IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re: NOBILIS HEALTH CORP., *et al.*, Debtors.	Chapter 11 Case No. 19-12264 (CTG) (Jointly Administered)
ALFRED T. GIULIANO, in his capacity as Chapter 7 Trustee for the jointly administered bankruptcy estates of Nobilis Health Corp., *et al.*, Plaintiff, v. HARRY J. FLEMING, *et al.*, Defendants.	Adv. Pro. No. 21-51183 (CTG) **Related Docket Nos. 16, 18, 22, 24, 26, 28, & 31**

MEMORANDUM OPINION

Plaintiff Alfred T. Giuliano, in his capacity as Chapter 7 trustee for the debtors' bankruptcy estates,[1] filed a complaint against former directors and officers of the various debtors, which are alleged to have owned and operated surgical facilities and clinics. In broad strokes, the complaint faults the defendants for two categories of problems. *First*, the complaint points to operational deficiencies, such as regularly missing appeal deadlines in recovering insurance reimbursements, providing insufficient operational support for the company's billing and collection activity, and

[1] The debtors are Northstar Healthcare Holdings, Inc., Northstar Healthcare Acquisitions, L.L.C., and Nobilis Health Corp.

having insufficient procedures, controls, and monitoring. *Second* (and, it is alleged, as a result of the first set of failures), the complaint alleges that the company adopted an inappropriate accounting practice under which receivables that could not be collected continued to be carried on the company's books as assets. As a result of that practice, the complaint alleges, the company's financial statements misstated its actual financial condition, and creditors were thus defrauded into extending credit. From these events, the complaint asserts claims for (i) breach of fiduciary duties, (ii) corporate waste, and (iii) common law fraud.[2]

Defendants move to dismiss the complaint, arguing that the allegations are insufficient to state causes of action on the trustee's three theories. For the reasons described below, the Court will deny the motion dismiss the claim for breach of fiduciary duty but will grant the motion to dismiss the claims for corporate waste and common law fraud (though without prejudice).

In addition, Watt moves to dismiss the complaint against her on the ground that it does not allege facts sufficient to support the exercise of personal jurisdiction over her. The Court is persuaded that the facts as alleged are insufficient to support the exercise of personal jurisdiction over Watt. The claims against her will thus be dismissed in their entirety, but also without prejudice to repleading.

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[2] The defendants are: (i) Harry J. Fleming, (ii) P. David Young, (iii) Brandon Moreno, (iv) Kenneth Efird, (v) James Springfield, (vi) Donald Kramer, (vii) Steve Ozonian, (viii) Susan Watt, (ix) Tom Foster, (x) Peter Horan, (xi) Samuel Palermo, and (xii) Marcos Rodriguez. Each is alleged, in paragraphs 13-24 of the Complaint (which is docketed at D.I. 1, and referred to as the "Complaint"), to have served as either a director, an officer, or both of one or more of the debtors.

Factual Background

The debtors owned and operated over 30 surgical facilities and clinics throughout Texas and Arizona, providing a variety of surgical procedures directly to consumers.[3] In 2014, the debtors, who were until then a generally profitable enterprise, sought to expand their operations. To finance the expansion plans, the debtors obtained an $82.5 million credit facility in 2016 and a $50 million term loan in 2017 from various lenders.

The debtors' facilities were, by and large, out-of-network service providers for their patients. Because a significant portion (87% in the first two quarters of 2016) of the debtors' revenue was from out-of-network insurance benefits, and third-party payors can deny coverage for out-of-network procedures for a variety of reasons, Nobilis was required to pursue outstanding payments directly from patients to the extent insurance claims for procedures were denied by carriers.

The debtors' accounting practice, however, was to recognize revenue on the date they provided service to a patient. In view of the risk that Nobilis might not be able actually to collect the full amount billed, Nobilis' accounting convention was to realize the estimated net realizable amount – an amount the debtors expected to collect based on historical data for a given patient, medical procedure, and current economic conditions[4] – at the time the services were provided.

[3] Complaint ¶ 25. As Fed. R. Civ. P. 8(a) (made applicable hereto by Fed. R. Bankr. P. 7008) requires, the facts set forth herein are based on the allegations made in the complaint, which are taken as true for the purpose of considering the pending motions to dismiss.

[4] *Id.* ¶ 29.

When Nobilis recognized revenue before it collected payment, it recorded an account receivable on its balance sheet. These accounts receivable served as the primary collateral for the debtors' loans from lenders.[5] Nobilis' ability to service those loans, however, depended on its ability actually to collect the accounts receivable.

Historically, the debtors did not keep receivables that were more than a year old on their balance sheet. Before 2017, the company collected nearly all of the revenue it had recognized. And to the extent there were receivables still on the company's books that were more than a year old, the practice was to write off the receivable as a bad debt expense, even though the company continued to engage in collection efforts.[6]

The Complaint alleges, however, that things changed in mid-2017. As the company grew, its ability to collect its accounts receivable apparently diminished.[7] By December 2017, the debtors' receivables that were more than a year old significantly increased to over $20 million, which management attributed to "problems with the operating environment of Nobilis' facilities and Nobilis' revenue cycle department."[8]

The trustee alleges that the "first stage" of the debtors' misconduct – alleged operational deficiencies – included the debtors' decision to move collection efforts in-house as a cost-saving measure, without establishing the systems and procedures necessary to collect those receivables.[9] The alleged operational failings also included

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[5] *Id.* ¶ 30.

[6] *Id.* ¶ 31.

[7] *Id.* ¶ 32.

[8] *Id.* ¶¶ 31-32.

[9] *Id.* ¶¶ 45-52.

the debtors' failure to seek reimbursement for out-of-network claims from insurers (or pursue appeals from denials) within the relevant timeframes.[10]

The alleged "second stage" of the debtors' misconduct arose out of a change in the debtors' accounting policies. Specifically, the trustee alleges that as the company's financial situation deteriorated, it changed its accounting practice (a change that the debtors allegedly did not disclose to their outside accounts) so that receivables that were more than a year old, rather than being written off, would be carried on their books at a 25% discount to the gross charge amount (thus assuming that the company would collect 75% of the old receivables). The trustee further alleges that the directors and officers knew there was no basis for valuing the receivables that were more than a year old at a 25% discount.[11]

The result of this practice, the trustee alleges, is that the debtors' financials were materially misleading, and that the representations made to lenders in connection with the company's borrowings were therefore false. For example, the trustee points out that during a quarterly earnings call, the debtors stated to investors that they "expect[ed] to collect everything that's on the balance sheet."[12] The complaint alleges that these

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[10] *Id.* ¶¶ 36-44. Aetna, for example, required that appeals be filed within 180 days from claim denial. United Healthcare required that appeals be filed within 12 months from claim denial. The trustee alleges that Aetna and United Healthcare accounted for approximately 54% of the debtors' payor mix. *Id.* ¶ 36. Therefore, the failure to seek reimbursement in a timely fashion would have significant consequences for the debtors.

[11] *Id.* ¶¶ 34-38; 45-52.

[12] *Id.* ¶ 70.

statements were false, and that the defendants knew the financial statements prepared and provided to creditors grossly overvalued the outstanding accounts receivable.[13]

When the truth ultimately came out, the company was required to write down more than $72 million of its outstanding accounts receivable.[14] On September 3, 2019 the company became the subject of delisting procedures by the New York Stock Exchange. Nobilis commenced these bankruptcy proceedings on October 21, 2019.

Jurisdiction

The Court has subject-matter jurisdiction over this adversary proceeding pursuant to 28 U.S.C. § 1334 as a matter "related to" a bankruptcy proceeding.[15] The U.S. District Court for the District of Delaware has referred such cases, as authorized by 28 U.S.C. § 157(a), to this Court under its February 29, 2021 standing order.[16]

Analysis

Rule 8(a)(2) of the Federal Rules of Civil Procedure, applicable to this bankruptcy proceeding by Bankruptcy Rule 7008, requires that a complaint contain a "short and plain statement of the claim[s] showing that the pleader is entitled to relief."[17] The aim

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[13] *Id.* ¶¶ 46-52, 68-70.

[14] *Id.* ¶¶ 67-71.

[15] *In re MPC Computers, LLC*, 465 B.R. 384, 392 (Bankr. D. Del. 2012) (applying "conceivable effect" test and determining an adversary proceeding is "related to" a bankruptcy case, so as to fall within a bankruptcy court's "related to" jurisdiction, if the outcome could alter debtor's rights, liabilities, options, or freedom of action, either positively or negatively, and in any way impact the handling and administration of the estate) (citing *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984)).

[16] *Amended Standing Order of Reference*, dated Feb. 29, 2012.

[17] Fed. R. Civ. P. 8(a)(2); *see also Connelly v. Lane Construction Corp.*, 809 F.3d 780, 786 (3d Cir. 2016) (explaining that a complaint may be dismissed for failure to state a claim, but that the complaint need not contain a "detailed pleading" to survive a motion to dismiss).

of this rule is to provide defendants with fair notice of the claims alleged against them such that they can put forth an adequate defense. Factual allegations in a complaint need not be detailed but must provide notice to the defendants "as to the basics of the complaint" and set forth fact-based allegations that extend beyond thread-bare assertions and conclusory accusations.[18]

When considering a motion to dismiss courts employ a plausibility standard—a plaintiff must allege sufficient facts to nudge the claims across the line from conceivable to plausible.[19] A motion to dismiss is an attack on the sufficiency of the allegations in a complaint, which are taken as true, with all reasonable inferences drawn in favor of the non-moving party. The Third Circuit has set forth a three-step process governing a court's consideration of a motion to dismiss: (i) identify the elements of the claim alleged by the plaintiff, (ii) identify and separate the well-pleaded facts from legal conclusions, and (iii) accepting all factual allegations as true and construing the complaint in the light most favorable to the plaintiff, determine whether under any reasonable reading of the complaint the plaintiff may be entitled to relief.[20]

I. The complaint states a claim for breach of fiduciary duty.

In this action in which jurisdiction falls within the Court's related-to jurisdiction, the first question is which jurisdiction's substantive law governs the claim. This Court's opinion in *Art Institute* addresses the analytic framework for considering choice of law

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[18] *In re DBSI, Inc.*, 445 B.R. 351, 354-355 (Bankr. D. Del. 2011); *see also Ashcroft v. Iqbal*, 556 U.S. 662, 676 (2008) (citing *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007)).

[19] *Twombly*, 550 U.S. at 570.

[20] *Crystallex Int'l Corp. v. Petróleos De Venezuela, S.A.*, 879 F.3d 79, 83 n.6 (3d Cir. 2018); *see also Fowler v. UPMC Shadyside*, 578 F.3d 203, 206 (3d Cir. 2009).

in this context.[21] The upshot of that analysis is that (under any of the potentially applicable choice of law principles) the internal affairs doctrine will point to the law of the jurisdiction under which the applicable entity was organized as providing the substantive rule of decision for a claim of breach of fiduciary duty.

This case involves three debtors – one organized under the laws of British Columbia, Canada and two organized under Delaware law.[22] The complaint is not particularly precise in alleging that defendants served as directors or officers of specific debtor entities – describing these three separate legal entities collectively as "Nobilis." While painting with such a broad brush may be less than ideal when a trustee files suit against a defendant alleging that he or she violated a duty that runs to a particular legal entity, the imprecision turns out to be harmless enough here, as all parties apparently agree that the substantive obligations of officers and directors are the same under British Columbia law as under Delaware law.[23]

Under Delaware law, corporate directors and officers owe fiduciary duties to the corporation they serve.[24] The fiduciary duties of corporate officers are the same as those

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[21] *In re The Art Institute of Philadelphia LLC*, No. 20-50627 (CTG) (Bankr. D. Del. Jan. 12, 2022), D.I. 87 at 11-15.

[22] Complaint ¶¶ 10-12.

[23] Because the parties rely on Delaware law throughout their briefs, this Memorandum Opinion follows suit and addresses the issue as one of Delaware law. D.I. 37 at 9 n.6.

[24] *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939); *Anadarko Petrol. Corp. v. Panhandle E. Corp.*, 545 A.2d 1171, 1174 (Del. 1988); *see also In re HH Liquidation, LLC*, 590 B.R. 211, 271-272 (Bankr. D. Del. 2018) (recognizing that, in Delaware, a parent company does not owe a fiduciary duty to its direct or indirect subsidiaries, and that directors of a parent corporation do not owe fiduciary duties to subsidiary corporations); *Trenwick Am. Litig. Tr. v. Ernst & Young, LLP*, 906 A.2d 168, 173-174 (Del. Ch. 2006) (same).

of corporate directors.[25] A fiduciary owes the duty of care and the duty of loyalty. The duty of care requires that directors inform themselves, before making a business decision, of all the material information reasonably available to them.[26] Directors may be considered informed of all material information depending on the sufficiency of the opportunities the fiduciary had to acquire the knowledge concerning the problem before acting.[27] The duty of loyalty requires a fiduciary to avoid personal economic conflict. Corporate directors and officers are not permitted to use their position of trust and confidence to further their private interest.[28]

The elements of a breach of fiduciary duty claim under Delaware law are (i) that the fiduciary duty exists, and (ii) that the fiduciary breached that duty.[29] When directors fail to act in the face of a known duty to do so, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith.[30] The fiduciary duty of care requires that directors and officers of a Delaware corporation both (i) use that

[25] *Gantler v. Stephens*, 965 A.2d 695, 708-709 n.36 (Del. 2009); *see also In re Greater Southeast Cmty. Hosp. Corp.*, 353 B.R. 324, 339 (Bankr. D.D.C. 2006) ("With respect to the obligation of officers to their own corporation and its stockholders, there is nothing in any Delaware case which suggests that the fiduciary duty owed is different in the slightest from that owed by directors.").

[26] *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985).

[27] *Moran v. Household Intern., Inc.*, 490 A.2d 1059, 1075 (Del. 1985).

[28] *Guth*, 5 A.2d at 510.

[29] *In re PennySaver USA Publishing, LLC*, 587 B.R. 445, 463-464 (Bankr. D. Del. 2018) (citing *In re Tropicana Entertainment, LLC*, 520 B.R. 455, 470 (Bankr. D. Del. 2014)).

[30] *In re Bridgeport Holdings, Inc.*, 388 B.R. 548, 563-564 (Bankr. D. Del. 2008).

amount of care which an ordinarily careful and prudent person would use in similar circumstances, and (ii) consider all material information reasonably available.[31]

The Delaware Chancery Court has articulated the legal standard governing a claim asserting that a fiduciary failed adequately to oversee or supervise corporate operations.[32] To state such a claim, a plaintiff must allege (i) that directors utterly failed to implement any reporting or information system or controls, or (ii) having implemented such a system or controls, consciously failed to monitor or oversee its operations, thus disabling themselves from being informed of risks or problems requiring managerial attention.[33]

The complaint must allege facts establishing a decision that is so unreasonable that it is "essentially inexplicable on any ground other than bad faith."[34] A court considering a *Caremark* claim must first analyze the information system or controls that the Board implemented, and second, examine the pleading for facts suggesting that the Board consciously failed to monitor or oversee operations.[35] Facts demonstrating that

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[31] *Id.* at 568-569 (citing *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 749 (Del. Ch. 2005)).

[32] *In re Caremark Intern. Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996); *see also Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006) (Delaware Supreme Court endorsing the *Caremark* analysis framework); Colombo, Ronald J., LAW OF CORPORATE OFFICERS & DIRECTORS: RIGHTS, DUTIES & LIABILITIES § 3.3 (2021-2022) (collecting cases).

[33] *In re AgFeed USA, LLC*, 558 B.R. 116, 126-127 (Bankr. D. Del. 2016) (citing *Stone*, 911 A.2d at 370); *see also In re World Health Alternatives, Inc.*, 385 B.R. 576, 591-592 (Bankr. D. Del. 2008) (explaining that *Caremark* expressly referred to both corporate boards and senior officers in its analysis and reasoning that *Caremark* itself suggests the same test for oversight liability applies to officers as it applies to directors).

[34] *In re AgFeed*, 558 B.R. at 126.

[35] *In re Liquid Holdings Group, Inc.*, No. 16-10202 (KG), 2018 WL 2759301, at *14 (Bankr. D Del. June 6, 2018).

a director or officer observed certain “red flags” but knowingly disregarded them such that they completely disabled themselves from being informed of risks or problems are generally deemed sufficient for the purposes of a *Caremark* claim.[36]

The trustee alleges breach of fiduciary duties against all defendants, arguing by virtue of their role as directors and officers of the debtors, the defendants owed fiduciary duties to the debtors, including the duties of care, loyalty, and good faith.[37] The defendants do not contest that, as directors and officers of the debtors, they owed fiduciary duties to the entities for which they served as directors and officers.

The trustee asserts that each of the defendants breached their fiduciary duties by:

(a) failing to implement reporting or information systems or controls to fully and accurately report and effectively monitor the debtors’ financial condition;

(b) failing to provide accurate and complete financial statements reflecting the debtors’ true financial condition;

(c) failing to ensure the debtors’ financial statements properly reserved for uncollectable receivables and fully and accurately disclosed the collectability and net realizable value of accounts receivable;

(d) failing to ensure the debtors engaged in appropriate billing, collection, and accounting practices;

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[36] *Id.*

[37] Complaint ¶ 89.

(e) failing to ensure the debtors and their staff had the operational capability and training to handle collections and appeals; or that appropriate industry standards, practices, and procedures were implemented;

(f) failing to put in place appropriate internal controls to detect and address issues with billing practices and collection efforts; and

(g) causing the debtors to make misrepresentations to lenders and others concerning the company's true financial condition, collections, and accounts receivable.[38]

The trustee concludes that because of the above breaches the company suffered tens of millions of dollars in losses from uncollectable accounts receivable, incurred debt that it would be unable to pay, and ultimately collapsed into bankruptcy. The trustee further asserts in the complaint that the director defendants abdicated their roles through intentional ignorance and/or willful blindness toward the operational deficiencies, system failures, and improper accounting.[39]

There is no serious challenge to the trustee's *theory* that the various actions and inactions, set forth in paragraphs (a) through (g), above, are sufficient to state a claim for breach of fiduciary duty under Delaware law. The claim is, in substantial part, a *Caremark* claim for failure adequately to supervise the debtors' billing and collections practices and its accounting function. But where the complaint alleges the affirmative making of false statements regarding the company's financial condition, it also states a

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[38] *Id.* ¶¶ 95-96.

[39] *Id.* ¶¶ 97-100.

claim for direct conduct by the defendants that were inconsistent with their fiduciary duties.[40]

The gravamen of the pending motions to dismiss is that the complaint fails adequately to allege specific acts by specific defendants that amount to such breaches of their fiduciary duties. And for the purposes of the *Caremark* claim (for failure to oversee corporate operations), the complaint fails to allege specific "red flags" that ought to have alerted particular defendants to those failures in the corporate systems.

To be sure, the complaint does identify each defendant and describes his or her role with the company (though, as described above, it uses the name "Nobilis" to describe three separate legal entities).[41] And the complaint also does contain *some* allegations of specific conduct of particular defendants. For example, the complaint alleges that Moreno (the Chief Financial Officer) was informed by a physician that his attorney considered aspects of the company's billing practices (specifically, the practice of "split billing," which involved the creation of separate claims that would be submitted to insurers for incidental procedures) to be illegal.[42] That is, by any standard, a sufficient "red flag" to support a *Caremark* claim.

But most of the specific allegations regarding conduct by individual defendants are made not in the complaint itself, but in a separate complaint that one of the lenders

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[40] *In re Pitt Penn Holding Co.*, 484 B.R. 25, 55 (Bankr. D. Del. 2012) (claim that head of investor relations knew or should have known that company's public statements were false are "sufficient under the applicable pleading standards" to state a claim for breach of fiduciary duty).

[41] Complaint ¶¶ 13-24.

[42] *Id.* ¶ 62.

filed against Fleming, Young, and Moreno, which was attached as an exhibit to, and is quoted liberally in, the trustee's complaint. And while the trustee asserts, relying on Federal Rule of Civil Procedure 10(c),[43] that a written instrument that is an exhibit to a pleading is a part of the pleading, that is insufficient to incorporate the allegations of one complaint into another.

Rule 10(c) allows a plaintiff to attach a "written instrument," such as a contract or other such document that has legal effect, to a complaint without repeating the language of the instrument itself in the body of the complaint.[44] Attaching a complaint (which is not a "legal instrument" within the meaning of Rule 10(c)), however, is another matter. Doing so may be sufficient to assert that the allegations set out in the attached complaint were made by *another* plaintiff. But attaching another complaint is not the same as the plaintiff making those allegations itself, which carries with it a representation by the signer of the pleading that the allegations are based on belief formed after an "inquiry reasonable under the circumstances."[45]

The defendants argue that the complaint otherwise fails to contain sufficient allegations of specific conduct or of the receipt of "red flags" that relate to specific defendants. Instead, the complaint makes assertions that apply more generally to the "defendants," such as the claim that "Defendants chose to continue carrying [older

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[43] Fed. R. Civ. P. 10(c) ("A statement in a pleading may be adopted by reference elsewhere in the same pleading or in any other pleading or motion. A copy of a written instrument that is an exhibit to a pleading is a part of the pleading for all purposes.").

[44] *See, e.g., Rose v. Bartle*, 871 F.2d 331, 339-340 n.3 (3d Cir. 1989) (explaining that Rule 10(c) permits the incorporation of "instruments" but does not provide for the incorporation of other writings) (internal quotations omitted).

[45] *See* Fed. R. Bankr. P. 9011.

receivables] on the Company's books to inflate its revenue numbers and give a false picture of the Company's financial health,"[46] "Defendants … concealed [the debtors'] change in accounting policy from the Company's auditors,"[47] and "Defendants convinced an unsuspecting auditor to sign off on the Company's Form 10-K for fiscal year 2017."[48]

While a case can be made that these allegations are just too general to apprise those defendants who are not the subject of more specific allegations of the basis of the claim against them, this Court is persuaded that in the circumstances of this case, which are similar to those before the district court in *Buckley v. O'Hanlon*,[49] the allegations are sufficient to survive a motion to dismiss. There, the court emphasized that although the allegations did not "name the involved defendants individually," it was sufficient that the plaintiff "uses the categories of officers and directors … as substitutes for listing names."[50] Because "much of the alleged conduct involved collective action and decision making," the court found the complaint to be sufficient.

While the complaint here is hardly a model of specificity, the Court concludes that, in light of the liberal pleading standards under Rule 8, even in light of *Iqbal* and *Twombly*, it (barely) provides sufficient information to apprise the defendants of the nature of the claims and permit each defendant to formulate a response. The Court hastens to add, however, that while the allegations may be sufficient to survive a motion

[46] Complaint ¶ 66.

[47] *Id.* ¶ 68.

[48] *Id.* ¶ 69.

[49] No. 04-955 (GMS), 2007 WL 956947 (D. Del. Mar. 28, 2007).

[50] *Id.* at *5.

to dismiss, the trustee will be required at the summary judgment stage to present actual evidence from which a reasonable finder of fact might find that each defendant either engaged in affirmative conduct that violated his or her fiduciary duties or failed to act in the face of a "red flag." And while allegations may be general (such as allegations that "defendants" acted or failed to act), evidence (by its nature) tends to be more specific. So while the Court will not dismiss the fiduciary duty claims at the motion to dismiss stage, the trustee will certainly be held to his evidentiary burden if, after appropriate discovery, he is faced with a motion for summary judgment.

II. The trustee's corporate waste claims fail.

Like the claim for fiduciary duty, the claim for corporate waste is also subject to the internal affairs doctrine, such that Delaware law is applicable here.[51] Under Delaware law, a claim for corporate waste requires a showing of an exchange that was so one sided that no businessperson of ordinary, sound judgment could conclude that the corporation has received adequate consideration.[52] The standard for adequately pleading corporate waste is high and rarely satisfied. A corporate waste claim must fail if the corporation *received any benefit from the challenged transaction* or if there is a good faith judgment that the transaction is worthwhile under the circumstances.[53] In evaluating a waste claim, courts look to the exchange itself. The exchange must be

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[51] *In re Sportco Holdings, Inc.*, No. 19-11299 (JKS), 2021 WL 4823513, at *5 (Bankr. D. Del. Oct. 14, 2021).

[52] *In re Bridgeport Holdings, Inc.*, 388 B.R. 548, 576 (Bankr. D. Del. 2008); *see also In re The Art Institute of Philadelphia*, No. 18-11535 (CTG) (Bankr. D. Del. Jan. 12, 2022).

[53] *In re Sportco Holdings, Inc.*, No. 20-50554 (JKS) 2021 WL 4823513, at *17 (Bankr. D. Del. Oct. 14, 2021) (emphasis added).

irrational.[54] A claim for corporate waste must be based on an intentional action and cannot be based on gross negligence.[55] If, however, there is any substantial consideration received by the corporation, and if there is a good faith judgment that under the circumstances the transaction is worthwhile, there should be no finding of waste, even if the fact finder would conclude *ex post* that the transaction was unreasonably risky.[56]

This complaint does not meet that standard. The trustee alleges in the complaint that the outstanding accounts receivable constituted valuable assets which, if handled properly, could have brought significant revenue for the Company. The directors allegedly failed to take necessary steps to collect accounts receivable, and "by implementing questionable billing practices and failing to enact appropriate collection and appeal procedures for the Debtors' accounts receivable, the director Defendants squandered away Debtors' ability to collect on these valuable assets and caused tens of millions of dollars' worth of Debtors' accounts receivable to become worthless."[57] Those

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[54] *Id.*; *see also In re DSI Renal Holdings, LLC*, 574 B.R. 446, 476-477 (Bankr. D. Del. 2017).

[55] The definition and elements of gross negligence are incongruent with the definition and elements of corporate waste. In the corporate context, gross negligence means reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of reason. *Firefighters' Pension Sys. of City of Kansas City, Missouri Tr. v. Presidio, Inc.*, 251 A.3d 212, 287 (Del. Ch. 2021) (citing *Tomczak v. Morton Thiokol, Inc.*, Civ. A. No. 7861, 1990 WL 42607 (Del. Ch. Apr. 5, 1990)). Gross negligence has a stringent meaning under Delaware corporate (and partnership) law, one which involves a devil-may-care attitude or indifference to duty amounting to recklessness. To be grossly negligent in this context, a decision must be so grossly off the mark as to amount to reckless indifference or a gross abuse of discretion. *Solash v. Telex Corp.*, Civ. A. No. 9518, 1988 WL 3587, at *9 (Del. Ch. Jan. 19, 1988).

[56] *Brehm v. Eisner*, 746 A.2d 244, 263 (Del. 2000).

[57] Complaint ¶¶ 102-105.

allegations, taken as true, do not give rise to a claim for corporate waste under Delaware law.

At bottom, the trustee is alleging that the defendants were negligent in their pursuit of the accounts receivable. But there is no suggestion of any kind of one-sided "exchange" that might provide the basis for a claim of corporate waste. Nor has the trustee alleged the kinds of squandered opportunities that could give rise to such a claim. The corporate waste claim thus fails to survive the motion to dismiss.

III. The trustee's common law fraud claims fail.

The elements of common law fraud under Delaware law[58] are (i) a false representation of material fact made by the defendant; (ii) the defendant's knowledge or belief that the representation was false, or was made with reckless indifference to the truth; (iii) an intent to induce the plaintiff to act or to refrain from acting; (iv) the plaintiff's action or inaction taken in justifiable reliance upon the representation; and (v) damage to the plaintiff as a result of such reliance.[59] Rule 9(b) of the Federal Rules of Civil Procedure requires a party, when alleging fraud or mistake, to state with particularly the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally.[60]

The trustee alleges that Nobilis (i) falsely represented to third parties that its rapid growth strategy was being successfully implemented; (ii) engaged in fraudulent

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[58] While the parties do not expressly address which law governs the claim for common law fraud, all of the parties rely on Delaware law in briefing the issue. The Court will follow suit and treat the issue as one governed by Delaware law.

[59] *In re OSC 1 Liquidating Corp.*, 529 B.R. 825, 832 (Bankr. D. Del. 2015).

[60] Fed. R. Civ. P. 9(b).

billing practices; (iii) misrepresented the impact of the outstanding accounts receivable on the debtors' overall financial health, and (iv) facilitated the booking of false and inflated revenues.[61]

The trustee alleges sufficient facts to satisfy the first two common law fraud elements of (i) a false representation of material fact made by the defendant, and (ii) statements made by defendants that were known to be false, or reckless indifference to the truth. The complaint alleges that the defendants were aware that the outstanding accounts receivable was uncollectable as early as February 2018 when the debtors' independent auditor highlighted the change in procedure with respect to collection efforts and raised concerns about Nobilis' finances.[62] Despite this information, the defendants stated during a quarterly earnings call in 2018 that the Company "expected to collect everything that's on the balance sheet."[63]

The trustee alleges this was a false statement known to the defendants at the time it was shared with lenders and investors.[64] By representing that the Company's growth strategy was being successfully implemented, and that management had no concerns with respect to collecting debts on its balance sheet, the defendants demonstrated either a willingness to make false statements to third parties with the knowledge that they would be relied on, or an indifference to the truth despite additional

[61] Complaint ¶¶ 107-109.

[62] *Id.* ¶¶ 68-70.

[63] *Id.*

[64] *Id.*

"red flags" being raised regarding the outstanding accounts receivable. Both scenarios are sufficient to satisfy the first two elements of common law fraud.

The complaint fails to allege facts sufficient to satisfy the remaining elements of common law fraud—(iii) an intent to induce the plaintiff to act or to refrain from acting; (iv) the plaintiff's action or inaction taken in justifiable reliance upon the representation; and (v) damage to the plaintiff as a result of such reliance. While the complaint certainly alleges that defendants made statements to third parties such as investors and lenders regarding their financial health, no statement was made to the trustee-plaintiff (or to debtors, which were the trustee's predecessors in interest) to induce action or inaction.

That is the fatal flaw of the claim for fraud. The trustee, who steps in the shoes of the debtors, cannot sue for fraud in the absence of evidence that the debtors were the victims (rather than the perpetrators) of the alleged fraud. The core allegation, after all, is that the directors and officers defrauded lenders and investors by inflating the revenue and value of its books and records. There is no allegation that the debtors relied on any false representation of material fact that would give rise to a claim of common law fraud.[65]

[65] This Court addressed this issue in *Art Institute,* No. 20-50627, D.I. 87 at 35-36. Counsel for the trustee valiantly argued that this analysis is incorrect and that in the context of alleged corporate wrongdoing, a claim for fraud does not require a bankruptcy trustee to show that the corporation itself – as opposed to regulators or other third parties – relied on the allegedly false statements. The trustee, however, points to no case law in support of that assertion. The Court disagrees, and adheres to the traditional articulation of a claim for common law fraud as one that requires a showing that the plaintiff relied on the allegedly false statement.

Accordingly, the complaint fails to allege sufficient facts to assert a claim for common law fraud. That count will therefore be dismissed.

IV. The Court lacks personal jurisdiction over Watt.

Watt challenges the assertion of personal jurisdiction over her.[66] Her uncontradicted declaration asserts that she is a Canadian citizen who presently resides in Toronto, Ontario.[67] She served on the board of Nobilis Health Corporation, a Canadian corporation, which owned the other debtor entities. She has never resided in the United States, has never owned real property within the United States, is not a resident or domiciliary of the United States.[68]

She asserts the Court cannot find specific jurisdiction because there is no allegation that she attended board meetings in the United States, took any actions in the United States, or made any decision in the United States.[69] Watt argues no fiduciary

[66] This Court set forth the basic analytic framework governing such a claim of lack of personal jurisdiction in *Nystrom v. Vuppuluri*, No. 17-50001 (CTG) (Bankr. D. Del. Sept. 27, 2021). The ultimate question, for the reasons set forth therein (at pages 13-17), is whether the exercise of either specific or general jurisdiction over the defendant by a United States court would comport with the requirements of due process.

[67] D.I. 16-1 ¶ 3. In the context of a motion to dismiss for lack of personal jurisdiction a court may consider evidence outside of the pleadings to resolve factual issues. *See In re VeraSun Energy Corp.*, No. 08-12606 (BLS), 2013 WL 3336870 (Bankr. D. Del. June 28, 2013), at *3. The trustee did not challenge any of the assertions set forth in Watt's declaration. At argument on the motion, the trustee argued that if the Court were otherwise to find that it lacked personal jurisdiction over Watt, the trustee would like to take discovery in order to establish Watt's connections to the United States. Discovery to challenge the assertions in Watt's declaration or otherwise to establish a basis for personal jurisdiction would have been appropriate if sought before the hearing on the motion to dismiss. *See Toys "R" Us, Inc. v. Step Two, S.A.*, 318 F.3d 446, 456 (3d Cir. 2003). The trustee, however, never sought any such discovery before the Court's consideration of the motion to dismiss. The Court does not believe it appropriate to permit such discovery *following* the dismissal of the complaint for lack of personal jurisdiction.

[68] *Id.* ¶ 4.

[69] *Id.* ¶ 12.

duties were owed to a United States citizen or entity, and she therefore had no expectation of being subject to the jurisdiction of a United States court based on her service on the board of Canadian corporation.[70]

The trustee's response is that because Nobilis Health Corporation did business in the United States, Watt's service on its board is sufficient to subject her to personal jurisdiction in the United States.[71] The trustee makes no claim that this Court may exercise general jurisdiction over Watt as a defendant who is "at home" in the United States,[72] only that, by serving on the board of Nobilis Health Corporation, she "purposely availed" herself of the United States such that the exercise of personal jurisdiction over her in the United States is appropriate.[73]

The flaw in this argument, however, is that at least with respect to a claim of breach of fiduciary duty (the only surviving claim), the *subject* of Watt's duties was the Canadian-organized legal entity. Watt is a Canadian citizen, working and residing in Canada, whose fiduciary duties run entirely to a Canadian entity.

Critically, Watt owed no fiduciary duty to either of the United States-based debtors in this bankruptcy case. Absent unusual circumstances that no one has alleged are present here, the law respects the corporate form. To the extent Watt may have breached her fiduciary duties, any such harm was directed towards a Canadian

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[70] *Id.* ¶ 13-14.

[71] D.I. 37 at 26-27.

[72] *In re Pursuit Capital Management, LLC*, 595 B.R. 631, 647 n.46 (Bankr. D. Del. 2018) (citing *Goodyear Dunlop Tires Operations, S.A. v. Brown*, 564 U.S. 915, 919 (2011)).

[73] *In re Nortel Networks, Inc.*, 545 B.R. 469, 473 n.5 (Bankr. D. Del. 2016) (citing *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 297 (1980)).

corporation, not into the United States. The trustee makes much of the fact that Watt authorized the filing of the bankruptcy petition, citing to cases that (unremarkably) hold that a party cannot invoke a court's jurisdiction and then resist that court's exercise of jurisdiction.[74] But it is Noblis Health Corp., not Watt, that filed for bankruptcy in this Court. The trustee's effort to blur the distinction between the separate legal entities is unsuccessful, and ultimately dooms his argument for personal jurisdiction over Watt. The claims against Watt must therefore be dismissed.

Conclusion

For the foregoing reasons, the Court finds that the claims for breach of fiduciary duties survive the motions to dismiss, while the claims for corporate waste and common law fraud fail. The Court finds that it lacks personal jurisdiction over Defendant Watt such that the claims against her should be dismissed in their entirety. The trustee is directed to settle an appropriate order reflecting these rulings.

Dated: July 27, 2022

CRAIG T. GOLDBLATT
UNITED STATES BANKRUPTCY JUDGE

[74] D.I. 37 at 28-29.