

community BANKER

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Welcome to the latest issue of the COMMUNITY BANKER.

The Community Banker is prepared by attorneys at Olson & Burns P.C. to provide information pertaining to legal developments affecting the field of banking. In order to accomplish this objective, we welcome any comments our readers have regarding the content and format of this publication. Please address your comments to:

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The attorneys at Olson & Burns represent a wide range of clients in the financial and commercial areas. Our attorneys represent more than 30 banks throughout North Dakota.

Court Upholds Contempt and Sanctions Ruling Against a South Dakota Independent Community Bank and Its President

The 8th Circuit Court of Appeals recently affirmed a ruling against South Dakota lender First State Bank of Roscoe and its president, John Beyers, who was accused of manipulating the borrowers into repaying debt that had been discharged in bankruptcy. In 2016, Pres. Beyers was found to be in contempt of a final bankruptcy court injunction, based on findings in a parallel state court proceeding. The contempt motion was granted in June 2016, ordering \$159,606.77 in compensatory damages and another \$50,000 in punitive damages. Half the punitive damages were owed by the bank, half by Pres. Beyers. In that this has worked its way up to the 8th Circuit in nearly three years, the interest on these awards is substantial; much worse, the damage to the good name of the Bank is immense.



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What *happened*? Brad and Brenda Stabler borrowed from the First State Bank of Roscoe to fund an ag services business. When the enterprise failed, they liquidated their business and Pres. Beyers advised them to seek bankruptcy protection; Pres. Beyers also recommended an attorney to the Stablers without telling them that the lawyer had previously served as the Bank's lawyer. In the bankruptcy, the Stablers' lawyer failed to list all debt owed by the Stablers to the Bank; they owed the Bank over \$600,000, but the bankruptcy schedules listed the Bank as a secured creditor claiming much less than that amount. The Bank held loan guarantees from the Stablers, held priority liens against the Stablers' land and farm machinery, and held a lien on land owned by Brad Stabler's parents. However, the total liens were insufficient to secure fully the Stablers' pre-bankruptcy indebtedness to the Bank.

After the Stablers received their bankruptcy discharge, the Bank continued to hold security interests on the Stablers' land and equipment and on Brad's parents' land. Instead of foreclosing on this collateral and suffering a substantial loss, the Bank and John Beyers obtained a commitment to pay a new \$650,000 note from the Stablers and Brad's parents, Stanley and Rose Marie Stabler. This was an amount substantially more than the security interests that had survived bankruptcy.

The Bank and Pres. Beyers obtained this commitment without court approval and attempted to conceal the loans with a series of transactions and debt transfers involving third parties. Brad and Brenda Stabler and Brad's parents became obligated on a \$416,000 note to a partnership named Schurrs, a \$213,000 note to Roger Ernst, and a \$21,000 note to a company named H&K Acres. These three other parties had relationships with Pres. Beyers or the Bank and received assignments of security interests from the Bank. Eventually, the Stablers paid off the \$21,000 note, and Pres. Beyers received the other notes and related security interests by assignment. Later, acting as a guarantor, Pres. Beyers helped the Stablers obtain a \$150,000 loan from Ipswich State Bank and secured by the Stablers' property. The Stablers used this additional \$150,000 to pay the Bank, but the parties disputed whether this payment to the Bank was for discharged debt or post-discharge debt. Eventually, Pres. Beyers obtained assignment of the Ipswich Note and related security interests from Ipswich.

The Stablers fell behind on their payments on the post-bankruptcy obligations; the Bank and Pres. Beyers commenced collection efforts. In response, both Stabler families brought a state-court action seeking a determination of what they owed the various lenders. In the state-court action, they alleged the post-bankruptcy commitments were unenforceable and improper reaffirmations of debt discharged by the bankruptcy court. They also alleged claims of fraud, breach of fiduciary duty, and conspiracy, claiming that the Bank and Pres. Beyers knew the debt refinanced with the \$650,000 note had been discharged but misrepresented that the discharged amounts were still owed. The Bank and Pres. Beyers asserted various counterclaims in response, alleging that they could enforce the post-bankruptcy commitments.

The Stablers then filed an adversary action in bankruptcy court against the Bank and Pres. Beyers, alleging a violation of the discharge injunction and seeking contempt sanctions. Ultimately, the state court determined that the Bank and Pres. Beyers coerced the Stablers into reaffirming their debt and wrongly attempted to collect on a discharged debt. Separately, a jury found that in Brad's parents' case, \$439,100

of the \$650,000 note was obtained by fraud on the part of the Bank and Pres. Beyers.

In the bench trial, the state court entered a written order describing in detail its findings as to the events that led the Stablers to enter into the \$650,000 post-discharge note. None of the findings were flattering to the Bank or Pres. Beyers:

Things did not go well with [the Stablers' business]. [The business] was being sued by various parties. John Beyers assessed the situation and realized that [the business] was doomed. More importantly, John Beyers realized that if the litigation was allowed to proceed, those other parties were going to obtain judgments against [the business]. Beyers realized that [the business] did not have sufficient assets to cover all of its liabilities and was essentially bankrupt. Being an astute and experienced businessman, Beyers saw the natural progression. Unless he took action, [the business] eventually would be forced into bankruptcy. He realized that [the Bank] was under-secured on the loans to Brad and Brenda Stabler and [the business]. In order to protect [the Bank's] interests, Beyer[s] arranged for Brad and Brenda Stabler to meet with Attorney Rob Ronayne about filing for bankruptcy.

The evidence establishes that this bankruptcy was not Brad or Brenda's idea. This idea was solely that of John Beyers. John Beyers decided that Brad and Brenda Stabler should file bankruptcy. John Beyers personally decided who Brad and Brenda Stabler should use as their bankruptcy attorney - Rob Ronayne. Rob Ronayne is an experienced bankruptcy attorney. Rob Ronayne also regularly served as an attorney for [the Bank]. John Beyers also knew this. John Beyers convinced Brad and Brenda Stabler that he was acting in their best interests. He was not and knew it. I find and conclude that John Beyers'[s] intention was to protect the financial interests of [the Bank].

John Beyers owns [the Bank]. John Beyers knew that if the lawsuits were allowed to proceed, [the business] and Brad and Brenda Stabler would eventually end up filing for bankruptcy. By maintaining their trust, encouraging them to file bankruptcy, and selecting their bankruptcy attorney, Beyers believed that he could control the situation so that the debts of other creditors could be discharged while the obligations to [the Bank] could be maintained or reassumed. Over the course of the next year, this is exactly what John Beyers and [the Bank] accomplished.

Brad and Brenda Stabler filed for and received discharge from bankruptcy court. The discharge eliminated Brad's personal guarantee of [the business] debt. [The Bank] still held security interests in Brad and Brenda Stabler's farm and machinery because such secured interests are not discharged by bankruptcy. [The Bank] still held a security interest worth approximately \$110,000 over a quarter section parcel of land owned by [Brad's parents]. [The Bank] could have foreclosed on that quarter of land to recover on that debt. [The Bank] could have foreclosed on Brad and Brenda's land and other secured property. This course of action would have resulted in a significant shortfall for [the Bank]. [The Bank] would have recovered some money but would have taken a significant loss on the various loans of Brad and Brenda and [the business]. More importantly, [the Bank] would have had no further recourse against any of the Stablers. John Beyers understood this.

Instead of accepting such a loss, John Beyers devised a scheme through which he would convince Brad and Brenda Stabler to continue paying on their discharged debt. Alone, this would be practically useless because Brad and Brenda clearly did not have the resources to service the reaffirmed debt. It was only a matter of time before they would default. John Beyers'[s] scheme included a plan to improve [the Bank's] security interests by convincing [Brad's parents] to sign increasingly larger mortgages to their entire farm in order to secure the debt of Brad and Brenda. This is exactly what transpired. As found by the jury and by this Court, \$439,100 of the value of those mortgages was obtained by fraud on the part of John Beyers and [the Bank].

Stablers v. First State Bank of Roscoe, et al., Civ. No. 07-11 (S.D. Cir. July 8, 2013) (Memorandum Decision following court trial). Ouch.

The state trial court concluded that Pres. Beyers had coerced Brad and Brenda into reaffirming their debt, it granted the Stablers' rescission of the \$650,000 note, and awarded the Stablers \$142,908.27. Once the state-court action concluded, the Stablers returned to bankruptcy court seeking attorneys' fees from and a contempt sanction against the Bank and Pres. Beyers for violation of the discharge injunction. The bankruptcy court found that the Bank and Pres. Beyers violated the discharge injunction, held them in contempt and sanctioned each \$25,000, and found them liable for the Stablers' attorneys' fees in the amount of \$159,605.77.

The Bank and Pres. Beyers appealed. The 8th Circuit rejected the argument made by the Bank and Pres. Beyers that they acted in good faith for a number of reasons, including (1) there was no case law that would support their theory that it was permissible to obtain a new commitment from a bankrupt debtor after discharge based upon a secured lender's forbearance in foreclosing on a security interest; (2) the Bank and Pres. Beyers clearly knew no unsecured debt had survived bankruptcy; and (3) because Pres. Beyers guided Brad and Brenda Stabler into bankruptcy in the first place and then later sought to collect on the discharged debt, the Bank and Pres. Beyers demonstrated a lack of good faith and an effort to defeat the bankruptcy discharge.

There's a moral to this story, but you bankers already know it.

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