UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

In re:	)	Chapter 11
	)	
DBSI, INC., et al.	)	Case No. 08-12687(PJW)
	)	
Debtors.	)	Jointly Administered
	)	
JAMES R. ZAZZALI, as Trustee of the DBSI Estate Litigation Trust created by operation of the Second Amended Joint Chapter 11 Plan of Liquidation; and CONRAD MYERS, as Trustee of the DBSI Liquidating Trust created by operation of the Second Amended Joint Chapter 11 Plan of Liquidation,	)	
	)	
Plaintiffs,	)	
	)	
v.	)	Adv. Proc. No. 10-55963 (PJW)
	)	
WAVETRONIX LLC, DAVID V. ARNOLD, LINDA S. ARNOLD, MICHAEL JENSEN, JOHN DOES 1-50, and ABC ENTITIES 1-50,	)	
	)	
Defendants,	)	

MEMORANDUM OPINION

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Dated: February 4, 2011

WALSH, J

This opinion is with respect to the motion of Wavetronix LLC to strike the Complaint pursuant to Federal Rule of Civil Procedure 12(f). (Doc. #4.) The Complaint was filed by James R. Zazzali and Conrad Myers, as Trustees of the DBSI Estate Litigation Trust and DBSI Liquidating Trust, respectively, (together, "Trustees"), against Wavetronix LLC, David V. Arnold, Linda S. Arnold, Michael Jensen, and unknown individuals and entities denominated John Does 1-50 and ABC Entities 1-50. The 115-page, 747-paragraph Complaint contains 20 counts asserting causes of action for, inter alia, actual and constructive fraudulent transfers, breach of contract, and breach of fiduciary duty. For the reasons discussed below, I will deny the motion.

Background

DBSI, Inc. and certain of its affiliates filed bankruptcy petitions under Chapter 11 of the Bankruptcy Code, 11 U.S.C. §§ 101 et seq., on November 6, 2008. A plan of liquidation was confirmed on October 26, 2010, resulting in the appointment of Trustees to administer the DBSI Litigation Trust and DBSI Estate Liquidation Trust. As that confirmation order sets forth in greater detail, DBSI, Inc. and its affiliates were operated as a single enterprise under the control of a small group of insiders. (Case No. 08-12687, Doc. # 5924, ¶ 27.) The DBSI enterprise was involved in three main spheres of business activity: (i) the syndication and

sale to investors of tenant-in-common ("TIC") interests in real estate, (ii) the purchase of real estate, and (iii) investment in technology companies. (Id. ¶ 25.) The instant action concerns this third sphere of activity.

Trustees seek to recover transfers made to Wavetronix LLC ("Wavetronix"), an Idaho limited liability corporation that designs and manufactures products related to traffic flow and road safety. Wavetronix is owned by Stellar Technologies ("Stellar") and by defendants David Arnold ("Arnold") and Michael Jensen ("Jensen"). Stellar, a holding company majority-owned by DBSI insiders, owns approximately 60 percent of Wavetronix, with Arnold and Jensen owning the remaining 40 percent. Stellar provided the financing, and Arnold and Jensen supplied the intellectual property and the "technology knowhow." (Doc. # 1, ¶ 414.) Arnold served as the chairman of the Wavetronix Management Board, manager, president, and CEO. Jensen was a manager and board member. Arnold's wife, Linda, was also on the board, with the remaining board seats held by various individuals alleged to be DBSI insiders ("Insiders"), including Douglas Swenson, John Foster, Thomas Var Reeve, and Charles Hassard.

It is undisputed that between 2001-2006 DBSI, through its affiliate DBSI Redemption Reserve ("DRR"), an Idaho general partnership, transferred no less than $23,198,268 to Wavetronix. The parties dispute whether these transfers were capital

contributions or loans to Wavetronix. Trustees allege that these transfers were loans, memorialized by yearly promissory notes Wavetronix signed for the amounts it received the prior year. Thus, Wavetronix signed a promissory note in 2002 for the amounts it received from DBSI in 2001, a promissory note in 2003 for the amounts received in 2002, and so on. Trustees allege that, even though the transfers came from DRR, these promissory notes were made payable to Stellar. Arnold, as president and CEO, signed these promissory notes every year between 2002-2007. Arnold also personally guaranteed the 2002 and 2003 notes up to his pro rata percentage ownership in Wavetronix.

Trustees allege that (i) these transfers to Wavetronix were fraudulent conveyances under the Bankruptcy Code, 11 U.S.C. § 548, and under Idaho Law, Idaho Code Ann. §§ 55-906, 913(1)(a) & (b), and 55-914(1); (ii) that Wavetronix and Arnold, as guarantor, breached their obligations under the promissory notes; (iii) that Arnold, his wife Linda, and Jensen breached their fiduciary duties; and (iv) that, in the event the transfers were capital infusions, Arnold and Jensen breached the Wavetronix Operating Agreement. Trustees further seek access to Wavetronix's books and records as well as a declaratory judgment that the transfers constituted loans and not equity infusions.

Trustees' 20-count Complaint contains extensive factual allegations concerning the DBSI enterprise. The Complaint's 115

pages and 747 paragraphs provide extensive factual allegations concerning how Swenson and the other Insiders conducted the DBSI enterprise as an elaborate Ponzi scheme. Wavetronix contends that it would be prejudicially expensive and time-consuming to respond to every allegation in the Complaint, describing the factual allegations as redundant and/or substantially unrelated to this action. (Doc. # 5, p. 9.) Wavetronix further asserts that "[c]ertainly, the hundreds of allegations about Swenson's Ponzi scheme that have nothing to do with Wavetronix are scandalous and prejudicial to Wavetronix and should be stricken." (Id.)

Trustees raise three arguments opposing the motion to strike. First, Trustees contend that Wavetronix, by broadly asserting that the Complaint should be stricken, has failed to meet its burden of identifying specific improper allegations in the Complaint. Second, Trustees argue that the factual allegations concerning the DBSI Insiders' scheme are relevant to establish the intent to hinder, delay, or defraud creditors. And third, Trustees contend that, even if the Complaint contains redundant and irrelevant material, Wavetronix has failed to demonstrate prejudice.

Wavetronix, in its reply brief, repeats its contention that it would be impractical to identify improper material in the Complaint because "striking only those allegations would leave the parties (and the Court) with such a disjointed Complaint that it

would not make any sense." (Doc. # 16, p. 1.) Alternatively, Wavetronix lists several definitions and roughly 300 paragraphs that it describes as unrelated. (Id., p. 2.) Concerning prejudice, Wavetronix makes three arguments. First, Wavetronix repeats its concern that responding to the hundred of factual allegations would be overly burdensome. Second, Wavetronix contends that allegations of the Insiders' scheme could make Wavetronix appear guilty by association. And third, Wavetronix argues that it would have to undertake unnecessary and expensive discovery regarding Swenson's scheme.

Discussion

Rule 12(f), made applicable here by Rule 7012(f) of the Federal Rules of Bankruptcy Procedure, provides that a "court may strike from a pleading . . . any redundant, immaterial, impertinent, or scandalous matter." Fed. R. Civ. P. 12(f). Motions to strike are disfavored "unless the presence of the surplusage will prejudice the adverse party." Schwarzkopf Tech. Corp. v. Ingersoll Cutting Tool Co., 820 F.Supp. 150, 154 (D. Del. 1992) (quoting Puma v. Marriott, 294 F.Supp. 1116, 1122 (D. Del. 1969)).

In support of this argument, Wavetronix cites Symbol Technologies, Inc. v. Aruba Networks, Inc., 609 F.Supp.2d 353 (D. Del. 2009) and In re "Agent Orange" Product Liability Litigation, 475 F.Supp. 928 (E.D.N.Y. 1979). In Symbol Technologies, the

plaintiff sought to strike language in the defendant's answer that impugned the motives of the litigation and extolled the defendant's success in the marketplace. 609 F.Supp.2d at 359. The court rejected the defendant's contention that this language provided critical background information, instead striking the language as "unrelated in any substantive way to [d]efendant's equitable defenses." Id.

Similarly, in In re "Agent Orange", the court struck language in the complaint that was unrelated to the cause of action. 475 F.Supp. at 936. The complaint contained 425 paragraphs regarding the defendants' corporate history, and the court found these allegations were "unnecessary, would be burdensome to answer, and would unduly prejudice defendants." Id. The court also found the 68 paragraphs in the complaint containing factual allegations about two chemicals to "place an overly heavy pleading burden on defendants." Id. Because these allegations could be made on a more limited basis, the court struck these paragraphs with leave to replead. Id.

Wavetronix contends that the Complaint should be stricken because, as in In re "Agent Orange", it would be overly burdensome to respond to each of the extensive factual allegations and, as in Symbol Technologies, the Complaint contains irrelevant material.

There are three problems with Wavetronix's arguments, as set forth in Trustees' memorandum in opposition to the motion to

strike. First, even though the Complaint is lengthy, the factual allegations are related to the adversary proceeding, thus distinguishing this case from In re "Agent Orange" and Symbol Technologies. Central to Trustees' fraudulent transfer actions is the Ponzi-scheme nature of the DBSI enterprise and the Insiders' knowledge of this elaborate scheme. The Complaint alleges that DRR transferred money to the Defendants when the DRR general partners knew, or should have known, that DRR and the DBSI enterprise were insolvent. Trustees allege four bases of this knowledge: (i) the DBSI Companies depended on new investor money to fund operations and to pay prior investors; (ii) the DBSI Companies' assets were overvalued, due to improper accounting; (iii) income from the DBSI Companies' real property was insufficient to cover the burdens of the debt service and the guaranteed payments to TIC investors; and (iv) DBSI management was closely monitoring cash needs and meeting weekly to identify sources of cash to meet near-term funding requirements. (Doc. #1, ¶¶ 590-592, 608.) The factual allegations concerning the Ponzi scheme, the improper accounting, the weekly cash meetings, and the actions of the Insiders are necessary to support these bases and, therefore, are related to this adversary proceeding. I agree with the Trustees that "[t]he allegations describing the DBSI insiders' scheme to defraud creditors, and how the transfers to Wavetronix are part of that scheme, are therefore

relevant and material to the Actual Fraudulent Transfer Counts." (Doc. # 11, p. 8)(footnote omitted).

Second, Wavetronix's opening brief describes the Complaint as containing redundant and immaterial factual allegations, but it does not list specific paragraphs or sections that need to be stricken. As the movant, Wavetronix bears the burden of identifying the improper material. Staro Asset Mgmt., LLC v. Soose, 2005 U.S. Dist. LEXIS 32320, *9-10 (W.D. Pa. Aug. 17, 2005) ("Rule 12(f) motions are generally disfavored and the burden is on the movant to show that the disputed allegations 'have no possible relation to the controversy and may cause prejudice to one of the parties, or . . . confuse the issues.'") (quoting In re Westinghouse Sec. Litig., 1998 U.S. Dist. LEXIS 3033, *12 (W.D. Pa. March 12, 1998)). Wavetronix's opening brief does not refer to specific material in the Complaint that is redundant or immaterial. Instead, it has broadly asserted that "Wavetronix should not be put to the burden of figuring out which of the 747 paragraphs contain irrelevant, needless, redundant, immaterial, impertinent, or scandalous matter, and then have to move to strike each individual allegation. This burden should be borne by Plaintiffs." (Doc. #5, p. 4.) Wavetronix has cited no authority for this burden-shifting, and I am aware of no cases supporting this position. Wavetronix's reply brief does not remedy this problem. It lists over 300 specific paragraphs to be stricken, but it does not describe the

contents of those paragraphs or why they are improper. Accordingly, Wavetronix has failed to meet its burden of identifying improper material in the Complaint.

Finally, even if the Complaint contains factual allegations that are immaterial or redundant, Wavetronix has failed to establish prejudice. Wavetronix contends that responding to the extensive factual allegations in the Complaint would lead to extensive and expensive discovery. This argument is unavailing because Wavetronix, where applicable, can deny factual allegations by responding that it is without knowledge or information sufficient to form a belief as to their truth. Fed. R. Civ. P. 8(b)(5); see Moore's Federal Prac. Civ. § 8.06(5). Furthermore, Trustees, as plaintiffs, bear the burden of establishing the Insider's scheme and the discovery costs related thereto.

Finally, I find there to be no merit to Wavetronix's argument that the Insiders' affiliation with Wavetronix threatens to suggest that the Defendants are guilty by association. The Complaint contains great detail concerning the Insiders' scheme, but it does not suggest that the Defendants here were aware of or participants in this scheme.

CONCLUSION

For the forgoing reasons, I will deny Wavetronix's motion to strike the Complaint.

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Defendants,	)	

ORDER

For the reasons set forth in the Court's memorandum opinion of this date, Defendant Wavetronix LLC's motion (Doc. # 4) to strike Trustees' Complaint is **denied.**

Peter J. Walsh
United States Bankruptcy Judge

Dated: February 4, 2011