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STATE OF NORTH DAKOTA

IN THE SUPREME COURT
STATE OF NORTH DAKOTA

Donna Watts, Jack Watts, Georgia Bonderenko,)
Mabel Brauer, Gaylen Erck, Vickie Erck, Rodney)
Getzlaff, Kathy Getzlaff, Harlon Getzlaff, Dennis)
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Jim Suydam, Bonnie Suydam, Clara Thompson,)
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Weigel, LaRinda Weigel, Lynn Wood, Vernon F.)
Bohara, Elinda Kay Bohara, Laverne Mikkelson as)
Trustee of Ann C. Bonebrake Trust, and Carol)
Uecker,)

Supreme Court
Case No. 20110145

Plaintiffs-Appellants,)

vs.)

Magic 2 x 52 Management, Inc., a North Dakota)
corporation, B K Properties, L.L.C., a North Dakota)
limited liability company, Herslip Construction, Inc.,)
a North Dakota corporation, Kenneth Herslip,)
individually, and doing business as Herslip)
Restaurants, Bradley Wells, and Mark Guttormson.)

Defendants-Appellees.)

APPEAL FROM LETTER OPINION ENTERED MARCH 25, 2011
BY THE HONORABLE WILLIAM W. MCLEES, NORTHWEST JUDICIAL
DISTRICT, WARD COUNTY, NORTH DAKOTA, CIVIL NO. 51-07-C-00280

REPLY BRIEF OF APPELLANT

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RESPONSE TO APPELLEE'S STATEMENT OF THE CASE

(1.) Defendants Statement of the Case contains numerous inaccuracies and is misleading in the extreme. Due to word limitations, and for purposes of clarity, such inaccuracies are addressed, where appropriate, directly in the argument below.

ARGUMENT

I. Plaintiffs' Motion to Pierce the Corporate Veil and for Punitive Damages Was Timely – Defendants' Continue To Misconstrue Plaintiffs' Motion

(2.) Defendants continue to misconstrue the Plaintiffs' requested remedy from the District Court as a motion seeking to amend or modify the existing judgment. Plaintiffs do not seek to amend the existing judgment. Instead, Plaintiffs seek an additional judgment based upon ongoing fraudulent conduct by the Defendants engaged in for the primary wrongful purpose of frustrating Plaintiffs' collection upon the existing judgment. Plaintiffs seek to hold defendant Kenneth Herslip personally liable for the existing judgment amount as a result of his ongoing fraud of transferring judgment debtor assets and committing intentional waste of judgment debtor assets for the sole purpose of preventing Plaintiffs' collection upon the existing judgment. The facts underlying Plaintiffs' claim in this regard were not at issue during the trial in this action (the merits of Plaintiffs' claims have never been addressed) as the financial condition of the Defendants did not even become relevant until after Plaintiffs' obtained judgment against the Defendants and the Defendants failed to voluntarily pay the judgment prior to expiration of the ten day stay on execution pursuant to Rule 62 of the N.D.R.Civ.P. The issue before this Court is not whether the District Court should have amended or modified the existing judgment, but rather whether the District Court erred in concluding it lacked the power to grant additional post-judgment relief

requested by Plaintiffs to address ongoing (both pre and post-judgment) fraudulent conduct by the Defendants.

(3.) Although the District Court sympathized with the Plaintiffs' plight, the District Court accepted the Defendants' position the District Court lacked the power to grant the requested relief "**in this action,**" (bold in original) essentially stating Plaintiffs must commence a separate lawsuit to pursue the requested relief. Although Plaintiffs disagree with the District Court's determination, and hence this appeal, Plaintiffs have none-the-less commenced another civil lawsuit before the District Court (pending) against the Defendants, as well as additional Defendant-related entities, entitled *Magic 2 x 52 Limited Partnership v. Kenneth Herslip, et al.*, Ward County District Court, Civil No. 51-2011-CV-00742 (hereinafter "companion case"), seeking a remedy for the ongoing fraudulent conduct of Defendants and their related entities. Defendants, in a pending motion to dismiss in the companion case, have argued Plaintiffs' claims are barred by res judicata and/or collateral estoppels as a result of the District Court's ruling appealed from in this action. In other words, Defendants argued to the District Court in the present case a remedy must be sought in a separate lawsuit, and now that a separate lawsuit has been commenced, they argue Plaintiffs' claims are barred by res judicata and/or collateral estoppel. In addition, Defendants have recently filed a baseless motion in the bankruptcy court proceedings involving Herslip Construction (Case No. 10-30713) and Magic Management (Case No. 10-30714) requesting an order to enforce an automatic stay against all state court legal proceedings by Magic Partnership against Herslip Construction and Magic Management, including these proceedings. Defendants have taken the position they can never be held to account for their ongoing

fraudulent conduct which has never been addressed on the merits by any court. It should be noted corporate entities cannot obtain a discharge of debts in bankruptcy, as a matter of law.

(4.) The District Court has continuing jurisdiction over the parties post-judgment and the inherent power to award the Plaintiffs' requested post-judgment relief. *See Bank Center First v. Kostelecky*, 2000 ND 84, ¶ 3, 609 N.W.2d 721 (trial court's do not lose jurisdiction over the parties once judgment is entered). Plaintiffs' motion to the District Court simply requested additional post-judgment relief in aid of collection upon the existing judgment based upon the District Court's original and continuing jurisdiction over the parties.

(5.) Defendants attempt to distinguish *Axtmann v. Chillemi*, 2007 ND 179, 740 N.W.2d 838, and the other cases cited by Plaintiffs, is without merit. While it is true *Axtmann* involved a new action to pierce the corporate veil of the judgment debtor, the necessity of the new action was due to the fact the trial court did not have personal jurisdiction over the individuals and entity sought to be held responsible for the judgment debt as they were not parties to the original action in which the judgment was obtained. Those sought to be held responsible for the corporation's judgment debt included its officers and a new corporate entity formed by the officers to which judgment debtor assets had been wrongfully transferred to avoid collection upon the judgment. In the present case, the party sought to be held responsible for the judgment debt, namely Ken Herslip, has always been a party to this action and the District Court has continuing post-judgment jurisdiction over him, whether in his personal capacity, or as a shareholder, officer and director of the judgment debtors.

(6.) Similarly, Defendants attempt to distinguish the proposition in *Hamilton v. Hamilton*, 410 N.W.2d 508, 515 (N.D. 1987) that trial courts have the inherent power to

grant relief from a judgment in equity in the interests of justice outside of N.D.R. Civ. P. 59 and 60 on the alleged basis such equitable power can only be exercised by the trial court in a separate action is without merit, and defies logic. While Plaintiffs deny relief from the existing judgment is necessary in this action, even assuming, arguendo, such relief were necessary, the trial court had the equitable power to grant such relief on the basis of ongoing fraud by Defendants and the absence of fault or negligence on the part of the Plaintiffs.

(7.) Further, Defendants completely fail to address Plaintiffs' argument the District Court had the power to grant the Plaintiffs' requested relief pursuant to North Dakota's Uniform Fraudulent Transfer Act, codified at chapter 13-02.1, as discussed in paragraph II of the Argument in Appellants' Brief. Defendants thereby concede this point.

II. The Merits of Plaintiffs' Claim of Ongoing Fraud And Intentional Waste of Judgment Debtor Assets Have Never Been Addressed By Any Court

(8.) Defendants' assertion on page 4 that Eide Bailly conducted a full forensic audit of Mr. Herslip and all related entities in this action is absolutely false and misleading in the extreme. Eide Bailly's examination was focused upon the specific pre-trial allegations of wrongdoing made by the Plaintiffs, as spelled out in the Plaintiffs' Fourth Amended Complaint. Eide Bailly only reviewed the records of Magic Partnership, Magic Management, Herslip Construction, BK Properties, and Ken Herslip to the extent it deemed necessary to investigate those specific underlying claims. When this examination occurred, the fraudulent conduct now at issue, i.e. fraudulent asset transfers of Defendants' assets and intentional asset waste, was not even relevant and was not investigated. It is highly improbable the District Court would have even allowed Plaintiffs to conduct discovery into the financial condition of, and any asset transfers by, the Defendants, prior to Plaintiffs

obtaining judgment against them. Prior to trial, the issue was wrongful asset transfers out of Magic Partnership by the Defendants, not the wrongful asset transfers out of any of the Defendants.

(9.) As to the issue of punitive damages, as stated, the District Court determined Defendants had committed fraud which could justify an award of punitive damages. However, the District Court exercised its discretion by not awarding punitive damages. The fact the District Court previously determined the evidence under consideration at the time of trial did not justify an award of punitive damages does not preclude the District Court from now granting punitive damages against the Defendants on the basis of all relevant facts of ongoing fraud, occurring both pre and post-trial. In other words, the District Court's consideration of relevant evidence of fraud at the time of trial does not now preclude the District Court's consideration of those same facts, in conjunction with new evidence of fraud, in analyzing whether punitive damages are now justified.

(10.) Similarly, although the District Court determined the evidence under consideration at the time of trial was not sufficient to warrant piercing the corporate veil of the corporate Defendants, such determination does not preclude the District Court from considering that same evidence, in conjunction with the new evidence of ongoing fraud, in analyzing whether it is now appropriate to pierce the corporate veils of the judgment debtors to hold Ken Herslip personally liable for the judgment debts on the basis of fraud. Plaintiffs' current allegations of ongoing fraud by the Defendants have never been addressed on the merits.

III. The District Court Is The Proper Venue For Plaintiffs' Claims – There Has Been No Violation Of Any Automatic Stay In The Pending Bankruptcy Proceedings

(11.) Plaintiffs' motion was properly addressed to the District Court. Defendants confuse the issue of recovery of assets improperly transferred by the judgment debtors (arguably the province of the bankruptcy trustee as to Herslip Construction and Magic Management), with Plaintiffs' requested remedy of holding the shareholder/officer/director of the judgment debtors (Ken Herslip) personally liable for the judgment debts due to wrongful conduct by making fraudulent transfers and engaging in intentional waste of judgment debtor assets. These are two distinct and separate issues. While the Bankruptcy Court may be an appropriate forum to pursue recovery of specific assets wrongfully transferred by Herslip Construction and Magic Management, that is not the relief sought by the Plaintiffs pursuant to their motion to the District Court, at issue. Bankruptcy Court is not the proper forum to address Plaintiffs' request to pierce the corporate veils of Herslip Construction and Magic Management to hold Ken Herslip personally responsible for their judgment debts. Ken Herslip has not filed for bankruptcy protection and a judgment piercing the corporate veils of Herslip Construction and Magic Management will not violate any automatic stay as such would not affect the ownership or disposition of the assets of Herslip Construction or Magic Management. Instead, such a decision would only impact the assets of Ken Herslip.

(12.) With regard to discovery, the Bankruptcy Court granted Plaintiffs' request to depose Ken Herslip as to the activities of Magic Management and Herslip Construction. With that authorization in place, Plaintiffs requested the District Court to compel Ken Herslip to also answer questions concerning other Herslip-owned/controlled entities believed to also be involved in the fraudulent conduct. The District Court only partially granted Plaintiffs' requested discovery by limiting Plaintiffs' examination of Herslip to only the non-bankrupt

debtor, namely BK Properties, LLC, on the basis it lacked authority to compel discovery from Herslip Construction and Magic Management as a result of the automatic stay, and as the other entities were not parties to the present action. Instead of proceeding with the deposition of Ken Herslip in the present action in which questioning would be limited by the discovery orders of the District Court and Bankruptcy Court to BK Properties, Magic Management and Herslip Construction, for purposes of economy, Plaintiffs have elected to simply conduct discovery in the companion case through which discovery may also be obtained from all other Herslip-related entities believed to have participated in the fraud – parties in the companion case.

IV. Evidence of Fraud and Intentional Waste of Judgment Debtor Assets Presented Justifying Requested Remedy

(13.) As a preliminary matter, Defendants’ portrayal of Ken Herslip as a victim in these proceedings would be laughable were it not for the serious consequences of his fraudulent conduct through his various corporate shells. The District Court determined Ken Herslip’s conduct at issue during the trial in this action violated every fiduciary duty he owed to his limited partner investors and he committed fraud which could justify imposition of punitive damages. Ken Herslip’s wrongful conduct resulted in the loss of several hundred thousand dollars to the limited partner investors, and nearly put the restaurant he managed for them, via Magic Management, out of business. While it is unfortunate Ken Herslip has experienced health problems, those health problems have not prevented Mr. Herslip from remaining active with his other numerous business interests.

(14.) Defendants’ description of Herslip Construction, Inc. as a company that did limited construction work, primarily related to restaurant properties, is inaccurate and misleading. As discussed at length at paragraph II(B) of the Statement of Facts in Appellants’ Brief,

Herslip Construction was also involved in managing numerous Herslip owned/controlled restaurants in North Dakota, South Dakota and Montana. Herslip Construction continued to do so until shortly after Plaintiffs' obtained their judgment against Herslip Construction, and just prior to Herslip Construction filing for bankruptcy protection. Also immediately after Plaintiffs obtained their judgment in this case, Herslip formed another company called Herslip Management, LLC, a North Dakota limited liability company, and transferred all of the restaurant management services work from Herslip Construction to Herslip Management, LLC. Keep in mind Herslip owned/controlled all of the entities involved in these transactions – the companies providing the management services, and the companies receiving and paying for the services. There can be no doubt the transfer of these lucrative service agreements from the judgment debtor to a newly formed entity immediately after Plaintiffs obtained their judgment was for a fraudulent purpose as discussed in paragraph III(C) of the Argument in Appellants' Brief.

(15.) Herslip's assertion he discontinued the construction operations of Herslip Construction due to illness is disputed. Aside from judgment debtors Herslip Construction and Magic Management, Herslip has not discontinued the operations of any of his other numerous entities located in various states since his illness was diagnosed, including, but not limited to BK Properties, LaMore Restaurants Group, LLC, GHW Enterprises, LLC, Grand Restaurants, LLC, Herslip Management, LLC, Herslip Restaurant, LLC, and Wings of Minot ND, LLC. In addition, Defendants completely ignore the fact Herslip Management, LLC has advertised itself as a building contractor on Yellowpages.com and identifies itself as also being known as Herslip Construction, Inc. This evidences a wrongful transfer of the goodwill value of Herslip Construction, Inc. to Herslip

Management, LLC for the sole purpose of defrauding Plaintiffs. These facts, in addition to the other evidence of siphoning away of judgment debtor assets and other wrongful conduct as discussed at paragraph III of the Argument in Appellants' Brief, justifying piercing the corporate veils of the judgment debtors to hold Ken Herslip personally liable for the existing judgment in this action, and further justifies an award of punitive damages in favor of Magic Partnership and against Ken Herslip.

CONCLUSION

(16.) The District Court erred in determining it lacked the power to grant the Plaintiffs' requested post-judgment relief. The District Court not only had the inherent power to grant the requested relief, but also had the power to do so pursuant to North Dakota's Uniform Fraudulent Transfers Act and pursuant to its equitable power to reform the existing judgment, should that be necessary.

Dated this 29th day of July, 2011.

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CERTIFICATE OF COMPLIANCE

(17.) The undersigned, as attorneys for the Plaintiffs/Appellants in the above matter, and as the authors of the above brief, hereby certify, in compliance with Rule 32(a) of the North Dakota Rules of Appellate Procedure, that the above brief was prepared with proportional type face and that the total number of words in the above brief, excluding words in the table of contents, table of authorities, signature block, certificate of service and certificate of compliance totals 2,490.

Dated this 29th day of July, 2011.

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CERTIFICATE OF SERVICE

(18.) I hereby certify that a true and correct copy of the foregoing Appellants' Reply Brief was on the 29th day of July, 2011, emailed to the following:

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Appellants' Reply Brief