

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE**

In re:)	Chapter 11
)	
DBSI, INC., et al.)	Case No. 08-12687 (PJW)
)	
Debtors.)	Jointly Administered
)	
<u>JAMES R. ZAZZALI, as Trustee of</u>)	
the DBSI Estate Litigation)	
Trust created by operation of)	
the Second Amended Joint)	
Chapter 11 Plan of Liquidation,)	
)	
Plaintiff,)	
)	
v.)	Adv. Proc. No. 10-54649 (PJW)
)	
DOUGLAS L. SWENSON, et al.,)	
)	
Defendants.)	

MEMORANDUM OPINION

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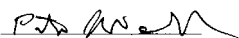
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Litigation Trust

Dated: May 5, 2011

WALSH, J 

This opinion is with respect to defendant Douglas L. Swenson's Partial Motion to Dismiss the Second Amended Complaint pursuant to Federal Rules of Civil Procedure 12(b)(6) and 9(b), applicable here under Federal Rules of Bankruptcy Procedure 7012 and 7009. (Doc. #42.) For the reasons set forth below, I will deny the motion.

Background

DBSI, Inc. and certain of its affiliates (the "Debtors") 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 James R. Zazzali as trustee of the DBSI Estate Litigation Trust ("Trustee").

As the 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, including defendant-movant Douglas L. Swenson. (Case No. 08-12687, Doc. # 5924, ¶ 27.) Trustee commenced this adversary proceeding against Swenson, other insiders, and certain taxing authorities in order to recover allegedly fraudulent transfers made to those insiders and to the taxing authorities on behalf of the insiders.

Trustee's Second Amended Complaint (the "Complaint") alleges that, during the four years prior to DBSI's bankruptcy,

Swenson received over \$42 million from the DBSI enterprise, in the form of cash payments or tax payments made on his behalf. (Doc. #33, ¶¶ 482-83.) The 208-page Complaint contains hundreds of paragraphs describing how the DBSI enterprise allegedly worked to defraud investors. (Id., ¶¶ 47-394.) The Complaint alleges that “[w]hatever its original business plan may have been, for many years DBSI had come loose from and operated unattached from any rational economic moorings, and ultimately became nothing more than the instrument of the Insiders’ elaborate pyramid or ‘Ponzi’ scheme to defraud Investors.” (Id. at ¶ 47.) It further alleges that “[t]he entire enterprise was operated as a fraud on investors and as the alter ego of Swenson.” (Id. at ¶ 49.)

Among the Complaint’s numerous allegations concerning accounting fraud and misuse of investor funds is an allegation, based on the court-appointed bankruptcy examiner’s report, that “[a] small group of management personnel, including Douglas Swenson, regularly tracked cash on a global basis and directed that investor funds be used to meet pre-existing obligations and operating expenses by evading restrictions governing the use of investor funds.” (Id. at ¶ 50.)

The Complaint alleges in detail the transfers made to Swenson (id., ¶¶ 482-486), and Exhibit A to the Complaint contains a 13-page spreadsheet listing transfers made to Swenson in the four years prior to DBSI’s bankruptcy, including the following

information for each transfer: the date of the transfer, the identity of the transferor, the type of transfer (distribution to Swenson or a tax payment), amount of transfer, and, for the tax payments, the identity of the taxing authority.

Trustee seeks to recover these transfers as actual fraudulent transfers (Counts 1, 4, and 7 of the Complaint) and constructively fraudulent transfers (Counts 2, 3, 5, and 6 of the Complaint), under section 548 of the Bankruptcy Code, 11 U.S.C. § 548, and relevant Idaho statutes, Idaho Code Ann. §§ 55-906, 55-913, 55-914, 55-916, and 55-917 .

Swenson has moved to dismiss Counts 1, 4, and 7 of the Complaint for failing to plead causes of action for actual fraudulent transfers with the degree of particularity required by Rule 9 of the Federal Rules of Civil Procedure. Swenson argues that, even though the Complaint makes broad allegations that the DBSI enterprise was fraudulent, it fails to allege specific facts to support Trustee's claim that any specific transfers were made with fraudulent intent. (Doc. #50, 3-5.) Swenson summarizes his argument as follows: "Trustee must allege not merely that the DBSI companies were engaged in fraud and that insiders benefitted; he must allege that the specific transfers at issue were made with the intent to defraud creditors." (Id. at 4-5.)

In his opposition brief, Trustee responds that the Complaint adequately pleads circumstantial evidence to support a

finding of fraudulent intent. Specifically, Trustee contends that the Complaint alleges at least six badges of fraud. Trustee further argues that fraudulent intent is presumed as a matter of law when, as here, the Complaint alleges a Ponzi scheme.

In his reply brief, Swenson does not challenge these badges of fraud. Instead, he argues that those badges of fraud are alleged too broadly, stating his argument as follows:

While the Trustee is correct that badges of fraud may be sufficient to establish fraudulent intent at the pleading stage, he fails to recognize that the particularity requirements of Rule 9(b) require him to tie those badges of fraud to specific transactions. . . . Here, the Trustee has made no attempt to plead fraudulent intent (whether by pointing to badges of fraud or otherwise) with respect to any specific transactions. Instead, he simply cites six badges of fraud and asserts generally that they apply to every transfer made to Mr. Swenson by four different entities and also to transfers made on Mr. Swenson's behalf to certain state taxing authorities. Those sweeping allegations are insufficient under Rule 9(b).

(Doc. #80, 1-2.)

Swenson further argues that Trustee's mere allegations of a Ponzi scheme do not warrant any presumption of actual fraud. No such presumption is appropriate, he contends, without actually proving the existence of a Ponzi scheme. (Id., 3-4.)

Standard of Review

In considering Swenson's motion to dismiss, I must accept the Complaint's factual allegations as true, construe the Complaint

in the light most favorable to Trustee, and determine whether, under any reasonable reading of the Complaint, Trustee may be entitled to relief. See Rea v. Federated Investors, 627 F.3d 937, 940 (3d Cir. 2010). A complaint can survive a motion to dismiss if it contains sufficient factual allegations which, when construed in the light most favorable to the plaintiff, would establish "plausible grounds" for a claim. Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 557 (2007); Fowler v. UPMC Shadyside, 578 F.3d 203, 210-11 (3d Cir. 2009).

Factual allegations are sufficient to state a claim for relief under Federal Rule of Civil Procedure 8 if, when construed in the light most favorable to the plaintiff, they would establish "plausible grounds" for a claim. Twombly, 550 U.S. at 557. Typically, allegations of fraud must meet the heightened pleading requirements of Rule 9: "In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake." Fed.R.Civ.P. 9(b); Official Committee of Unsecured Creditors of Fedders North America, Inc. v. Goldman Sachs Credit Partners L.P. (In re Fedders North America, Inc.), 405 B.R. 527, 544 (Bankr. D. Del. 2009). "The purpose of this rule is to 'place the defendants on notice of the precise misconduct with which they are charged'" Pardo v. Gonzaba (In re APF Co.), 308 B.R. 183, 188 (Bankr. D. Del. 2004) (quoting Seville Indus. Mach. Corp. v. Southmost Mach. Corp., 742 F.2d 786, 791 (3d Cir. 1984)). Rule

9's requirements, however, are relaxed in the bankruptcy context, particularly in cases such as the present in which a trustee has been appointed. In re APF Co., 308 B.R. at 188.

The Court therefore, reviews Trustee's actual fraudulent transfer claims under Rule 12(b)(6), applying the relaxed Rule 9(b) scrutiny.

Discussion

Pursuant to § 548(a)(1)(A), a trustee may recover a transfer "of an interest of the debtor in property" if the debtor "made such transfer . . . with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made . . . , indebted." 11 U.S.C. § 548(a)(1)(A).¹

To survive this motion to dismiss, Trustee must "set forth the facts with sufficient particularity to apprise [Swenson] fairly of the charges made against [him] so that [he] can prepare an adequate answer.'" Zazzali v. Wavetronix LLC (In re DBSI, Inc.), 2011 WL 781487, *3 (Bankr. D. Del. March 4, 2011) (quoting AstroPower Liquidating Trust v. Xantrex Tech., Inc. (In re AstroPower Liquidating Trust), 335 B.R. 309, 333 (Bankr. D. Del. 2005)). Trustee must specifically identify the allegedly fraudulent transfers, and he may do so by providing specific facts

¹ The relevant Idaho statute, Idaho Code Ann. § 55-913(1)(a), contains substantially identical language.

about (a) the date of the transfer, (b) the amount of the transfer, (c) the name of the transferor, and (d) the name of the transferee. Id. (In re DBSI, Inc.), 2011 WL 781487, *3.

Trustee does not need to plead the transferors' fraudulent intent with particularity; instead Trustee can sufficiently plead fraudulent intent by alleging certain "badges of fraud," including "(1) the relationship between the debtor and the transferee; (2) consideration for the conveyance; (3) insolvency or indebtedness of the debtors; (4) how much of the debtor's estate was transferred; (5) reservation of benefits, control or dominion by the debtor over the property transferred; and (6) secrecy or concealment of the transaction." Zazzali v. Mott (In re DBSI, Inc.), 2011 WL 115876, at *3 (quoting Fedders, 405 B.R. at 545).²

Here, Trustee has specifically identified the subject transfers by date, amount, and identity of transferor and transferee. In addition, Trustee has adequately pleaded all six badges of fraud, and Swenson has not challenged the adequacy of these pleadings. Swenson, however, argues that the Complaint fails to state a claim because it does not connect the fraudulent intent with any specific transfers. As he states in his reply brief,

[Trustee] simply cites six badges of fraud and asserts generally that they apply to every transfer made to Mr. Swenson by four different entities and also to transfers made on Mr. Swenson's behalf to certain state taxing

²Idaho Code Ann. § 55-913(2) incorporates similar factors to determine actual intent.

authorities. Those sweeping allegations are insufficient under Rule 9(b).

(Doc. #80, 1-2.)

Swenson's argument reflects a misunderstanding of Trustee's allegations. The allegations themselves are not sweeping. It is the size of Swenson's alleged fraudulent scheme that is broad and sweeping. Trustee alleges that every transfer to Swenson from all DBSI entities, as well as every transfer made by the DBSI entities to a taxing authority on Swenson's behalf, were made with actual intent to hinder, delay, or defraud the transferors' creditors.

The Complaint's expansive sweep is rooted in the allegations that the DBSI enterprise was a Ponzi scheme. It is well-established that "where a Ponzi scheme exists, there is a presumption that transfers were made with the intent to hinder, delay and defraud creditors." In re Bayou Group, LLC, 439 B.R. 284, 306 n. 19 (S.D.N.Y.2010). This presumption applies to every transfer from the DBSI enterprise. See Cuthill v. Greenmark, LLC (In re World Vision Entm't, Inc.), 275 B.R. 641, 656 (Bankr. M.D. Fla. 2002) ("Every payment made by the debtor to keep the scheme on-going was made with the actual intent to hinder, delay, or defraud creditors, primarily the new investors.") In his reply brief, Swenson argues that the existence of a Ponzi scheme must be an established fact before the presumption can be made. I do not agree with that position. Trustee will eventually have to prove

the existence of a Ponzi scheme, but at this stage of the proceedings, the Complaint contains sufficient factual allegations to survive the motion to dismiss.

Because Trustee has adequately pleaded badges of fraud and has specifically identified every transfer made to Swenson, I will deny the motion.

Conclusion

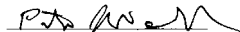
For the foregoing reasons, I will deny the motion to dismiss.

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ORDER

For the reasons set forth in the Court's memorandum opinion of this date, the partial motion of defendant Douglas L. Swenson to dismiss the Second Amended Complaint (Doc. # 42) is **denied.**



Peter J. Walsh
United States Bankruptcy Judge

Dated: May 5, 2011