3 (S.D.N.Y. Jan. 25, 2016). (Ares MOL, p. 9). The actual quote Ares seemingly references – when not re-written by Ares to attempt and fit its flawed legal theory – provides: "For purposes of New York constructive fraudulent conveyance law, insolvency is analogous to the Bankruptcy Code's definition, which requires some sort of 'balance sheet' test or information provided that the Court can use to infer that the corporation's liabilities exceeded their assets at the time the transfers took place." *See In re Trinsum Grp., Inc.*, 460 B.R. 379, 392 (emphasis added).[4] Ares is mistaken in its assertion that "balance sheet" pleading is necessary under New York law.

Further, the "Draft/Unaudited" Balance Sheet relied upon by Ares fails to include significant liabilities of InfiLaw (including millions owed to SCS and the substantial claims of law students who were defrauded by InfiLaw). Similarly, the "Draft/Unaudited" Balance Sheet does not reflect that one of InfiLaw's principal assets, CSL, had closed five months earlier. Instead, the

[4] Ares's repeated contention that SCS "deliberately removed balance sheets" is equally false. (Ares MOL, p. 2). SCS did not attach any of the original attachments to the Thompson affidavit -- as they were voluminous and not necessary to support the admissions made by InfiLaw. Further, the "Draft/Unaudited" alleged balance sheet provided by Ares is neither necessary at this stage nor in any way sufficient at the pleading stage to establish InfiLaw's financial situation at a given time. Moreover, as set out above, ample evidence shows that InfiLaw was insolvent prior to December 2017 and that the "Draft/Unaudited" balance sheet ignores millions in debt owed by InfiLaw.

"Draft/Unaudited" Balance Sheet supports the testimony of InfiLaw's CFO that it had no or minimal unencumbered assets to pay its debts.[5]

Here, the Complaint exceeds the low pleading threshold as SCS adequately alleges that, at a minimum, as of June 2015, InfiLaw was rendered insolvent by Ares's fraudulent scheme. Complaint, ¶¶ 15, 19. SCS further alleges that "the debt and capital structure imposed on InfiLaw by Ares" resulted in the demise of CSL and InfiLaw's inability to pay its debts owed to SCS. *Id.*, ¶ 7. Moreover, SCS alleges that Ares entered into agreements with InfiLaw to, amongst other things, acquire "substantial ownership interest in InfiLaw" (*id.*, ¶ 9), "replace InfliLaw's existing shareholder equity" (*id.*, ¶ 11), which ultimately "saddle[d] InfiLaw with payment obligations to Ares that were unsustainable" (*id.*, ¶ 12), in which "InfiLaw received virtually no financial benefit . . because the funds raised . . . were essentially used to replace the existing shareholder equity" (*id.*). To support this position, SCS referenced, amongst other information, testimony by InfiLaw's Chief Financial Officer indicating that InfiLaw suffered a net loss of approximately $10-12 million in tax years 2015-2016; explained that InfiLaw had to obtain a waiver of certain covenants with Ares to avoid a default in July 2015; and noted that in March 2015 InfiLaw received a demand from the US Department of Justice in connection with potential fraudulent practices. *Id.*, ¶ 14.

B. SCS Adequately Pled The Conveyances Were Made Without Fair Consideration

It is well-settled under New York law that "transfers to a controlling shareholder, officer or director of an insolvent corporation are deemed to be lacking in good faith and are presumptively fraudulent." *See UBS Securities LLC v Highland Capital Management, L.P.*, No. 09-CV-650097,

[5] The "Draft/Unaudited" Balance Sheet also confirms what is alleged in the Complaint and is set out in countless other documents – that Ares's Redeemable Preferred Units, Series A and B stand as "Members' Equity" – not an antecedent debt.

2017 WL 1103879, at *14 (N.Y. Sup. Ct. Mar. 13, 2017) (emphasis added); *Am. Panel Tec v. Hyrise, Inc.*, 31 A.D.3d 586, 587 (2d Dep't 2006) (finding that "preferential transfers of corporate funds to directors, officers, and shareholders of insolvent corporations in derogation of the rights of general creditors do not fulfill the requirement of good faith"); *Farm Stores, Inc. v. Sch. Feeding Corp.*, 102 A.D.2d 249, 254 (2d Dep't 1984). Although Ares acknowledges *UBS Securities LLC* is dispositive (Ares MOL, p. 14), Ares conveniently ignores SCS's allegations that Ares was a controlling shareholder that made preferential transfers. Complaint, ¶¶ 9-10, 20.

Here, SCS alleges that "InfiLaw received virtually no financial benefit" from Ares's payment structure and that "the Ares transactions were structured to milk cash from InfiLaw and its students as quickly as possible." Complaint ¶¶ 12, 20, 22. SCS also alleges that "fair consideration," as that term is used under § 272, was lacking because the conveyances were made to Ares as a shareholder, which amongst other relationships, has "substantial ownership interest" in InfiLaw. *Id.*, ¶¶ 9-10. Moreover, Ares's own motion admits the allegations of the Complaint that some of the payments at issue were dividend payments from InfiLaw. (Ares MOL, p. 5). The payment of dividends when a company is insolvent stands as a fraudulent conveyance. *See Chrysler Capital Corp. v. Century Power Corp.*, 778 F. Supp. 1260, 1273 (S.D.N.Y. 1991) (denying motion to dismiss fraudulent conveyance claims where plaintiff alleged payment of dividend was a fraudulent conveyance which rendered debtor insolvent).

Ares misapplies the DCL when it relies on *Ultramar Energy Ltd. v. Chase Manhattan Bank, N.A.*, 191 A.D.2d 86, 90 (1st Dep't 1993), and argues that the conveyances were made with "fair consideration" because they satisfied an antecedent debt. (Ares MOL, p. 13). An action may be "out of the purview of *Ultramar*" when a complaint alleges that an entity "was rendered insolvent by its activities." *See 265 W. 34th St., LLC v. Chung*, 47 Misc. 3d 1219(A) (N.Y. Sup.

Ct. 2015). Because SCS alleges that InfiLaw was rendered insolvent by the conveyances, *Ultramar* is not applicable to this action. (Ares MOL, pp. 13-14); Complaint ¶¶ 21-22. *See also Holme v. Glob. Minerals & Metals Corp.*, 127 A.D.3d 540, 541 (1st Dep't 2015) (holding that defendant's "preferential repayment of these debts to the individual defendants, who were officers of [defendant] in derogation of the rights of plaintiff, a general creditor, lack 'good faith' as a matter of law"); *RH39 Realty, L.P. v. Parigi Int'l., Inc.*, No. 07-CV-601682, 2010 WL 5642495 (N.Y. Sup. Ct. Dec. 27, 2010) (denying motion to dismiss DCL claims in their entirety and rejecting defendant's antecedent debt excuse by explaining that "preferential transfers of corporate funds to directors, officers, and shareholders of insolvent corporations in derogation of the rights of general creditors do not fulfill the requirement of good faith"); *P.A. Bldg. Co. v. Silverman*, 298 A.D.2d 327, 328 (1st Dep't 2002). Moreover, dividend payments unquestionably fall outside of the scope of *Ultramar*.

Ares also incorrectly relies on the summary judgment decision *Englander Capital Corp. v. Zises*, 60 Misc. 3d 659 (N.Y. Sup. Ct. 2018). (Ares MOL, pp. 2, 14). First, Ares improperly ignores the fact that in *Englander*, this Court denied the defendant's initial motion to dismiss the constructive and intentional fraudulent conveyance claims. *See Englander Capital Corp. v. Zises*, No. 12-CV-156927, 2013 WL 6043722, at *5–6 (N.Y. Sup. Ct. Nov. 14, 2013). Second, there are clearly significant questions of fact at this stage as SCS adequately alleges that Ares was an "insider," and that the conveyances were not disclosed to creditors, despite the liquidity issues InfiLaw faced. There is also a serious question of fact as to whether the varying conveyance amounts (Complaint, ¶ 16), which neither SCS nor this Court can confirm stem from any agreement, let alone to satisfy an antecedent debt. As this Court explained in *Englander*, "[g]ood faith is always essential" in order to constitute "fair consideration" for payment of an antecedent

debt. Thus, SCS's allegations, at a minimum, raise questions of fact as to whether the transfers were made in good faith and whether Ares is an "insider." *See UBS Securities LLC*, 2017 WL 1103879, at *16; *Northpark Assocs., L.P. v. S.H.C. Mergers, Inc.*, 8 A.D.3d 642, 643 (2d Dep't 2004) (finding question of fact as to whether transfer by the defendant judgment debtor to defendant's parent company and sole shareholder was made in good faith, although parent company contended that it was a secured creditor and that the transfer was made in payment of an antecedent debt); *see also Am. Panel Tec*, 31 A.D.3d at 588; *EAC of New York, Inc. v. Capri 400, Inc.*, 49 A.D.3d 1006, 1007 (3d Dep't 2008); *Julien J. Studley, Inc. v. Lefrak*, 66 A.D.2d 208, 215, *aff'd*, 48 N.Y.2d 954 (2d Dep't 1979).

III. SCS Has Adequately Pled The Second Cause Of Action For Fraudulent Conveyance Under DCL § 274

DCL § 274 states: "Every conveyance made without fair consideration when the person making it is engaged or is about to engage in a business or transaction for which the property remaining in his hands after the conveyance is an unreasonably small capital, is fraudulent as to creditors and as to other persons who become creditors during the continuance of such business or transaction without regard to his actual intent."

The Complaint satisfies the pleading requirements for the second cause of action under DCL § 274 by alleging that (1) SCS was a creditor of InfiLaw under a lease; (2) InfiLaw made conveyances to Ares for no consideration; and (3) InfiLaw was insolvent or rendered insolvent by the series of conveyances, as InfiLaw would be unable to pay its debts and obligations as they became due. Complaint, ¶¶ 1, 13-15, 19, 21. Further, the Complaint alleges that the conveyances were made without fair consideration (*see* Section II(B), *supra*), and that the person making it was

engaged or was about to engage in a business or transaction for which the property remaining in his hands after the conveyance was an unreasonably small capital. Complaint, ¶¶ 25, 26.

Ares contends that SCS failed to adequately allege a cause of action under DCL § 274, relying on *In re Operations NY LLC.*, 490 B.R. 84 (Bankr. S.D.N.Y. 2013) and *Innovative Custom Brands, Inc. v. Minor*, No. 15-CV-2955, 2016 WL 308805 (S.D.N.Y. Jan. 25, 2016). (Ares MOL, pp. 16-19). Both cases are distinguishable. In *In re Operations NY LLC*, the plaintiff failed to allege "any facts relating to the Debtor's sales, its ability to generate cash or its ability to pay its debts and sustain itself." 490 B.R. at 98. However, here, SCS alleges that "[t]he effect of these agreements was to saddle InfiLaw with payment obligations to Ares that was unsustainable" and "that the financial drain would result in InfiLaw being unable to pay its debts and obligations as they became due." Complaint, ¶¶ 12, 13. Similarly, in *Innovative Custom Brands*, the DCL § 274 claim was dismissed because the Complaint "allege[d] that the Company had sufficient assets to pay its creditors during the relevant period" and did not provide dates of the transfers. Here, in contrast, SCS alleges insolvency, alleges InfiLaw had insufficient assets, and provides specific dates of the transfers. Complaint, ¶¶ 14-16, 19, 21. Thus, the cases cited by Ares are inapposite.

IV. SCS Has Adequately Pled The Third Cause Of Action For Fraudulent Conveyance Under DCL § 275

DCL § 275 states: "Every conveyance made and every obligation incurred without fair consideration when the person making the conveyance or entering into the obligation intends or believes that he will incur debts beyond his ability to pay as they mature, is fraudulent as to both present and future creditors."

The Complaint satisfies the pleading requirements for the third cause of action under DCL § 275 by alleging that the conveyances were made without fair consideration to a shareholder (Complaint, ¶¶ 20, 29, 30), and that the conveyances were made by a person who intends or

believes that he will incur debts beyond his ability to pay as they mature. Complaint, ¶¶ 1, 29, 30. In addition, SCS alleges the existence and cumulative effect of a series of transactions and course of conduct lowering the standards of the failing law schools after the incurring of debt, onset of financial difficulties, and existence of unpaid creditors. *Id.*, ¶¶ 6, 13-16. The Complaint even goes one step further, by outlining the general chronology of events and transactions of a fraudulent scheme. *Id.*, ¶¶ 5-16.

DCL § 275 does not require proof of an actual intent to defraud. *See Menaker v. Alstaedter*, 134 A.D.2d 412, 413 (2d Dep't 1987); *UBS Sec. LLC v. Highland Capital Mgmt., L.P.*, 30 Misc. 3d 1230(A) (N.Y. Sup. Ct. 2011). Rather, the Complaint need only plead a lack of fair consideration and an element of intent or belief that insolvency will result from the challenged transaction. *See Wall St. Assocs. v. Brodsky*, 257 A.D.2d 526, 528 (1st Dep't 1999).

Circumstances of actual intent to incur debts beyond the ability to pay, for the purposes of DCL § 275, may include: (1) the lack or inadequacy of consideration; (2) the family, friendship or close associate relationship between the parties; (3) the retention of possession, benefit or use of the property in question; (4) the financial condition of the party sought to be charged both before and after the transaction in question; (5) the existence or cumulative effect of a pattern or series of transactions or course of conduct after the incurring of debt, onset of financial difficulties, or pendency or threat of suits by creditors; and (6) the general chronology of the events and transactions under inquiry. *See SungChang Interfashion Co. v. Stone Mountain Accessories, Inc.*, No. 12-CV-7280, 2013 WL 5366373, at *10 (S.D.N.Y. Sept. 25, 2013).

Yet again, Ares "cherry-picks" parts of legal standards to ignore well-established law in a futile attempt to escape liability. For example, Ares inaccurately cites to *Carlyle, LLC v. Quik Park 1633 Garage LLC*, 160 A.D.3d 476 (1st Dep't 2018) to suggest that a source is needed for

all allegations at this pre-discovery phase. (Ares MOL, p. 19). This could not be further from the truth as the threshold to sufficiently plead a claim under DCL § 275 is minimal. *See UBS Sec. LLC*, 30 Misc. 3d 1230(A). Similarly, Ares relies on *In re Trinsum Grp., Inc.*, 460 B.R. 379 (Bankr. S.D.N.Y. 2011) to suggest that SCS fails to allege "the belief that Debtor would not pay its debts had been formed at the time the alleged conveyances were made." (Ares MOL, pp. 19-20). Ares's reliance is again misplaced, as the actual standard discussed in that case was that "the debtor . . . (i) was insolvent at the time of the transfer *or became insolvent as a result of the transfer . . . or* (iii) *intended to incur or believed that it would incur debts beyond its ability to pay as they mature*." *In re Trinsum Grp., Inc.*, 460 B.R. at 388.

Here, SCS has more than sufficiently set forth specific allegations to establish a lack of fair consideration. SCS alleges that Ares is a shareholder–which voids any transfer from having fair consideration–and provides specific dates of when funds were transferred. *Complaint*, ¶¶ 16, 20. SCS also alleges that the "effect of these agreements was to saddle InfiLaw with payment obligations to Ares that were unsustainable" in that it would "require InfiLaw to essentially double the value of [InfiLaw] within six years or face default on its agreements to Ares," and that "as a result of the incredible debt and equity payments that Ares required of InfiLaw, InfiLaw experienced liquidity and operational difficulties." *Id.*, ¶¶ 12-13. Despite the fact that the fraudulent scheme rendered InfiLaw insolvent, Ares continued to extract preferred dividends from InfiLaw without reasonably equivalent value. *Id.*, ¶ 15.

V. SCS Has Adequately Pled The Fourth Cause of Action For Fraudulent Conveyance Under DCL §§ 276 and 276-a

DCL § 276 states: "Every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors." DCL § 276-a allows a

creditor to be awarded attorneys' fees.

SCS satisfies the pleading requirements for the fourth cause of action under DCL §§ 276 and 276-a by alleging that the fraudulent conveyances were made with actual intent to hinder, delay or defraud present or future creditors. Complaint, ¶ 33.

New York courts have held that a DCL § 276 claim is adequately pled by alleging a fraudulent scheme to prove actual intent. *See Marine Midland Bank*, 263 A.D.2d at 383 ("In pleading intentionally fraudulent conveyance . . . plaintiff alleged the overall fraudulent scheme in detail . . . and fraudulent intent is fairly inferred from such details . . . Plaintiff was, therefore, in compliance with CPLR 3016(b)"); *UBS Real Estate Sec., Inc. v. Fairmont Funding Ltd.*, 19 Misc. 3d 1123(A) (N.Y. Sup. Ct. 2008).

Accordingly, SCS properly relies on 'badges of fraud' to prove actual intent. *See Wall St. Assocs.*, 257 A.D.2d at 529. "Among such circumstances [that constitute "badges of fraud"] are: a close relationship between the parties to the alleged fraudulent transaction; a questionable transfer not in the usual course of business; inadequacy of the consideration; the transferor's knowledge of the creditor's claim and the inability to pay it; and retention of control of the property by the transferor after the conveyance." *Id.*[6]

Ares's reliance on *RTN Networks, LLC v. Telco Grp., Inc.*, 126 A.D.3d 477 (1st Dep't 2015) and *Carlyle, LLC v. Quik Park 1633 Garage LLC*, 160 A.D.3d 476 (1st Dep't 2018), to suggest this claim fails "as a matter of timing," is misplaced. (Ares MOL., p. 11). In *RTN*, the plaintiff was suing pursuant to a judgment and the court found that the transaction at issue occurred

[6] Ares confuses the standard under CPLR 3016(b) with an even higher–and incorrect–all-knowing standard. (Ares MOL, p. 12). However, when "such information is likely exclusively in the knowledge of the [Defendant]," there is no requirement for SCS to plead such information. *See 1424-1428 Realty LLC*, 169 A.D.3d at 587 (1st Dep't 2019); *Marcus v. Hemphill Harris Travel Corp.*, 193 A.D.2d 543, 544 (1st Dep't 1993).

before the judgment was obtained. *See RTN Networks, LLC,* 126 A.D.3d at 478. Here, SCS is suing to recover a debt that is a result of a fraudulent scheme and its causes of action are not based solely on the date the Judgment was obtained. Complaint, ¶¶ 5-34. Indeed, SCS could not have obtained a judgment until after the conveyances were made because they rendered InfiLaw insolvent. Similarly, in *Carlyle*, the plaintiff was a judgment creditor who failed to plead fraudulent intent; in addition, the plaintiff in that case alleged a completely different kind of fraudulent scheme relating to misrepresentation. *See Carlyle, LLC v Quik Park 1633 Garage LLC*, No. 15-CV-653347, 2016 WL 7338330, at *2 (N.Y. Sup. Ct. Dec. 15, 2016). The Complaint does not present a similar timing issue, as it adequately explains that the fraudulent scheme had been ongoing for an extended period of time and not just immediately in relation to a judgment obtained by SCS. Complaint, ¶ 33.

Here, SCS has sufficiently alleged "badges of fraud" to sustain a DCL §§ 276 and 276-a claim. First, SCS alleges that Ares has a close relationship with InfiLaw. Complaint, ¶¶ 7, 9-13. Second, SCS alleged specific facts to establish a fraudulent scheme intent on hindering, delaying or defrauding, including: the conveyances were not disclosed to creditors, despite the liquidity issues faced by InfiLaw (Complaint, ¶ 33(a)); 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 (*id.*, ¶ 33(b)); InfiLaw essentially received no value for the conveyances (*id.*, ¶ 33(c)); InfiLaw became or was insolvent at the time of the conveyances (*id.*, ¶ 33(d)); and the conveyances occurred shortly after a substantial debt was incurred by Infilaw (*id.*, ¶ 33(e)). Accordingly, Ares's attempt to differentiate its fraud against its students and InfiLaw from its fraud against SCS, is essentially an effort to remove pieces of the puzzle of a fraudulent scheme. (Ares MOL, p. 12 at fn. 19). The fraud against CSL's students–

CSL's financial source–is directly a part of the larger fraudulent scheme against SCS and a "badge of fraud" that demonstrates InfiLaw's knowledge of SCS's claim and the inability to pay it. Complaint, ¶¶ 12-14, 33. Thus, the Complaint sufficiently sets forth an actual intent to hinder, delay or defraud by alleging a fraudulent scheme and various "badges of fraud."

Furthermore, at this pre-discovery stage, because SCS sufficiently alleges claims of constructive fraud, fraudulent intent under § 276 may be inferred. *See ABN AMRO Bank, N.V. v. MBIA Inc.*, 17 N.Y.3d at 228.

VI. At A Minimum, SCS Is Entitled To Amend The Complaint

SCS has sufficiently alleged four distinct causes of action against Ares under DCL §§ 273-276 based on Ares's fraudulent scheme as a majority stakeholder to defraud creditors. However, should the Court determine that more specificity is required, SCS respectfully requests leave to amend the Complaint.

Leave to amend a pleading, pursuant to CPLR 3025(b), should be freely granted provided there is no prejudice or surprise to the non-moving party. *See McCaskey, Davies & Assocs., Inc. v. New York City Health & Hosps. Corp.*, 59 N.Y.2d 755, 757 (1983). As the case is in an early stage, and discovery between Ares and SCS has not yet commenced, any amendment would not prejudice Ares. Further, because the amendment would be premised on the same facts and circumstances, it would not surprise nor prejudice Ares.

CONCLUSION

For all of the reasons set forth above, SCS respectfully requests that the Court deny Ares's motion to dismiss in its entirety and grant SCS such further relief as this Court deems just and proper.

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CERTIFICATE OF COMPLIANCE

I hereby certify that the foregoing Memorandum of Law complies with the word count limitations set forth in Rule 17 of the Rules of the Commercial Division of the Supreme Court. This Memorandum of Law uses Times New Roman 12-point typeface and contains 6,803 words, excluding parts of the document exempted by Rule 17.

/s/ Matthew J. Aaronson
Matthew J. Aaronson