

In the United States Bankruptcy Court

for the Northern District of Iowa

BOYT LIMITED PARTNERSHIP
Debtor(s).

Bankruptcy No. 96-42688M
Chapter 7

LARRY S. EIDE Trustee
Plaintiff(s)

Adversary No. 98-9266M

vs.

THE KEYSTONE GROUP INC.;
ANDREW J. ROLFE d/b/a The
Keystone Group; BOYT HARNESS
COMPANY L.L.C.
Defendant(s)

ORDER RE: MOTION TO DISMISS AND STRIKE

On October 19, 1998, Larry S. Eide, Chapter 7 Trustee, filed a complaint to avoid certain transfers and recover property under 11 U.S.C. §§ 544 and 548. The complaint relates to the sale of assets of the debtor to defendant Boyt Harness Company, L.L.C. ("Boyt Harness"), which Eide alleges took place July 30, 1996. The first three claims of the complaint are against defendants The Keystone Group, Inc. and Andrew J. Rolfe. Eide alleges that Keystone Group and Rolfe, through their involvement in the sale transaction, received a preferential transfer or effected a fraudulent conveyance. The fourth and fifth claims of the complaint are against Boyt Harness. Eide alleges that the sale of assets to Boyt Harness constituted an avoidable transaction under theories of actual and constructive fraud. Eide seeks to recover the property or its value under 11 U.S.C. § 542 as property of the estate. See also 11 U.S.C. § 550(a) (to the extent fraudulent transfer is avoided, trustee may recover from transferee for benefit of the estate).

Boyt Harness obtained an extension of time to file an answer or responsive motion. Docs. 4, 9, 10. On February 8, 1999, Boyt Harness filed a motion to strike and dismiss under Fed.R.Civ.P. 9(b), 12(b)(6) and 12(f), made applicable in this proceeding by Fed.R.Bankr.P. 7009 and 7012. Doc. 15. Boyt Harness concedes that the complaint adequately states a claim for constructive fraud. It contends, however, that Eide has not pleaded sufficient facts so as to state a claim for actual fraud. It requests the court to dismiss the claim and to strike all immaterial allegations, including those unrelated to the remaining claim against Boyt Harness for constructive fraud.

On March 17, 1999, Eide filed a resistance to the motion. Doc. 22. Both parties have filed briefs. Docs. 16, 23, 24. A telephonic hearing on the motion was held May 14, 1999. Bruce E. Lithgow and David M. Nelsen appeared for movant Boyt Harness. Randall S. Nielsen appeared for Eide.

Motion to Dismiss

Boyt Harness requests the court to dismiss Eide's claim for actual fraud for failure to plead fraud with particularity, as required by Rule 9(b), and for failure to state a claim upon which relief can be granted, under Rule 12(6)(b). In testing the sufficiency of a complaint to withstand a motion for Rule 12(b)(6) dismissal, the court must accept Eide's factual allegations as true.

A complaint must be viewed in the light most favorable to the plaintiff and should not be dismissed merely because the court doubts that a plaintiff will be able to prove all of the necessary factual allegations.... A court may dismiss a complaint only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations.

Ginder v. Peed (In re Peed), Adv. No. 92-3234XF, slip op. at 3 (Bankr. N.D. Iowa Feb. 17, 1993) (quoting Palmer v. Tracor, Inc., 856 F.2d 1131, 1132 (8th Cir. 1988)).

Boyt Harness concedes that Eide has sufficiently stated a claim for constructive fraud. It argues, however, that, because of the particularity requirement of Rule 9(b), the complaint does not state a claim for actual fraud.

Rule 9(b) provides:

In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally.

Fed.R.Civ.P. 9(b).

The particularity requirement of Rule 9(b) satisfies three goals: "(1) providing a defendant fair notice of plaintiff's claim, to enable preparation of a defense; (2) protecting a defendant from harm to his reputation or goodwill; and (3) reducing the number of strike suits." Lanmark Group, Inc. v. Rifkin (In re Rifkin), 142 B.R. 61, 65 (Bankr. E.D.N.Y. 1992) (quoting DiVittorio v. Equidyne Extractive Industries, Inc., 822 F.2d 1242 (2d Cir. 1987)); accord, United States ex rel. O'Keefe v. McDonald Douglas Corp., 918 F.Supp. 1338, 1345 (E.D. Mo. 1996). Whether a pleading satisfies the particularity requirement of Rule 9(b) depends upon the "nature of the case, the complexity or simplicity of the transaction or occurrence, the relationship of the parties and the determination of how much circumstantial detail is necessary to give notice to the adverse party and enable him to prepare a responsive pleading." Payne v. United States, 247 F.2d 481, 486 (8th Cir. 1957) (quoted in United States ex rel. O'Keefe, 918 F.Supp. at 1345). In some instances, courts apply a less rigid standard for pleading fraud in bankruptcy proceedings. Rifkin, 142 B.R. at 65-66; Hassett v. Zimmerman (In re O.P.M. Leasing Services, Inc.), 32 B.R. 199, 203 (Bankr. S.D.N.Y. 1983). A more "relaxed standard" may apply when the plaintiff is the bankruptcy trustee, an outsider to the allegedly fraudulent transaction. Rifkin, 142 B.R. at 66.

The "circumstances constituting fraud," within the meaning of Rule 9(b), are the facts telling when and where the alleged fraud took place, who was involved, the nature of the fraudulent action and how it was accomplished. Parnes v. Gateway 2000, Inc., 122 F.3d 539, 549-50 (8th Cir. 1997) (the "who, what, when, where, and how" of the fraudulent conduct, quoting DiLeo v. Ernst & Young, 901 F.2d 624, 627 (7th Cir. 1990)); see also Rifkin, 142 B.R. at 65 (plaintiff must allege "(1) specific facts, (2) sources that support the alleged specific facts, and (3) a basis from which an inference of fraud may be fairly drawn") (quoting Crystal v. Foy, 562 F.Supp. 422 (S.D. N.Y. 1983)).

The court must determine whether the complaint states a claim for fraudulent transfer under Iowa law. "Applicable law" under 11 U.S.C. § 544(b)(1) is the law of the state where the allegedly fraudulent transfer took place. Seidle v. Carpenter (In re Janis), 60 B.R. 349, 351 (S.D. Fla. 1986). Although fraudulent intent under 11 U.S.C. § 548(a)(1) is a matter of federal law, it is appropriate for the court to consider the factors listed in a state's codification of the common law badges of fraud. Brown v. Third Nat'l Bank (In re Sherman), 67 F.3d 1348, 1354 (8th Cir. 1995).

Eide has alleged that the fraudulent transaction was a sale of the debtor's assets that took place approximately July 30, 1996, that Boyt Harness was the purchaser in the sale, that Keystone Group and Rolfe negotiated the sale, and that Boyt Harness paid approximately \$1,000,000 for the assets. Complaint, Count IV, ¶¶ 13-16. Eide claims that Boyt Harness purchased the assets with actual fraudulent intent. Eide alleges that Boyt Harness knew that the debtor was insolvent on the date of the sale or would become insolvent as a result of the sale, that it knowingly gave less than reasonably equivalent value for the assets it received, and that it had a close relationship with both the debtor and Keystone or Rolfe. See, e.g., Complaint, Count IV, ¶¶ 26(f), (g), (l), (m), (n), (o), (u) (insolvency); ¶ 26(v) (value given); ¶¶ 17, 26(e), (p), (q), (r), (s) (relationship). Eide has alleged circumstances that constitute badges of fraud under Iowa law. See Iowa Code § 684.4(2) (badges of fraud enumerated in Uniform Fraudulent Transfer Act as enacted in Iowa); Graham v. Henry, 456 N.W.2d 364, 366 (Iowa 1990) (badges of fraud under common law).

Eide has alleged that Boyt Harness was in some type of "insider" relationship with the debtor, Keystone and Rolfe, and that there was a failure to disclose the relationship. See Complaint, Count IV, ¶¶ 26(r), (s). Boyt Harness argues that Eide has failed to state facts to show that it was an "insider" under 11 U.S.C. § 101(31). Reply Brief, doc. 24, at 7. The badges of fraud listed in Iowa's fraudulent transfer statute are not exclusive. Iowa Code § 684.4(2) (in determining actual intent, court may consider "among other factors, ... any or all of the following"). Nor is the definition of "insider" exclusive for the purposes of Iowa Chapter 684. Iowa Code § 684.1.7 ("insider" includes all of the following). Close relationships between parties to a transfer, other than the relationships listed in § 684.1.7, may strengthen the inference of fraud arising from the circumstances of the transfer between parties. The strength of the inference of fraud arising from the presence of badges of fraud in a particular transaction is a matter for trial. The court concludes that Eide's complaint is sufficient to meet the requirements of Rule 9(b) and Rule 12(b)(6) on a motion to dismiss. The complaint states the circumstances of fraud with sufficient particularity so as to state a claim for actual fraud. The motion to dismiss should be denied.

Boyt Harness argues that the complaint fails to describe the property transferred, citing Parnes v. Gateway 2000, Inc., 122 F.3d 539, 550 (8th Cir. 1997). Brief, doc. 16, at 8. The Parnes v. Gateway case was an investors' suit for securities fraud. The complaint alleged that a variety of actions artificially inflated the price of Gateway stock prior to a public offering. It was alleged that "controlling shareholders" purchased "\$6 million of product" at inflated prices, and that a "significant amount of these fraudulent transactions took place in the third quarter of 1993." 122 F.3d at 550. The plaintiffs did not identify who purchased the goods or what the goods were, and gave only the "barest clue" as to when the purchases took place. Id. In contrast, Eide has alleged that the property transferred was the subject of a deal that closed July 30, 1996. Boyt Harness was a party to the transaction. The transaction was apparently memorialized in a closing binder. Boyt Harness Reply Brief, doc. 24, at 3. Eide has described the property transferred with sufficient particularity for purposes of Rule 9(b).

Boyt Harness argues that Eide has failed to plead a factual basis for his allegations of scienter, the participation of Boyt Harness with knowledge and actual fraudulent intent, citing Stern v. Leucadia Nat'l Corp., 844 F.2d 997, 1004 (2d Cir. 1988). Reply Brief, doc. 24, at 6-8. See also Brief, doc. 16, at 6, 8, citing Helms v. Arboleda (In re Arboleda), 224 B.R. 640, 646 (Bankr. N.D. Ill. 1998), and Goveart v. Capital Bank (In re Miami General Hospital, Inc.), 124 B.R. 383, 391 (Bankr. S.D. Fla. 1991).

Rule 9(b) provides that "intent, knowledge, and other condition of mind ... may be averred generally." See generally, 5 Wright & Miller, Fed. Practice & Procedure: Civil § 1301 (2d ed. 1990). As discussed above, the court has concluded that Eide's complaint states a basis from which an inference of fraud may be drawn and gives Boyt Harness notice of the nature of the alleged fraud so that it is able to formulate a responsive pleading. The complaint meets the standards outlined in Parnes v. Gateway, 122 F.3d 539 (8th Cir. 1997), and Rifkin, 142 B.R. 61 (Bankr. E.D.N.Y. 1992). The court is not persuaded that the cases cited by Boyt Harness create a more stringent standard to withstand a motion to dismiss under Rule 9(b).

The case of Miami General involved a post-trial motion to dismiss, and has little value for deciding a motion to dismiss under Rule 9(b). In Arboleda, the court granted motions to dismiss a fraud claim on the ground that it was barred by the statute of limitations. 224 B.R. at 649. The court then held that the claim should be dismissed on the alternate ground of failure to plead fraud with particularity. The trustee plaintiff made the "bare bones" allegation that the debtor transferred money to another pre-petition and that, on "information and belief," the transfer was made with fraudulent intent. Id. at 650. The case of Stern v. Leucadia was a shareholder's claim for securities fraud. All the material allegations were made on the basis of information and belief. 844 F.2d at 999. The court in Stern stated that, although state of mind may be "averred generally," the plaintiff must plead circumstances that "provide a factual foundation for otherwise conclusory allegations of scienter." Id. at 1004. In the case before this court, Eide's complaint alleges that the transfer at issue was made with actual fraudulent intent. The factual foundation for this allegation is laid by the pleading of the badges of fraud, which the court finds are sufficient to state a claim.

Boyt Harness contends, however, that the allegations of the badges of fraud themselves require additional facts. Reply Brief, doc. 24, at 5-8. It argues that Eide must state "foundational facts" to support the allegations of insolvency and lack of reasonably equivalent value. Id. at 5-6. The court disagrees. The plaintiff needs to state a "basis from which an inference of fraud may be fairly drawn," Rifkin, 142 B.R. at 65, but need not go into great detail as to factual matters that may be obtained by discovery or brought out as evidence at trial. D & G Enterprises v. Continental Illinois Nat'l Bank & Trust Co. of Chicago, 574 F.Supp. 263, 267 (N.D. Ill. 1983) (plaintiff need not plead "detailed evidentiary matters"); Continental Illinois Nat'l Bank & Trust Co. of Chicago v. Doppelt (In re Doppelt), 57 B.R. 124, 127 (Bankr. N.D. Ill. 1986) (need not attach discoverable evidence documents to the complaint); see also 5 Wright & Miller, § 1298 at 624-27 (discussing "pleading evidence").

Motion to Strike

Rule 12(f) provides that a "court may order stricken from any pleading any insufficient defense or any redundant, immaterial, impertinent, or scandalous matter." Boyt Harness relies primarily on the language allowing immaterial matter to be stricken. It argues that, if the claim for actual fraud were dismissed, allegations in the complaint unrelated to the remaining claim for constructive fraud would become irrelevant. That argument is now moot because of the court's ruling on the motion to dismiss.

Boyt Harness also argues that portions of Counts IV and V are addressed to defendants Keystone and Rolfe. In Clorox Co. v. Chromium Corp., 158 F.R.D. 120, 129 (N.D. Ill. 1994), the court struck references to a defendant in counts which sought relief only against other defendants. Boyt Harness is in the reverse situation. Counts IV and V do seek relief against Boyt Harness. There are several references to defendants Keystone and Rolfe, including allegations as to the knowledge of those defendants. See, e.g., Complaint, Count IV, ¶¶ 26(c), (d), (h). These allegations, however, are not confusing or unduly lengthy. Eide alleges each of the defendants was involved in the transaction sought to be avoided. He contends that the relationships among the defendants and the debtor are relevant to the nature of his fraud claim. The court concludes that the inclusion of references to other defendants in the claims against Boyt Harness does not warrant striking portions of Eide's complaint. The motion to strike should be denied.

IT IS ORDERED that the motion to dismiss and strike is denied. Defendant Boyt Harness shall have 10 days from the date of this order [date certain] to serve an answer.

SO ORDERED THIS 16th DAY OF JUNE 1999.

William L. Edmonds
Chief Bankruptcy Judge