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Delaware Court Cracks Down on Insufficiently Plead Preference-Action Complaints

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The U.S. Bankruptcy Court for the District of Delaware recently issued a series of decisions in which the court dismissed preference-action complaints for insufficiency of the factual allegations contained in the complaints. These decisions represent an acknowledgment by the bankruptcy judiciary that the U.S. Supreme Court "meant what it said" in the *Twombly*[2] and *Iqbal*[3] cases about a heightened pleading standard with respect to civil-action complaints.

Federal Rules of Civil Procedure 8(a)(2) and 12(b)(6)


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Rule 8(a)(2) of the Federal Rules of Civil Procedure (FRCP) provides that a complaint that states a claim for relief, must contain "a short and plain statement of the claim showing that the pleader is entitled to relief."[4] To withstand a motion to dismiss based on FRCP 12(b)(6), a complaint must "state a claim upon which relief can be granted."[5] Application of these rules traditionally has been anything but straightforward, but recent Supreme Court decisions provide new guidance for courts charged with applying the pleading standards.

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Supreme Court Decisions

Twombly was the first of two cases in which the Supreme Court promulgated a heightened pleading standard for civil-action complaints. The case involved a consumer class action under the Sherman Act against local telephone and Internet-exchange carriers.[6] To sufficiently allege a violation of the Sherman Act, a plaintiff is required to, among other things, allege that an agreement was made among the defendants.[7] The Court concluded that the complaint in that case was insufficient on its face to allege a claim under the Sherman Act because the allegations fell short of setting forth sufficient facts upon which the Court could infer that the defendants entered into an agreement, combination or conspiracy.[8] The Court explained that "[w]hile a complaint attacked by a Rule 12(b)(6) motion to dismiss does not need detailed factual allegations...a plaintiff's obligation to provide the 'grounds' of


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his 'entitle[ment] to relief' requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do."[9] Further, "[f]actual allegations must be enough to raise a right to relief above the speculative level."[10] The factual allegations in the complaint must provide the defendant with "'fair notice' of the nature of the claim" against the defendant and the "'grounds' on which the claim rests."[11] The plaintiff must nudge his or her "claims across the line from conceivable to plausible" to withstand a motion to dismiss.[12] In *Twombly*, given that discovery is costly, the Court stressed the importance of dismissing a deficient complaint at the pleading stage, which is "the point of minimum expenditure of time and money by the parties and the court."[13]

The Supreme Court in *Iqbal* analyzed and applied the *Twombly* decision at length with respect to the motion to dismiss filed by the petitioners/defendants. The Court analyzed *Twombly* and explained that *Twombly* articulated a two-prong analysis with respect to determining whether a complaint is facially sufficient.[14] The first step in the analysis is to take "note of the elements a plaintiff must plead to state

On the Edge

1 This article represents the views of the authors and such views should not necessarily be imputed to Fulbright & Jaworski LLP, its affiliates and clients.
2 *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007).
3 *Aschcroft v. Iqbal*, 129 S.Ct. 1937 (2009).
4 *See* Fed. R. Civ. P. 8(a)(2). *See also* Fed. R. Bankr. P. 7008.
5 *See* Fed. R. Civ. P. 12(b)(6). *See also* Fed. R. Bankr. P. 7012.
6 *See Twombly*, 550 U.S. at 548.
7 *See id.* at 554-55.
8 *See id.* at 554-70.
9 *See id.* at 555-56.
10 *See id.* at 555.
11 *See id.* n. 3.
12 *See id.* at 570.
13 *See Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 558-59 (2007) (quotation marks and citations omitted).
14 *See Iqbal*, 129 S.Ct. at 1947.

a claim" with respect to a particular cause of action.[15] The second step is to determine whether the complaint on its face contains sufficient factual matter to state a plausible claim for relief.[16] "A claim has factual plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged."[17] Thus, after *Iqbal* and *Twombly*, federal courts now have explicit guidelines to follow when determining whether a complaint satisfies the standard for stating a claim.

Prima Facie *Case for Preferential Transfer Avoidance*

Bankruptcy courts have indeed been applying *Iqbal* and *Twombly* with increased frequency, most notably in connection with preference actions. *Iqbal* and *Twombly* instructed plaintiffs that they must do more than merely parrot the elements set forth in § 547(b) and/or state bare legal conclusions.

Recent Series of Delaware Preference-Action Dismissals

Most recently, Hon. **Mary F. Walrath** dismissed a preferential transfer-avoidance action for failure to state a claim for relief in *Gellert v. The Lenick Co. (In re Crucible Materials Corp.)*.[18] The bankruptcy court dismissed the complaint because it set "forth only conclusory allegations parroting the statutory language of section 547."[19] The plaintiff filed a complaint initiating an adversary proceeding to recover, among other conveyances, alleged preferential transfers.[20] The defendant moved to dismiss the complaint pursuant to FRCP 8(a) and 12(b)(6) for failure to state a claim.[21]

Judge Walrath noted that post-*Iqbal*, the Third Circuit articulated a two-part analysis for the determination of whether allegations in a complaint are sufficient. "First the factual and legal elements of a claim should be separated.[22] The [court] must accept all of the complaint's well-pleaded facts as true, but may disregard any legal conclusions."[23] The Third Circuit instructed that the court must next determine whether the plaintiff's factual allegations in the complaint nudge the plaintiff's claims "across the line from conceivable to plausible."[24]

Further, "alleged preferential transfers must be indentified with particularity to ensure that the defendant receives sufficient notice of what transfer is sought to be avoided... Simply quoting the statutory language is insufficient to withstand a motion to dismiss."[25] Moreover, since before the *Iqbal* and *Twombly* decisions, the Delaware bankruptcy court has required a preference-action complaint to go beyond the mere parroting of the statutory elements and identify (1) the nature and amount of each alleged antecedent debt, (2) the date of each alleged preferential transfer, (3) the transferor by name, (4) the transferee by name and (5) the amount of each alleged transfer.[26]

The court found that the complaint adequately alleged "facts identifying the date of transfer, name of the transferee and transfer amount."[27] However, the court dismissed the complaint because the litigation trustee failed to "sufficiently identif[y] the transferor of the alleged preferential payments" and "provide sufficient facts detailing the nature of the alleged antecedent debt."[28]

Because there was more than one debtor in the bankruptcy proceeding, the litigation trustee was required to identify the transferor by name—alleging that "one or more of the Debtors made transfers" was not enough to withstand a motion to dismiss.[29] Additionally, the court found that the complaint failed to allege sufficient facts showing an antecedent debt (pre-existing debtor/creditor relationship) was owed at the time of the transfer:

> The Complaint provides no detail of any contracts between the parties or any description of the goods or services exchanged. Beyond stating that the "Defendant was a creditor of one or more of the Debtors at the time of the Transfers," the Trustee completely fails to describe any type of relationship between the Defendant and any of the Debtors.[30]

Judge Walrath dismissed another preference action complaint in *Claybrook v. Bear Growth Capital Partners LLC (In re WBE LLC)*.[31] The chapter 7 trustee commenced an adversary proceeding against certain defendants seeking avoidance of both alleged preferential and fraudulent transfers.[32] The defendants moved to dismiss the complaint pursuant to FRCP 12(b)(6) for failure to state a claim. The court dismissed the preference action against one defendant because although the trustee listed the transfer dates and amount, the trustee failed to identify which specific defendant received the transfer.[33] The complaint alleged only that the transferee may have been one or more of the defendants.[34]

Judge Walrath dismissed yet another preference-action complaint in *Miller v. Mitsubishi Digital Electronics America Inc. (In re Tweeter OpCo)*[35] after finding that the complaint failed to identify the transferor of the preferential transfer by name when there were multiple debtors in the case.[36] In addition, the second basis for dismissal was the plaintiff's failure to "explain the nature of the antecedent debt... The Complaint provide[d] no detail of any relationship between the Debtors and [the defendant] such as the identity of contracts between the parties or any description of goods or services exchanged."[37]

Hon. **Brendan Shannon** likewise dismissed a preference complaint in *Charys Liquidating Trust v. Hades Advisors LLC (In re Charys Holding Company Inc.)*[38] on the grounds that the plaintiff failed to allege sufficient facts "showing an antecedent debt" owed to defendant by the debtor.[39] The complaint did not allege that the defendant provided services to the debtor prior to the alleged transfer or that the debtor owed the defendant any pre-existing debt prior to the transfer.[40] Bankruptcy courts in other districts have also dismissed preference-action complaints after applying the heightened-pleading standard articulated by the Supreme Court.[41] However, these courts either granted the plaintiff leave to amend the complaint or dismissed the preference claim without prejudice.

15 *See id.*
16 *See id.* at 1949.
17 *See id.*
18 Nos. 09-11582, 10-55178, 2011 WL 2669113, at *1 (Bankr. D. Del. July 6, 2011). Although Judge Walrath dismissed the complaint, she granted the plaintiff leave to amend the complaint pursuant to FRCP 15(a). *Crucible Materials*, 2011 WL 2669113, at *5.
19 *See Crucible Materials*, 2011 WL 2669113, at *1.
20 *See id.*
21 *See id.*
22 *See id.* at *2.
23 *See Fowler v. UPMC Shadyside*, 578 F.3d 203, 210-11 (3d Cir. 2009).
24 *See id.* at 212 (quoting *Twombly*, 550 U.S. at 570).
25 *See Crucible Materials Corp.*, 2011 WL 2669113, at *3.
26 *See id.* at *2 (citing *OHC Liquidation Trust v. Credit Suisse First Boston (In re Oakwood Homes Corp.)*, 340 B.R. 510, 522 (Bankr. D. Del. 2006); *Valley Media Inc. v. Borders, Inc. (In re Valley Media Inc.)*, 288 B.R. 189, 192 (Bankr. D. Del. 2003)).
27 *See Crucible Materials Corp.*, 2011 WL 2669113, at *1.
28 *See id.* at *4.
29 *See id.*
30 *See id.* (internal citation omitted).
31 Nos. 09-10649, 11-50598, 2011 WL 2607090, at *1 (Bankr. D. Del. June 30, 2011) (granting motion to dismiss, but allowing trustee leave to amend).
32 *See WBE LLC*, 2011 WL 2607090, at *2.
33 *See id.* at *3.
34 *See id.*
35 Nos. 08-12646, 10-54038, 2011 WL 2433090, at *1 (Bankr. D. Del. June 14, 2011) (granting motion to dismiss, but allowing plaintiff leave to amend).
36 *Tweeter OpCo*, 2011 WL 2433090, at *4.
37 *See id.*
38 Nos. 08-10289, 10-50211, 2010 WL 2788152, at *5 (Bankr. D. Del. July 14, 2010) (dismissing preferential-transfer claim without prejudice).
39 *Charys*, 2010 WL 2788152, at *5.
40 *See id.*

Recent Decisions

The recent dismissals of preference complaints reveal the bankruptcy bench's reluctance to turn a blind eye to such insufficiently plead complaints. Because decisions of the Delaware bankruptcy court carry weight among the bankruptcy judiciary, one should expect to see more bankruptcy courts cracking down on insufficiently plead preference complaints. Bankruptcy litigators should especially take note of this emerging trend: If you represent the creditor/defendant in an avoidance action, it would behoove you to move for dismissal of the insufficiently plead avoidance complaint. If, on the other hand, you represent the plaintiff in a preference action, it is imperative that you gather sufficient facts and draft complaints containing the requisite specificity as required by *Iqbal* and *Twombly*. ■

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41 *See KHI Liquidation Trust v. Wisenbaker Builder Servs. (In re Kimball Hill Inc.)*, Nos. 08B10095, 10A00824, 2011 WL 2182429, at *10-11 (Bankr. N.D. Ill. June 3, 2011) (antecedent debt requirement was alleged in conclusory fashion); *The Antioch Co. Litigation Trust v. Morgan (In re The Antioch Co.)*, No. 09-3409, 2011 WL 1670952, at *3 (Bankr. S.D. Ohio Apr. 28, 2011) ("The recitation of the elements with a total preference amount for each Preference Defendant is inadequate...because the Preference Defendants cannot provide a complete response under Rule 12."); *Elder v. Greer (In re Sand Capital Partners III LLC)*, No. 08-30989, 2010 WL 4269622, at *2 (Bankr. N.D. Cal. Oct. 25, 2010) (failed to allege sufficient facts with respect to insider status of defendants); *Official Comm. of Unsecured Creditors of Hydrogen LLC v. Blomen (In re Hydrogen LLC)*, 431 B.R. 337, 355-56 (Bankr. S.D.N.Y. 2010) ("Without a single relevant detail such as date, amount or type of transfer, it is impossible to identify any specific avoidable transfer to [the defendant]."); *Angell v. Haveri (In re Caremerica Inc.)*, 409 B.R. 346, 350-52 (Bankr. E.D.N.C. 2009) (failed to sufficiently plead number of elements of preferential transfer cause of action); *Angell v. Day (In re Caremerica Inc.)*, 415 B.R. 200, 203-07 (Bankr. E.D.N.C. 2009) (same); *Angell v. Ber Care Inc. (In re Caremerica Inc.)*, 409 B.R. 737, 745-54 (Bankr. E.D.N.C. 2009) (same).