IN THE UNITED STATES BANKRUPTCY COURT
FOR THE 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: May 27, 2011

WALSH, J.

This opinion is with respect to the motion of defendant Wavetronix LLC to defer considering plaintiff's motion for summary judgment to allow time for discovery, pursuant to Federal Rule of Civil Procedure 56(d). (Doc. # 57.) For the reasons below, I will grant 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. Pursuant to the confirmed plan of liquidation, James R. Zazzali and Conrad Myers were appointed as trustees of the DBSI Estate Litigation Trust and DBSI Liquidating Trust, respectively (the "Trustees").

Trustees commenced this adversary proceeding against Wavetronix LLC ("Wavetronix" or "Defendant"), David V. Arnold, and Michael Jensen, et al., seeking to recover over $23 million transferred from DBSI to Wavetronix in the four years preceding DBSI's bankruptcy. Trustees' complaint sets forth the following as background for their allegations:

> 20. The DBSI Companies were a sprawling, fraudulent real estate investment empire, involving hundreds of corporations and properties, but dominated and controlled by [Douglas] Swenson and the other Insiders.
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> ***
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> 24. Vastly simplified, the DBSI Companies can be separated into three general spheres of activity, although as will be seen, the entire business was

> operated as a single, integrated entity. For purposes of these allegations, these sphere of activity were: (i) the syndication of commercial real estate properties as allegedly qualified investments under Section 1031 of the Internal Revenue Code; (ii) raising money by issuing debt and equity interests in various DBSI Companies; and (iii) siphoning off very large sums for distribution to the Insiders themselves and for investment in new, technology-oriented ventures through the use of a complex system of related partnerships and other entities.
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> ***
>
> 57. Although the Technology Company investment was neither productive for the DBSI Companies as a whole nor for the Investors whose cash was diverted to pay for them, it was structured in such a way that it facilitated the siphoning off of substantial distributions to the Insiders and the appropriation of significant tax advantages for them that otherwise would have belonged to the DBSI Companies.

(Doc. #1.)

Wavetronix is one of the Technology Companies, as defined in the complaint. (Id., ¶ gg.) Wavetronix, an Idaho limited liability corporation that designs and manufactures products related to traffic flow and road safety, is majority-owned by Stellar Technologies ("Stellar"). Stellar is, in turn, majority-owned by DBSI insiders. Defendants David Arnold ("Arnold") and Michael Jensen ("Jensen") are the minority owners of Wavetronix. Stellar provided the financing, and Arnold and Jensen supplied the intellectual property and the "technology knowhow." (Doc. # 1, ¶ 414.)

It is undisputed that between 2001-2006 DBSI, through its affiliate DBSI Redemption Reserve ("DRR"), transferred no less than

$23,198,268 to Wavetronix. The parties dispute whether these transfers were all capital contributions or whether some were loans to Wavetronix. Trustees allege that some of 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.

Myers, as trustee of the DBSI Liquidating Trust, (the "Trustee"), filed a motion for partial summary judgment, pursuant to Federal Rule of Civil Procedure 56, that the promissory notes are enforceable and that Wavetronix has breached those notes. (Doc. #42.)

Wavetronix filed this motion asking the Court to defer ruling on Trustee's summary judgment motion to allow time for discovery, pursuant to Federal Rule of Civil Procedure 56(d). Wavetronix submitted the declaration of its attorney, Joseph M. Hepworth, (the "Hepworth Declaration") in support of its motion. The Hepworth Declaration states that Wavetronix seeks to oppose Trustee's motion for summary judgment by arguing that the contributions set forth in the promissory notes were intended as

equity infusions, not loans. Alternatively, Wavetronix contends that, even if the contributions are considered loans, the promissory notes are not enforceable because they were entered into as part of DBSI's fraudulent scheme. (Doc. # 58, pp. 14-17.)

Wavetronix has filed discovery requests for facts supporting its contentions that (i) DBSI intended the transfers as equity; (ii) DBSI had no expectation, or no reasonable expectation, of being repaid for the transfers; (iii) DBSI directed Wavetronix to change its financial records to re-characterize the equity infusions as loans; (iv) DBSI insiders misled Arnold into signing the promissory notes; and (v) DBSI re-characterized the equity infusions as loans in order to perpetrate DBSI's securities fraud and tax evasion.

The Hepworth Declaration identifies several discovery requests concerning these arguments made to Trustees, to which Trustees have not yet responded. For instance, Wavetronix seeks to depose Swenson and other DBSI insiders and to obtain Stellar's financial and tax records from the time of the transfers.

Trustee opposes Wavetronix's Rule 56(d) motion, arguing that summary judgment can, and should, be granted solely on the basis of the plain language in the promissory notes. Trustee's argument is a simple one: the promissory notes unambiguously required Wavetronix to make principal and interest payments, Wavetronix signed the promissory notes, and Wavetronix did not meet

its repayment obligations. Trustee contends that the parole evidence rule and the integration clause within the promissory notes preclude the Court from considering extrinsic evidence concerning the transfers. Therefore, Trustee contends that Wavetronix's discovery requests concerning the transfers are irrelevant. Furthermore, to the extent Wavetronix asserts that the promissory notes were signed under undue influence, fraud, or duress, Trustee contends that Wavetronix has ratified the promissory notes by accepting the transfers, thus barring Wavetronix from asserting its defenses of fraud, duress, and undue influence.

Discussion

Federal Rule of Civil Procedure 56(d), made applicable here pursuant to Federal Rule of Bankruptcy Procedure 7056, reads:

> If a nonmovant shows by affidavit or declaration that, for specified reasons, it cannot present facts essential to justify its opposition, the court may:
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> (1) defer considering the motion or deny it;
>
> (2) allow time to obtain affidavits or declarations or to take discovery; or
>
> (3) issue any other appropriate order.

A Rule 56(d) motion is favored when discovery is incomplete and the movant possesses pertinent facts. Reiver v. Murdoch & Walsh, P.A., 625 F.Supp. 998, 1004 n.2 (D. Del. 1985) (citing Costlow v. United States, 552 F.2d 560, 564 (3d Cir. 1977)); see also Shaw Group Inc. v. SWE & C Liquidating Trust (In re Stone & Webster, Inc.),

Adv. No. 08-51839, 2009 WL 426118 at *5 (Bankr. D. Del. Feb. 18, 2009) ("generally courts are careful not to prematurely consider motions for summary judgment, especially when little or no discovery has been conducted"). In such cases "where the facts are in possession of the moving party a continuance of a motion for summary judgment for purposes of discovery should be granted almost as a matter of course." Costlow, 552 F.2d at 563-64.

The Hepworth Declaration sets forth discovery requests for facts concerning the parties' intent at the time DBSI transferred funds to Wavetronix, facts that will be essential to Wavetronix's argument that the transfers are properly classified as equity. See Cohen v. KB Mezzanine Fund II, LP (In re SubMicron Sys. Corp.), 432 F.3d 448, 457 (3d Cir. 2006) ("the determinative inquiry in classifying contributions as debt or equity is the intent of the parties as it existed at the time of the transaction."). Even though Trustee contends that the motion for summary judgment should be decided solely on the plain language in the promissory notes, this Court may look through the form of the promissory notes in order to determine whether the transfers to Wavetronix were intended as capital contributions. Id. at 456 (in determining whether transfers should be characterized as debt or equity, "[f]orm is no doubt a factor, but in the end it is no more than an indicator of what the parties actually intended and acted on.")

Furthermore, because Wavetronix contends it signed the promissory notes based on DBSI's fraudulent misrepresentations, the Court may consider extrinsic evidence of the parties' intent concerning the Wavetronix transfers. See Valley Bank v. Christensen, 808 P.2d 415, 417 (Idaho 1991) ("If the written agreement is complete upon its face and unambiguous, no fraud or mistake being alleged, extrinsic evidence of prior or contemporaneous negotiations or conversations is not admissible to contradict, vary, alter, add to or detract from the terms of the written contract."); see also Tangren Family Trust v. Tangren, 182 P.3d 326, ¶¶ 14-15 at 330-31 (Utah 2008) ("extrinsic evidence is appropriately considered even in the face of a clear integration clause, . . . where a contract is voidable for fraud, duress, mistake, or illegality.").

Finally, Wavetronix's acceptance of the contributions from DBSI does not constitute ratification of the promissory notes' classification of the contributions as loans. "Ratification results where the party entering the contract under duress intentionally accepts its benefits, remains silent, or acquiesces in it after an opportunity to avoid it, or recognizes its validity by acting upon it." Clearwater Const. & Eng'g, Inc. v. Wickes Forest Indus., 697 P.2d 1146, 1149 (Idaho 1985) (citing Restatement (Second) of Contracts §§ 380, 381 (1981)). The Restatement (Second) of Contracts explains that the opportunity to avoid the

contract (i) for duress or undue influence begins once the conditions that made the contract voidable have ceased to exist and (ii) for misrepresentation begins once the party knows of the fraudulent misrepresentation. Restatement (Second) of Contracts § 380. Here, Wavetronix argues that it did not know of DBSI's fraud at the time it accepted the benefits of the promissory notes. Accordingly, at this stage of the proceedings it cannot be said that Wavetronix ratified DBSI's characterization of the transfers as loans.

Wavetronix, through the Hepworth Declaration, has identified information which is essential to its opposition of Trustee's motion for summary judgment and that is within the control of Trustee, DBSI entities, or former DBSI employees. Wavetronix has thus satisfied its burden of establishing cause to defer consideration of Trustee's motion for summary judgment in order to allow discovery to go forward.

Conclusion

For the aforementioned reasons, I will grant Wavetronix's motion to defer consideration of Trustee's motion for summary judgment to allow time for discovery.

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DISTRICT OF DELAWARE

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Debtors.	)	Jointly Administered
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Defendants,	)	

ORDER

For the reasons set forth in the Court's memorandum opinion of this date, the motion of defendant Wavetronix LLC (Doc. # 57) to defer considering plaintiff's motion for summary judgment to allow time for discovery is **granted**.

Peter J. Walsh
United States Bankruptcy Judge

Dated: May 27, 2011