SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: HON. JENNIFER G. SCHECTER **PART** IAS MOTION 54EFM

Justice

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SOUTH COLLEGE STREET, LLC,

Plaintiff,

- v -

ARES CAPITAL CORPORATION,

Defendant.

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INDEX NO. 655045/2019

MOTION DATE

MOTION SEQ. NO. 002

DECISION & ORDER ON MOTION

The following e-filed documents, listed by NYSCEF document number (Motion 002) 26, 27, 28, 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 44, 45, 46

were read on this motion to/for DISMISS.

Defendant Ares Capital Corporation (Ares) moves to dismiss the complaint. Plaintiff South College Street, LLC (South College) opposes the motion. The motion is granted.

Background

The following facts are drawn from the complaint (Dkt. 25) and documentary evidence.

InfiLaw Corporation (the Debtor) is a subsidiary of InfiLaw Holding, LLC (Holdco). In October 2012, the Debtor guaranteed the lease of its subsidiary, Charlotte School of Law, LLC (CSL), which operated a for-profit law school in North Carolina (*see* Dkt. 34). In April 2015, plaintiff purchased the property subject to the lease and became CSL's landlord. CSL stopped paying rent in October 2017 and, in January 2018, plaintiff commenced a North Carolina action against CSL and the Debtor to enforce the lease and

the guaranty (*see* Dkt. 32). In February 2019, plaintiff obtained a judgment against CSL and the Debtor, jointly and severally, in the amount of $24.55 million (*see* Dkt. 3 at 4).

In September 2019, plaintiff commenced this action alleging that, between June 2015 and August 2016, more than $32 million was fraudulently conveyed to Ares. Plaintiff seeks to enforce its judgment against the Debtor by setting aside those conveyances. Significantly, although plaintiff lists the dates and amounts of transfers to Ares, it does not plead who made any of them, which is critical to assessing the viability of its claims (Complaint ¶ 16 ["Between June 2015 and August 2016, transferred $34,225,114.00 to Ares"]). In fact, throughout the complaint, plaintiff lumps the Debtor and Holdco together, referring to them as "InfiLaw."

Ares moves to dismiss on the ground that plaintiff has not stated a New York Debtor and Creditor Law (DCL) claim. It contends, among many other things, that the money it received from the Debtor was on account of secured debt and that plaintiff has no right to challenge conveyances that Holdco made because South College does not plead either that Holdco is obligated to pay it anything or a theory under which Holdco's transfers may be attacked. In opposition, plaintiff contends that because Holdco and the Debtor – both of which are Delaware entities[1] – are alter egos, it can assert DCL claims as to all of the transfers. But it has not alleged that Holdco or the Debtor were created or operated as shams to defraud creditors as opposed to having a typical parent-subsidiary relationship with distinct existences for the legitimate purpose of limiting their liability; therefore, its

[1] Holdco is an LLC while the Debtor is a corporation. No one argues that the veil-piercing inquiry turns on the nature of the entity.

claims must be dismissed. And with respect to the portion of the transfers that may have been made by the Debtor (*see* Dkt. 27 at 6 [the Secured Debt Payments]), the DCL claims are insufficiently pleaded because they were in satisfaction of an antecedent secured debt.

Discussion

On a motion to dismiss, the court must accept as true the facts alleged in the complaint and all reasonable inferences that may be gleaned from them (*Amaro v Gani Realty Corp.*, 60 AD3d 491 [1st Dept 2009]). The court is not permitted to assess the merits of the complaint or any of its factual allegations, but may only determine if, assuming the truth of the facts alleged and the inferences that can be drawn from them, the complaint states the elements of a legally cognizable cause of action (*Skillgames, LLC v Brody*, 1 AD3d 247, 250 [1st Dept 2003], citing *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 [1977]). If the defendant seeks dismissal of the complaint based upon documentary evidence, the motion will succeed only if "the documentary evidence utterly refutes plaintiff's factual allegations, conclusively establishing a defense as a matter of law" (*Goshen v Mutual Life Ins. Co. of N.Y.*, 98 NY2d 314, 326 [2002]).

Ordinarily, DCL claims may only be asserted by creditors of the transferor (*Matter of Application of City of Syracuse Indus. Dev. Agency*, 156 AD3d 1329, 1332 [4th Dept 2017], citing *Eberhard v Marcu*, 530 F3d 122, 129-31 [2d Cir 2008] ["It is well settled that in order to set aside a fraudulent conveyance, one must be **a creditor of the transferor** … Fraudulent conveyances are binding on all non-creditors"] [emphasis added]; *see Federal Deposit Ins. Corp. v Porco*, 75 NY2d 840, 842 [1990] [DCL provides a "creditor's remedy for the transfer of **its debtor's** assets] [emphasis added]). However, as with any cause of

action, DCL liability may be extended to alter egos (*Cortlandt St. Recovery Corp. v Bonderman*, 31 NY3d 30, 50 [2018]; *see 2406-12 Amsterdam Assocs. LLC v Alianza LLC*, 136 AD3d 512, 513 [1st Dept 2016]). Alter ego liability requires piercing the corporate veil, which is an exception to the presumption that corporate entities are distinct from their owners "and that it is perfectly legal to incorporate for the express purpose of limiting the liability of the corporate owners" (*Matter of Morris v New York State Dept of Taxation & Fin.*, 82 NY2d 135, 140 [1993]).

Whether veil piercing is warranted, is governed by the law of the state of incorporation of the entities whose veils are sought to be pierced (*Gristede's Foods, Inc. v Madison Capital Holdings LLC*, 174 AD3d 455, 456 [1st Dept 2019], citing *Klein v CAVI Acquisition, Inc.*, 57 AD3d 376, 377 [1st Dept 2008]). Here, both the Debtor and Holdco are Delaware entities, so Delaware law governs (*see MMA Meadows at Green Tree, LLC v Millrun Apartments, LLC*, 130 AD3d 529, 530 [1st Dept 2015]).

Under Delaware law, "to state a 'veil-piercing claim,' the plaintiff must plead facts supporting an inference that the corporation, through its alter-ego, **has created a sham entity designed to defraud investors and creditors** (*Crosse v BCBSD, Inc.*, 836 A2d 492, 497 [Del 2003] [emphasis added]). This is difficult to do (*Wallace v Wood*, 752 A2d 1175, 1183 [Del Ch 1999] ["Persuading a Delaware court to disregard the corporate entity is a difficult task"]). In addition to showing a parent's domination over its subsidiary, the corporate structure itself must have been used to cause a "fraud or similar injustice" (*see id.* at 1184). "Effectively, the corporation must be a sham and exist for no other purpose than as a vehicle for fraud" (*id.*; *see Pensmore Investments, LLC v Gruppo, Levey & Co.*,

143 AD3d 588 [1st Dept 2016] ["defendants used a variety of corporate entities and accounts to collect and disburse money to themselves and the various corporate entities without consideration or corporate formalities, and . . . used this web of payments to keep the judgment debtor corporation in business but grossly undercapitalized by paying its debts without putting any funds into it"]).[2]

Pensmore, which applied Delaware law, is instructive. There, the court explained that to satisfy "the so-called 'fraud' prong of the veil piercing standard, the plaintiff must prove more than domination and disregard of corporate formalities" (2017 WL 1281815, at *7 [Sup Ct, NY County Apr. 6, 2017], citing *EBG Holdings LLC v Vredezicht's Gravenhage*, 2008 WL 4057745, at *12 [Del Ch Sept. 2, 2008] ["the requisite element of fraud under the alter ego theory must come from an inequitable use of the corporate form itself as a sham, and not from the underlying claim"] [emphasis added]). The veil piercing claim in *Pensmore* went forward because there was evidence that the owners of the debtor company were operating the business through alter ego companies specifically to keep the debtor company a judgment proof shell (*see id.*), and, at trial, those claims were proven (*see* 2019 WL 2106091, at *6-8 [Sup Ct, NY County May 14, 2019]).

Here, by contrast, plaintiff does not allege facts permitting a reasonable inference that the corporate structure of Holdco and the Debtor was designed to defraud the Debtor's creditors (*see Capone v Castelton Commodities Intl. LLC*, 148 AD3d 506, 507 [1st Dept

[2] The outcome would be the same under New York law (*Tap Holdings, LLC v Orix Fin. Corp.*, 109 AD3d 167, 174 [1st Dept 2013]; *see TNS Holdings, Inc. v MKI Secs. Corp.*, 92 NY2d 335, 339 [1998] ["Evidence of domination alone does not suffice without an additional showing that it led to inequity, fraud or malfeasance"]).

2017] [allegations insufficient to support veil-piercing claim "especially in light of . . . concession that the entities were established for a legitimate business purpose"]). While plaintiff alleges that Holdco dominates and controls the Debtor, that is not enough. Rather, plaintiff must plead, for instance, that the capital structure of Holdco and the Debtor was specially designed to ensure the Debtor's creditors would be left seeking to collect from an empty shell. Nothing of the sort is alleged (*see MMA*, 130 AD3d at 530 ["The record does not support an inference that (the companies) are sham entities designed to defraud investors and creditors"]). The closest plaintiff comes is its claim that the debt structure pursuant to which the underlying fraudulent conveyances were made left CSL destined to fail (which, presumably, would doom the Debtor's prospects). This scheme, allegedly, involved asset stripping by imposing unrealistic payment obligations on Holdco that incentivized it to manage the law school recklessly, risking its accreditation and ultimately leading to its eventual failure. Yet, even if this were true, the fraud prong of a veil piercing claim must rely on something other than merits of the underlying claim on which alter ego liability is sought (*see Vredezicht's Gravenhage*, 2008 WL 4057745, at *12). Thus, plaintiff cannot rely on its DCL claims to establish the fraud prong. Instead, it must plead other facts showing that the way in which Holdco and Debtor were structured and operated was designed to defraud creditors. Not only is the current complaint devoid of such allegations, plaintiff actually continued to receive rent, totaling approximately $13.5 million, after the allegedly fraudulent conveyances began (*see* Dkt. 27 at 6-7). That is not exactly the hallmark of a shell game and, in the parlance of the DCL, is seemingly an inverse badge of fraud.

To be sure, plaintiff may well be capable of pleading veil piercing but overlooked the fraud prong. Though the court will not permit an amended complaint based on the request made in plaintiff's opposition brief, which does not specifically explain how it would cure its pleading deficiencies or attach a proposed amendment (CPLR 3212[b]; *see Moore Charitable Found. v PJT Partners, Inc.*, 178 AD3d 433, 434 [1st Dept 2019]), as set forth below, plaintiff will be given the opportunity to make a proper motion for leave to amend prior to the action being dismissed with prejudice.

Plaintiff may also seek leave to amend its claims concerning the Secured Debt Payments. These payments were made to satisfy an antecedent secured debt to Ares, which ordinarily cannot support a DCL claim by an unsecured creditor even if the secured creditor was an insider (*Englander Capital Corp. v Zises*, 60 Misc 3d 659, 664 [Sup Ct, NY County 2018]; *see Korea Trade Ins. Corp. v Neema Clothing, Ltd.*, 2015 WL 363569, at *2 [SDNY Jan. 28, 2015]). To survive a subsequent motion to dismiss the amended complaint must expressly allege who made the transfer and specific facts must be alleged to support an argument that an exception to *Englander* applies (*see Northpark Assocs., L.P. v S.H.C. Mergers, Inc.*, 8 AD3d 642, 644 [2d Dept 2004], citing *Rebh v Rotterdam Ventures Inc.*, 252 AD2d 609, 611 [3d Dept 1998]).

Accordingly, it is

ORDERED that defendant's motion to dismiss the complaint is granted without prejudice to plaintiff moving, by July 15, 2020, for leave to file an amended complaint that addresses the issues raised herein; and it is further

ORDERED that if plaintiff does not move for leave to amend by July 15, 2020, the claims will be dismissed with prejudice.

6/15/2020
DATE

JENNIFER G. SCHECTER, J.S.C.

CHECK ONE:		CASE DISPOSED			X	NON-FINAL DISPOSITION	
	X	GRANTED		DENIED		GRANTED IN PART	OTHER
APPLICATION:		SETTLE ORDER				SUBMIT ORDER	
CHECK IF APPROPRIATE:		INCLUDES TRANSFER/REASSIGN				FIDUCIARY APPOINTMENT	REFERENCE