UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

CRAIG T. GOLDBLATT
JUDGE

824 N. MARKET STREET
WILMINGTON, DELAWARE
(302) 252-3832

August 5, 2022

VIA CM/ECF

Re: *Miller v. Nelson*, Adv. Proc. No. 20-50627

Dear Counsel:

The chapter 7 trustee's original complaint in this adversary proceeding asserted claims for breach of fiduciary duty, common law fraud, preference, fraudulent conveyance, civil conspiracy, corporate waste and unjust enrichment against various officers and directors of debtor Education Management Corporation and its various affiliates.[1]

In an opinion dated January 12, 2022, this Court granted the motion as to certain claims (though without prejudice) and denied it as to others. Specifically, the Court found that the fiduciary duty claims failed against certain defendants because of the statute of limitations but adequately stated a claim against others. The Court dismissed the claims for common law fraud, civil conspiracy (except to the extent it related to surviving claims of breach of fiduciary duty), corporate waste, unjust enrichment, and intentional fraudulent conveyance. The Court denied the motions to dismiss the claim for constructive fraudulent conveyance and granted the motions to dismiss the preference claim.[2]

The trustee thereafter filed a first amended complaint.[3] The only material changes relate to the preference claim, where the trustee has endeavored to address certain deficiencies that led the Court to dismiss the preference claims as originally pled. Specifically, the trustee has now alleged which of the debtors (Education

[1] D.I. 1.

[2] D.I. 87.

[3] D.I. 91.

Management II LLC) made the payments he challenges. The trustee also alleged that he conducted reasonable due diligence into the potential defenses before asserting the claim.[4] Defendants have again moved to dismiss.

Defendants respond to the new preference claim with a variety of arguments. One argument struck the Court as novel and surprising – the contention that the alleged preferential payments were not alleged to involve a transfer of an interest of the debtor in property because the funds used to make the payment were the cash collateral of the debtor's secured lender. The Court accordingly asked the parties to provide supplemental briefing on that issue. On further reflection, however, the Court concludes that the preference claim in any event fails for other reasons (described below). As such, the Court need not reach the novel question on which the Court sought supplemental briefing, and the request for such briefing has therefore been mooted (with the Court's apologies to counsel that has been drafting the requested response).

The reason the preference claim, as amended, is still insufficient is that even as amended the complaint contains no allegation regarding which of the debtors owes the debt. Judge Walrath explained in *In re Tri-Valley Corporation* that "[w]hen there are multiple debtors in a case, the [c]omplaint must state which debtor owed the antecedent debt and that the same debtor made the preferential transfer."[5] The amended complaint contains no such allegation and must therefore be dismissed. While the dismissal will again be with leave to re-plead (within 30 days of the entry of the order dismissing the amended claim), the Court would not expect, absent a genuine showing of good cause, to provide the trustee with further leave to amend thereafter.

The defendants' remaining arguments largely rehash matters that the Court considered and rejected when it ruled on the original motions to dismiss. Defendants Kramer and Novad (in addition to addressing the preference claim) argue that the allegations of insolvency, reasonably equivalent value, and breach of fiduciary duty are too general to state a claim.[6] Defendants West and Beekhuizen point out that the claims against them relating to their service on the EDMC board have been dismissed on statute of limitations grounds and that the only remaining claims are those arising out of their service on the boards of various holding companies. They argue that those claims should be dismissed because there are no specific allegations of improprieties about the conduct of those holding companies.[7] Defendants McEachen, Jalufka and

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[4] *Id.* ¶¶ 136, 199.

[5] No. 12-12291 (MFW), 2015 WL 110074, *3 (Bankr. D. Del. Jan. 7, 2015).

[6] D.I. 94 at 24-30.

[7] D.I. 99.

Danielson also argue that the allegations made against them are too general to survive a motion to dismiss.[8]

The Court rejects all of these arguments. Each of these claims is one as to which the defendants previously moved to dismiss. Those motions were denied. To the extent this Court issues a decision that makes a mistake or overlooks a point made by the parties in their briefs, the Court would certainly entertain a timely filed motion for reconsideration that points out the error. No such motion was filed here. And in the absence of such a motion, the Court's prior determination of these issues is subject to the doctrine of law of the case. As Judge Sontchi explained that doctrine:

> The doctrine of law of the case is as follows: once a matter has been addressed in a procedurally appropriate way by a court, it is generally held to be the law of that case and will not be disturbed by that court unless compelling reason to do so appears. This doctrine is one of both fundamental fairness and judicial efficiency. The law of the case doctrine provides that when a court actually decides a rule of law, that decision should continue to govern the same issues in subsequent stages in the same case. However, that doctrine only applies to issues that were actually litigated and decided by the court. Law of the case directs a court's discretion, it does not limit the tribunal's power. The law of the case doctrine does not act as an absolute bar on relitigation (in contrast to the doctrines of claim and issue preclusion). Rather the law of the case doctrine merely directs the court's discretion not to rehear matters ad nauseam.[9]

Other than the challenge to the preference claim (addressed above), the claims that defendants now challenge are all claims that previously survived the motions to dismiss. None of the points the defendants make in response even purports to make a showing that would justify revisiting a prior decision that is law of the case. The Court will thus deny the balance of the motions to dismiss.

The Court hastens to add, however, that it has a measure of sympathy for the points made by the defendants regarding the level of generality of the allegations. As defendants note, the complaint (a) contains some number of quite specific allegations of wrongdoing that came to light in connection with governmental investigations and qui tam actions, alleging specific conduct through 2011 or so; (b), asserts, in rather general terms, that the alleged misconduct "was ongoing and continued until shortly

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[8] D.I. 103.

[9] *In re Broadstripe, LLC*, 435 B.R. 245, 255 (Bankr. D. Del. 2010) (internal quotations, citations and footnotes omitted).

before or to the Petition Date;"[10] and (c) claims that none of the defendants (who are all adequately alleged to be fiduciaries of one or more of the debtors) failed to take necessary or appropriate action to prevent that misconduct.

The Court found these allegations sufficient to state a claim for breach of fiduciary duty and civil conspiracy. Defendants argue that this is all far too general to be sufficient. In fairness, the level of *specificity* necessary to survive a motion to dismiss may well be more a matter of art than science. Rule 8(a)(2) tells us that a pleading must contain "a "short and plain statement of the claim showing that the pleader is entitled to relief."[11] But how *specific*? There is well developed case law on certain requirements that a complaint must meet to survive a motion to dismiss. *First*, even before *Iqbal*[12] and *Twombly*,[13] we knew that conclusory assertions were insufficient. A "conclusory" allegation is one that merely recites the element of the claim – such as asserting that the defendant was "negligent" or had "conspired" – rather than alleging an actual fact. The Supreme Court's decision in *Papasan v. Allain*, for example, explained that while "for the purposes of this motion to dismiss we must take all the factual allegations in the complaint as true, we are not bound to accept as true a legal conclusion couched as a factual allegation."[14]

Iqbal and *Twombly* added the further requirement that the allegations must also be "plausible." But despite the arguments pressed by the defendants, there is little in those cases that speaks directly to the question presented here. *Twombly* was an antitrust action in which the complaint alleged that telecommunications providers engaged in parallel conduct. The question was whether alleging the existence of "parallel conduct" was sufficient to state a claim for which an improper "agreement" in restraint of trade was a required element. The Court held it was not, explaining that the allegation of parallel conduct was equally consistent with lawful and unlawful conduct (since competitors may engage in parallel conduct in the absence of any improper agreement). The complaint was therefore insufficient to state a claim. Recognizing that when a complaint survives a motion to dismiss, such that the matter moves into potentially costly discovery, a plaintiff may gain the ability to extract "*in terrorem* . . . settlement value," the Court found that the complaint must allege enough to make out a "plausible entitlement to relief."[15]

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[10] D.I. 91 ¶ 90.

[11] Fed. R. Civ. P 8(a)(2).

[12] *Ashcroft v. Iqbal*, 556 U.S. 662 (2009).

[13] *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007).

[14] 478 U.S. 265, 286 (1986).

[15] *Twombly*, 550 U.S. at 558-559.

The Court arguably took that statement one step further in *Iqbal*. The complaint there alleged that the attorney general and the director of the FBI, in the wake of the September 11 attacks, unlawfully arrested and detained thousands of Arab Muslim men on account of their race, religion, or national origin. Drawing on *Twombly*'s statement that alleging conduct consistent with both lawful and unlawful conduct is insufficient to state a claim, the Court found that the facts alleged failed to state a claim. The Court observed that the arrests in question "were likely lawful and justified by [the Attorney General's] nondiscriminatory intent to detain aliens who were illegally present in the United States and who had potential connections to those who committed terrorist acts."[16] The Court held that as "between that obvious alternative explanation for the arrests," and the "purposeful, invidious discrimination respondent asks us to infer, discrimination is not a plausible conclusion."[17]

The motions to dismiss in this case raised two questions about the level of specificity required, neither of which is really addressed by *Iqbal* or *Twombly*. *First*, the complaint here made a number of specific allegations of misconduct, followed by a more general (though not "conclusory," as the caselaw uses that term) allegation that the misconduct continued and that the defendants failed to take action to prevent it. To the extent the defendants had a duty (under *Caremark*[18]) to take reasonable steps to monitor corporate affairs and had ignored the "red flags" arising out of the well-publicized investigations, the Court concluded in denying the original motions to dismiss that this was sufficient to state a claim. To be sure, the allegation that for several years the allegedly unlawful compensation and recruiting practices were "ongoing and continued until shortly before or to the Petition Date" is at a high level of generality. But if that allegation is true, as must be assumed for the purpose of the motions, nothing about that (unlike the allegations in *Iqbal* and *Twombly*) would be consistent with conduct that fails to state a claim. So while the level of generality is of some concern to the Court, the allegations are neither conclusory nor implausible, as the case law articulates those standards.

Second, as the dismissal of the preference claim demonstrates, the complaint is far from precise and careful in respecting the corporate form and treating each of the relevant debtors as a separate legal entity. In one recent decision, the undersigned judge expressed concern that a complaint was "not particularly precise in alleging that defendants served as directors or officers of specific legal entities," though (on the particular facts alleged in that case) concluded that the complaint was sufficient to survive a motion to dismiss.[19] The Court added, however, that "while

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[16] *Iqbal*, 556 U.S. at 682.

[17] *Id.* (internal quotations omitted).

[18] *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996).

[19] *In re Nobilis Health Corp.*, No. 21-51183 (CTG) (Bankr. D. Del. July 27, 2022), D.I. 75.

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."[20]

Even more recently, in a thoughtful opinion, Judge Owens observed that "Delaware embraces and protects corporate separateness unless exceptional circumstances are present. Liability is assessed on a director-by-director and company-by-company basis. The liability of the directors must be determined on an individual basis because the nature of their breach of duty (if any), and whether they are exculpated from liability for that breach, can vary for each director."[21] On the facts before her, Judge Owens dismissed claims for breach of fiduciary duty that failed to distinguish among the corporate entities and did not identify "the specific actions taken by the Director Defendants in violation of their alleged duties owed to each entity."[22]

As these cases demonstrate, there is no formulaic answer to the level of detail necessary to survive a motion to dismiss. Rather, as the Supreme Court noted in *Iqbal*, it is "a context-specific task that requires the reviewing court to draw on its judicial experience and common sense."[23] On the facts of this case, this Court concluded that the allegations were sufficient for certain claims to survive a motion to dismiss. Under the law of the case doctrine, this Court will adhere to that decision. But as the Court noted in *Nobilis*, it certainly is prepared to manage discovery in a way that ensures that it is conducted in a targeted and proportional manner. And after being afforded a reasonable opportunity to take such discovery, if faced with a motion for summary judgment, the trustee will be held to his evidentiary burden.

Three additional details should be addressed:

1. Defendants Danielson, Jalufka and McEachen move for a more definite statement, under Rule 12(e), of the fiduciary duty claim.[24] But that relief is available only where a complaint is so vague and ambiguous that a defendant cannot reasonably be expected to formulate a response.[25] The

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[20] *Id.* at 16.

[21] *In re Bayou Steel*, No. 21-51013 (KBO) (Bankr. D. Del. Aug. 3, 2022), D.I. 56 at 24.

[22] *Id.* at 23.

[23] *Iqbal*, 556 U.S. at 679.

[24] D.I. 103 at 15-16.

[25] *In re USDigital, Inc.*, 443 B.R. 22, 53 (Bankr. D. Del. 2011).

Court does not believe that this complaint meets that standard. The motion will accordingly be denied.

2. The same three defendants seek clarification that their deadline to respond to the first amended complaint has been tolled by the filing of the motion to dismiss the amended complaint. The Court agrees that it makes sense in the context of this case for the pleadings to come to rest before parties begin filing answers. Pursuant to Bankruptcy Rule 9006(b), the Court accordingly directs (subject to the right of the parties to seek, by way of motion or stipulation, a different deadline) that the time to answer shall be tolled until: (a) if the trustee does not file a second amended complaint, 45 days after the entry of the order dismissing the preference claim in the amended complaint; and (b) if the trustee does file a second amended complaint, on the later of (i) 30 days after the filing of the second amended complaint, or (ii) 30 days after the entry of an order granting or denying any motion to dismiss the second amended complaint.

3. In the briefs and at argument, the parties noted that certain of the allegations set forth in the original complaint should be deemed dismissed by virtue of the Court's original motion to dismiss ruling. To the extent the parties are able to reach agreement on those allegations that should be dismissed, that agreement should be reflected in the form of order the parties submit resolving the instant motions. In the absence of such an agreement, the rights of any party to seek clarification by an appropriate motion are preserved.

The parties are thus directed to settle an order, on certification of counsel, reflecting the rulings set forth herein.

Sincerely,

Craig T. Goldblatt
United States Bankruptcy Judge