CIRCUIT COURT OF SOUTH DAKOTA
SECOND JUDICIAL CIRCUIT
LINCOLN & MINNEHAHA COUNTIES
425 North Dakota Avenue
Sioux Falls, SD 57104-2471

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September 11, 2008

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RE: Home Federal Bank v. J. Tyler Haahr, Daniel A. Nelson, and MetaBank (CIV. 06-2230)

Dear Counsel:

A hearing was held in the above-entitled matter on June 4, 2008. After reviewing the record and arguments of counsel, my decision is as follows:

I. INTRODUCTION

Home Federal Bank (Plaintiff, Home Federal) is a federally chartered bank with its home office in Sioux Falls. MetaBank is a federally chartered bank with operations in Brookings and Sioux Falls. Tyler Haahr (Haahr) is an officer and shareholder of MetaBank. Daniel Nelson (Nelson) was formerly a Sioux Falls

business owner involved in the used automobile industry, and was the principal shareholder of the South Dakota Acceptance Corporation (SDAC) and Dan Nelson Automotive Group, Inc. (DNAG). Home Federal has filed suit against MetaBank, Haahr, and Nelson, alleging Fraud, Negligent Misrepresentation, Breach of Fiduciary Duty, Conspiracy, Breach of Duty of Good Faith and Fair Dealing, and Exemplary Damages.[1]

Now before me are the following motions:

1. Defendants' Motion for Summary Judgment;
2. Plaintiff's Motion for Partial Summary Judgment;
3. Defendants' Motion to Exclude Attorney Testimony, or in the Alternative, to Extend Discovery Deadline;
4. Defendants' Motion to Exclude Expert Testimony and Strike Expert Reports;
5. Defendants' Motion to Strike Affidavits.

II. FACTS AND PROCEDURE

In 1992, Nelson opened a J.D Byrider automobile franchise in Sioux Falls. The franchise's business model consisted of selling vehicles and providing financing to customers with poor credit. MetaBank was the "lead bank" on loans to Nelson's businesses. MetaBank began making such loans to Nelson's businesses in 1997. Home Federal, through one or more participation agreements with MetaBank, also began to participate in the lending arrangement.

[1] Nelson has not joined in MetaBank's and Haahr's Motion for Summary Judgment. As such, any reference in this memorandum to the "Defendants" will not pertain to Nelson, but only to Haahr and MetaBank.

The participation agreements executed between Home Federal and MetaBank included a provision stating that the loans were "without recourse" to MetaBank, meaning that Home Federal would bear its own risk of loss under the loans.[2] In September 2004, the existing participation agreement between Home Federal and MetaBank was scheduled to expire by its own terms on October 1, 2004.

Prior to October 1, 2004, Home Federal had received monthly financial information from MetaBank regarding the financial condition of the Nelson loans. This information included financial statements, borrowing base certificates, inventory reports, and contract receivables.

On September 29, 2004, a letter from Greg Harrell (Harrell), a commercial banker at Home Federal, to Jon Geistfeld (Geistfeld), Senior Vice President at MetaBank, notified MetaBank that Home Federal would not be renewing its loan participation in the Nelson credit arrangement. The letter, however, did indicate that Home Federal would consider working with MetaBank on a temporary extension of its participation for up to six months. Home Federal's reason for not wanting to renew its participation was that it was uncomfortable with the close relationship between Haahr and Nelson. Home Federal believed this close relationship was affecting the management of the credit.

[2] Prior to October 1, 2004, Home Federal, in addition to a participation agreement with MetaBank, also had an independent lending arrangement with Nelson wherein Home Federal would purchase DNAG consumer contracts that met Home Federal's lending standards. However, in January 2005, Home Federal terminated its lending relationship with DNAG due to dissatisfaction with the delinquency rates and repossession ratios of the loans they had acquired from the Dan Nelson Automotive Loan Portfolio under the Motor Vehicle Dealer Agreement.

Nelson and his business entities were scheduled to close on a new loan agreement with MetaBank on October 1, 2004. This agreement included a $20,000,000 line of credit for SDAC, and a $5,000,000 line of credit for DNAG. Because its "loan to one borrower" (LTOB) limit was insufficient for such a large loan, MetaBank needed other banks to participate in this lending arrangement. Home Federal was not concerned about the underlying credit of the Nelson loans at that time, and therefore entered into a six-month extension of its participation in the Nelson credit some time in October.

On October 6, 2004, Defendant Haahr received an email from Nelson informing Haahr that Nelson had received notifications in September from the Iowa Attorney General's Office that the Attorney General would be requesting documents from Nelson's businesses. Plaintiff claims that Haahr knew of this investigation as early as September 2004. Defendants dispute this allegation.

The Iowa Attorney General's requests—known as "Civil Investigative Demands" (CIDs)—indicated that the office was investigating Nelson's businesses due to a large number of consumer complaints that had been filed by J.D. Byrider customers since 1997. In fact, the CIDs inquired into numerous aspects of Nelson's business practices concerning SDAC and DNAG. In the email, Nelson informed Haahr that the requests by the Attorney General were similar to investigations of J.D. Byrider franchises in other states, and that the inquiries would not impact the business's earnings. Haahr informed Geistfeld of the CIDs and, after a telephone call with Nelson, opined that he did not believe it was material to the credit.

On October 7, 2004—the day after Haahr received the email from Nelson regarding the CIDs from the Iowa Attorney General—MetaBank mailed to Home Federal the loan documents pertaining to the six-month extension in the Nelson credit. One such document was a copy of the "Amended and Restated Loan and Security Agreement" executed between Nelson's entities and MetaBank, which was dated October 1, 2004. The "Representations and Warranties" portion of the document provided:

> [t]o induce Lender to enter into this Agreement, Borrower, and each Guarantor . . . represent and warrant that:
>
> . . .
>
> Section 7.5 Litigation and Judgments. There is no action, suit, investigation or proceeding before or by any court, governmental authority, or arbitrator pending, or to the knowledge of Borrowers and Guarantors, threatened against or affecting Borrowers or Guarantors, that, if adversely determined, have a material adverse effect on its business, condition (financial or otherwise), operations, prospects or properties of Borrowers or Guarantors or the ability of Borrowers or Guarantors to pay and perform the Obligations. There are no outstanding judgments against Borrowers or Guarantors.

October 2004 Loan Security Agreement, § 7.5.

In addition, various provisions of the Participation Agreement itself are at issue in this case. For instance, the participation agreement in effect prior to October 1, 2004 as well as the October 2004 Participation Agreement contained warranty and disclaimer provisions which provided:

> [p]urchaser acknowledges that it has made an independent investigation of the Loan, and has satisfied itself with respect to the credit standing of any Obligor of the Loan . . . . Purchaser acknowledges that it is not relying upon Seller's judgment, and that Seller has made no warranty of any kind, express or implied, in connection with the Loan or any of the foregoing. . . . Purchaser agrees to share the risks of collection of the Loan and of the adequacy of the Property in proportion to Purchaser's Share.

October 2004 Participation Agreement, ¶ 17. The participation agreements also provided that MetaBank promised to supply Home Federal with "any factual information bearing on the Borrower's continuing credit worthiness." *Id.* ¶ 10. Further, the parties agreed to "promptly notify each other should either receive actual notice or knowledge of any loss of Property or change in financial condition of any Obligor under the Loan, which will have a *material* adverse effect upon continuation of payments under the loan." *Id.* ¶ 18 (emphasis added). Lastly, the

agreements provided that one of the "qualifying events" for removal of MetaBank as the administrator of the loan is if MetaBank "fails to comply with [its] *fiduciary*, contractual, or legal obligations as provided under this Agreement or by state or federal law." *Id.* ¶ 19 (emphasis added). The form of the October 2004 Participation Agreement is identical with the form of the participation agreement which expired on October1, 2004.

It is undisputed that MetaBank did not notify Home Federal of the Iowa Attorney General investigation either prior to or when it mailed the extension loan documents to Home Federal on October 7, 2004. The reason for not revealing this information, according to MetaBank, was that it did not believe it to be material to the lending arrangement with Nelson. Home Federal eventually signed the Participation Agreement wherein it agreed to renew its participation in the Nelson credit from October 1, 2004 through April 1, 2005. None of the parties can point to a specific date on which this agreement was signed by Home Federal but it was obviously after October 7, 2004. Under this extension, Home Federal loaned over $6,000,000 to the Nelson entities.

The Iowa Attorney General followed the CIDs with a subpoena to SDAC and DNAG dated October 14, 2004. On January 7, 2005, the Iowa Attorney General filed a lawsuit against DNAG, SDAC, Nelson, and an officer of Nelson's entities. The suit alleged that Nelson's method of financing the sale of used vehicles targeted individuals with marginal credit histories, and as such, had harmed numerous Iowa consumers and defrauded Iowa financial institutions. Thereafter, on January 12,

2005, MetaBank sent an email to all of the banks participating in the Nelson credit, including Home Federal, informing them of the Attorney General's lawsuit. That email also informed the participants that MetaBank had known about the investigation "for the past few months." Home Federal did not complain to MetaBank about not receiving earlier notice of the investigation. Following disclosure of the lawsuit and after consulting with its legal counsel, officials of Home Federal claim that they believed they were contractually obligated to remain in the loan arrangement through April 1, 2005, and Home Federal continued to advance funds under the Participation Agreement.

After learning of the lawsuit, Home Federal did not lower its risk rating on the Nelson loans until June 2005. Curt Hage (Hage), Home Federal's Chief Executive Officer, discussed the lawsuit with Nelson in January 2005. Nelson assured Hage that the suit would not create any serious trouble for his businesses. Hage has testified that the lawsuit, in and of itself, did not render SDAC or DNAG "uncreditworthy," especially since there had not been any disruption in the repayment of those loans. Home Federal continued to perform under its Participation Agreement with MetaBank from January 2005 to May 2005 by advancing $1,890,000 in principal and receiving $61,599.81 in interest payments on the participating loans.

Home Federal's six-month extension of its participation in the Nelson loans was set to terminate on April 1, 2005. On March 21 and 22, 2005, Nelson called Hage again asking for an extension beyond April 1 in order to obtain alternate

financing. At this time, Nelson informed Hage that the Iowa Attorney General lawsuit was going well, and that it would settle for a relatively small amount of money. Hage believed Nelson's representations, and informed MetaBank at the end of May 2005 that Home Federal would extend its participation until June 30, 2005. However, Home Federal alleges that no extension was ever executed, as it did not deliver the signed agreement to MetaBank. Home Federal did advance $590,000 to the SDAC credit line on April 27, 2005. Home Federal claims that it did so in a continuing effort to mitigate its risk of loss due to the Attorney General's lawsuit.

At the end of May 2005, MetaBank received Nelson's April financial statements. At that time, it became apparent to MetaBank that Nelson was having cash flow problems. On June 6, 2005, MetaBank informed the participating banks, including Home Federal, that the Nelson loans had taken an "abrupt, negative turn." On June 8, 2005, MetaBank held a conference call with officials of the banks participating in the Nelson credit. In that call, Haahr discussed the poor condition of the Nelson credit due to the investigation, and allegedly admitted that MetaBank had known about the investigation since September 2004. By the time this conference call took place, there is evidence that over time MetaBank had arguably reduced its exposure by reducing its reliance upon collateral offered by SDAC and DNAG and increasing its collateral in Victory Properties, another entity owned or controlled by Nelson. By the end of June 2005, SDAC and DNAG had filed bankruptcy.

Home Federal has asserted the following causes of action against the Defendants: (1) Fraud; (2) Negligent Misrepresentation; (3) Breach of Fiduciary Duty; (4) Conspiracy; (5) Breach of Duty of Good Faith and Fair Dealing; and (6) Exemplary Damages. In response, the Defendants have filed a motion for summary judgment, and Home Federal has filed its own motion for partial summary judgment.

III. LAW AND ANALYSIS

A. Defendants' Motion for Summary Judgment

The Defendants have filed a motion for summary judgment as to all of Home Federal's claims. Each of these counts will be discussed separately, below.

Summary Judgment is proper where the moving party has demonstrated that there is no genuine issue of material fact and that it is entitled to judgment on the merits as a matter of law. SDCL § 15-6-56(c). "A disputed fact is not material unless it would affect the outcome of the suit under the governing substantive law in that 'a reasonable jury could return a verdict for the nonmoving party.'" SD State Cement Plant Comm'n v. Wausau Underwriters Ins. Co., 2000 SD 116, ¶ 9, 616 N.W.2d 397, 400-01 (quoting Weiss v. Van Norman, 1997 SD 40, ¶ 11 n.2, 562 N.W.2d 113, 116 (internal citations omitted)). "However, all facts and favorable inferences from those facts must be viewed in a light most favorable to the nonmoving party." Weitzel v. Sioux Valley Heart Partners, 2006 SD 45, ¶ 16, 714 N.W.2d 884, 891. *See also* Hayes v. Northern Hills Gen. Hosp., 1999 SD 28, ¶ 12, 590 N.W.2d 243, 247.

1. Fraud

Plaintiff alleges that the Defendants committed fraud or deceit by suppressing or failing to disclose the existence of the Iowa Attorney General investigation prior to execution of the October 2004 Participation Agreement by Home Federal. Plaintiff asserts that the Defendants were bound to disclose this information, but knowingly failed to make such a disclosure in order to protect their business interests and to induce Home Federal to enter into the Participation Agreement. According to Plaintiff this fraudulent conduct caused it significant financial losses when SDAC and DNAG failed.

The Defendants argue they are entitled to summary judgment as they owed no duty to Plaintiff to disclose the investigation. In particular, they assert that the Participation Agreement obviated a duty to disclose this information, and instead placed the burden on Plaintiff to conduct its own investigation into the creditworthiness of Nelson's entities. As such, the Defendants contend that Plaintiff simply could not have justifiably relied upon them to provide this type of information. Further, the Defendants argue that the investigation was simply not material to the lending relationship between Home Federal and MetaBank, and therefore they had no duty to disclose such information.

Under South Dakota law, "One who willfully deceives another, with intent to induce him to alter his position to his injury or risk, is liable for any damage which he thereby suffers." SDCL § 20-10-1. The following acts constitute deceit:

(1) The suggestion, as a fact, of that which is not true, by one who does not believe it to be true;

(2) The assertion, as a fact, of that which is not true, by one who has no reasonable ground for believing it to be true;

(3) The suppression of a fact by one who is bound to disclose it, or who gives information of other facts which are likely to mislead for want of communication of that fact; or

(4) A promise made without any intention of performing.

SDCL § 20-10-2. Fraud in relation to contracts is defined in SDC§ 53-4-5 and the elements are substantially similar to the elements for deceit except fraud in relation to contracts contains an additional catch-all element of fraud defined as any other act fitted to deceive. The statute also specifically provides that actual fraud is always a question of fact.

In South Dakota, the essential elements of fraud or deceit based upon fraudulent representations are:

> that a representation was made as a statement of fact, which was untrue and known to be untrue by the party making it, or else recklessly made; that it was made with intent to deceive and for the purpose of inducing the other party to act upon it; and that he did in fact rely on it and was induced thereby to act to his injury or damage.

North American Truck & Trailer, Inc. v. M.C.I. Communications, Inc., 2008 SD 45, ¶ 8, 751 N.W.2d 710, 713; Delka v. Continental Cas. Co., 2008 SD 28, ¶ 30, 748 N.W.2d 140, 151-52. The essential elements of fraud or deceit based upon a concealment of a material fact are (1) the suppression of a fact by one who is bound to disclose it, or (2) the suppression of a fact by one who gives information of other facts which are likely to mislead for want of communication of that fact. Milligan v. Waldo, 2001 SD 2, ¶ 10, 620 N.W.2d 377, 380.

"In order to be actionable, fraud must be based upon the misrepresentation of *material fact*." Cleveland v. BDL Enterprises, Inc., 2003 SD 54, ¶ 26, 663 N.W.2d 212, 219 (emphasis in original). "Questions of materiality and justifiable reliance constitute questions of fact which cannot be resolved on summary adjudication, unless . . . the undisputed facts leave no room for a reasonable difference in opinion." Waitt v. Speed Control, Inc., 2002 WL 1711817 (N.D. Iowa 2002) (quoting West Shield Investigations & Security Consultants v. Superior Court, 82 Cal. App.4th 935, 957 (2000)).

The South Dakota Supreme Court has long recognized, as have other courts, that materiality is a question of fact. Bushfield v. World Mut. Health & Accident Ins. Co. of Penn., 80 S.D. 341, 344, 123 N.W.2d 327, 328 (1963); General Electric Credit Corp. v. M.D. Aircraft Sales, Inc., 266 N.W.2d 548, 552 (S.D. 1978) (providing that materiality of an omission is a question of fact). *See also* Fitzgerald Railcar Services of Omaha, Inc. v. Chief Trans. Prod. Inc., 2004 WL 340011 (D. Neb. 2004) ("Materiality, by definition, is largely a question of fact). "While materiality is

generally a question of fact reserved for the jury, alleged misrepresentations are immaterial where a court determines that no reasonable [person] could have been swayed by the alleged misrepresentation." Little Gem Life Sciences, LLC v. Orphan Medical, Inc., 2007 WL 541677 (D. Minn. 2007). "The materiality . . . of a fact misrepresented, omitted, or concealed is a question of fact so long as the matter is debatable. It is a question of law *only* when it is so obvious that a contrary inference is not permissible." Burnett v. Philadelphia Life Ins. Co., 101 S.W.3d 843, 848 (Ark. Ct. App. 2003) (emphasis added).

In the case at hand, MetaBank had in the participation agreement in force in September 2004 agreed to provide Home Federal with information material to the Nelson credit arrangement. Both that agreement and the October 2004 Participation Agreement provided that MetaBank would supply Home Federal with "any factual information bearing on the Borrower's continuing credit worthiness." *Id.* ¶ 10. The parties further agreed to "promptly notify each other should either receive actual notice or knowledge of any loss of Property or change in financial condition of any Obligor under the Loan, which will have a *material* adverse effect upon continuation of payments under the loan." *Id.* ¶ 18 (emphasis added). Further, the loan documents provided by MetaBank to Home Federal in October 2004 included a representation by Nelson and the borrower that there were no governmental investigations "that would, if adversely determined, have a *material* adverse effect on its [borrower's] business [.]" October 2004 Loan and Security Agreement, § 7.4 (emphasis added).

A jury could reasonably find that Haahr and MetaBank knew of the Attorney General investigation as early as September 2004 while Home Federal and MetaBank were still parties to a participation agreement which required disclosure of material information. Even in the absence of this express affirmative duty under the participation agreement, as further discussed below, I conclude that as a matter of law MetaBank had a fiduciary duty to disclose materially adverse information about SDAC and DNAG. A fiduciary duty arises when one undertakes to act primarily for another's benefit. Taggart v. Ford Motor Credit Company, 462 N.W.2d 493, 500 (SD 1990). The very nature and purpose of the participation agreements compel the conclusion that Home Federal was placing its trust and confidence in MetaBank to perform its obligations as lead lender on behalf of the participating lenders in a fiduciary manner. MetaBank was privy to information which a jury could find had been disclosed by the borrower to MetaBank as the lead lender and which, in accordance with its fiduciary duty as lead lender, should have been disclosed by MetaBank to the participating lenders. Indeed, the participating lenders were contractually obligated not to interfere in MetaBank's role as lead lender absent a failure by MetaBank to comply with its fiduciary, contractual or legal obligations as provided either under the participation agreement or by state or federal law. As a fiduciary, MetaBank had a duty under state law not to suppress a fact by one who is bound to disclose it. SDCL § 20-10-2 (3).

MetaBank also had a duty under SDCL § 20-10-2 not to give information of other facts which are likely to mislead for want of communication of that fact. There

is evidence that MetaBank knew of the Attorney General investigation as early as September 2004. MetaBank knew in late September that Home Federal wanted to terminate its participation but was willing to work with MetaBank short term while either MetaBank tried to find another lender or lenders willing to participate or Nelson tried to find another lead lender. MetaBank did not have a sufficiently large enough lending limit to finance the Nelson companies on its own and needed participating loans to spread the risk. There is evidence that MetaBank may have already been worried about the credit line even earlier than September 2004. A jury could reasonably conclude that if the investigation had been disclosed at this critical time in late September when Home Federal's participation agreement expired, Home Federal would not have extended its participation and would not have made additional advances during the extension.

There is evidence which, if believed by a jury, would show that the failure to disclose the investigation occurred no more than a few weeks at most and perhaps as recently as the day prior to MetaBank's transmittal on October 7, 2004, of the Nelson/MetaBank loan documents to Home Federal along with a proposed six month extension of the participation agreement. Contained within these loan documents are representations that there were no investigations pending or threatened which, if determined adversely to the borrowers, would have a material adverse effect upon the business, condition, (financial or otherwise), operations, prospects, or properties of the borrowers. A jury could reasonably find that such representations were materially false, that MetaBank knew they were materially

false, and that the communication of such information by MetaBank was likely to mislead Home Federal for want of communication of the information regarding the investigation. I have already discussed the fact that the Participation Agreement which became effective on October 1, 2004, contained the same disclosure obligations and imposed the same fiduciary duties upon MetaBank as the earlier participation agreement which expired on October 1, 2004.

Alternatively, a jury could reasonably determine that MetaBank owed a duty of disclosure under the Restatement (Second) of Torts §§ 550, 551. Section 551 imposes a duty upon a party to a transaction not to conceal or otherwise intentionally prevent the other party to a transaction from acquiring material information and imposes liability as though the concealing party had affirmatively stated the nonexistence of the matter that the other party was prevented from discovering. This alternative basis for an action for deceit was discussed in *Taggart*, 462 NW2d at 501. While the Court in *Taggart* found no liability under this section or under this theory, it did so because the defendants in that case, Ford Motor Credit Company and Ford Motor Company, were not parties to the Stock Redemption Agreement with the plaintiff. They thus were not parties to the same transaction with the plaintiff. *Id*. Home Federal and MetaBank were parties to the same participation agreements and thus parties to the same transactions.

Restatement (Second) of Torts § 551 provides as follows:

> (1) One who fails to disclose to another a fact that he knows may justifiably induce the other to act or refrain from acting in a business

transaction is subject to the same liability to the other as though he had represented the nonexistence of the matter that he has failed to disclose, if, but only if, he is under a duty to the other to exercise reasonable care to disclose the matter in question.

(2) one party to a business transaction is under a duty to exercise reasonable care to disclose to the other before the transaction is consummated,

(a) matters known to him that the other is entitled to know because of a fiduciary or other similar relation of trust and confidence between them; and

(b) matters known to him that he knows to be necessary to prevent his partial or ambiguous statement of the facts from being misleading; and

(c) subsequently acquired information that he knows will make untrue or misleading a previous representation that when made was true or believed to be so; and

(d) the falsity of a representation not made with the expectation that it would be acted upon, if he subsequently learns that the other is about to act in reliance upon it in a transaction with him; and

(e) facts basic to the transaction, if he knows that the other is about to enter into it under a mistake as to them, and that the other, because

of the relationship between them, the customs of the trade or other objective circumstances, would reasonably expect a disclosure of those facts.

A jury could reasonably find facts to support liability under §§ 550 and 551.

I conclude that determining whether the Iowa Attorney General investigation was material to Home Federal's decision to extend its participation in the Nelson credit is a question of fact for the jury. Even if the Defendants did subjectively believe, as they contend, that the investigation was immaterial to Nelson's creditworthiness, there is evidence in the record that this information indeed *was* material to Home Federal in making its decision to renew its participation in October 2004. Further, both the participation agreement in effect in September 2004 and the October 2004 Participation Agreement provided that MetaBank would supply Home Federal with information if it would have a "material adverse effect" upon whether the loan would be repaid by Nelson. Thus, it is certainly for the jury to decide whether the investigation was material to the parties' lending arrangements.

The Defendants also argue that they are insulated from Home Federal's fraud claims due to the disclaimer language in both the earlier participation agreement and the October 2004 Participation Agreement. Specifically, the Defendants look to the agreements' "Liability and Disclaimer" provisions in support of their argument that they had no duty to disclose the investigation to Home Federal, and that Home Federal could not justifiably rely upon them to provide such information. This particular provision provides:

> [p]urchaser acknowledges that it has made an independent investigation of the Loan, and has satisfied itself with respect to the credit standing of any Obligor of the Loan . . . . Purchaser acknowledges that it is not relying upon Seller's judgment, and that Seller has made no warranty of any kind, express or implied, in connection with the Loan or any of the foregoing. . . . Purchaser agrees to share the risks of collection of the Loan and of the adequacy of the Property in proportion to Purchaser's Share.

October 2004 Participation Agreement, ¶ 17.

It is generally a question of fact whether a party claiming fraud reasonably relied upon the defendants' representations. *See* Commercial Property Inv., Inc. v. Quality Inns Int'l. Inc., 938 F.2d 870, 876 (8th Cir. 1991). "[T]he question of reliance is for the trier of fact, and thus should not be decided on summary judgment." *Id.* "Whether a party's reliance is reasonable is ordinarily a fact question for the jury unless the record reflects a complete failure of proof." Geneseo v. Utilities Plus, 533 F.3d 608,617 (8th Cir. 2008) (quoting Hoyt Props., Inc. v. Prod. Res. Group, L.L.C., 736 NW2d 313, 321 (Minn. 2007). In a given fraud action, it is a question of fact whether the plaintiff justifiably relied upon the representation. Banes v. Cornerstone Inv., 773 P.2d 884, 886 (Wash.App. Ct. 1989); Sims v. Tezak, 694 N.E.2d 1015, 1021 (Ill. App. 1998) (opining that "the justifiable reliance element

of fraud is a question of fact . . . to be determined by a finder of fact and not by the trial court as a matter of law.").

In a case with facts highly analogous to those now before me, the Eighth Circuit Court of Appeals reversed a district court's grant of summary judgment for a lead bank. In Northwest Bank & Trust v. First Illinois National Bank, the plaintiff participating bank entered into a participation agreement with the defendant lead bank in order to extend a substantial loan to one of the lead bank's "most important customers," a local entrepreneur. 354 F.3d 721, 723 (8th Cir. 2003). That participation agreement contained a disclaimer virtually identical to the one now at issue. The borrower's business failed shortly after the participation agreement was signed, and the borrower defaulted on the loan. The plaintiff filed suit against the lead bank, alleging, among other claims, fraud. According to the plaintiff, the defendant provided false and misleading information intending to fraudulently induce plaintiff to enter into the participation agreement. In addition, the plaintiff claimed that the defendant failed to inform plaintiff of detrimental changes in the borrower's financial position.

Although it acknowledged the general rule that "misrepresentations amounting to fraud in the inducement of a contract . . . give rise to a right of avoidance on the part of the defrauded party", the district court, applying Iowa law, granted the defendant lead bank's motion for summary judgment. *Id.* at 726. The trial court determined that this rule was inapplicable "where two sophisticated

lenders enter into a contract where one party specifically disclaims reliance upon a representation in a contract." *Id.*

In addressing this conclusion, the Eighth Circuit noted that "contractual disclaimers are ineffective to bar a plaintiff from asserting a claim for fraudulent inducement." *Id.* at 726. "[W]here there is evidence of fraudulent misrepresentations in the inception of a contract[,] such misrepresentations can be the basis for either an action to rescind or for damages, *despite the limiting provisions of a contract*." *Id.* (alterations and emphasis in original) (quoting Hall v. Crow, 34 N.W.2d 195, 199 (Iowa 1949)). This rule, according to the Court, "is premised on the principle that the fraudulent inducement precedes the formation of a contract, and that to give preclusive effect to language contained therein would allow a party to bind the defrauded party to the contract through the use of a boilerplate disclaimer." *Id. Accord* Banque Arabe et Internationale D'Investissement v. Maryland Nat'l Bank, 57 F.3d 146, 155 (2nd Cir. 1995) (noting that an express waiver or disclaimer in a participation agreement "will not be given effect where the facts are peculiarly within the knowledge of the party invoking it.")

As an alternative basis for denial of summary judgment, and as noted in my discussion above, ¶17 of the October 2004 Participation Agreement speaks to the time preceding the decision of Home Federal to become a participating lender. So even if ¶17 is construed to mean that the burden was upon Home Federal to make its own investigation as to the creditworthiness of the borrower and other matters addressed in ¶17, the disclaimer was operative only with respect to the process up

until execution of the participation agreement. Once the agreement was executed, the duty to disclose information regarding the borrower's *continuing* creditworthiness shifted to MetaBank under the plain language of ¶10. As discussed above, if MetaBank knew of the investigation in September 2004, it was under an affirmative obligation under the participation agreement then in force to disclose any "factual information bearing on the Borrower's continuing credit worthiness." *Id.* The disclaimer did not apply to this continuing duty of disclosure. It is undisputed that the parties had been involved in this participation relationship for an extended period of time and that the October 2004 Participation Agreement was a renewal or extension of an existing participation relationship.

Furthermore, blanket application of the disclaimer would create an inherent ambiguity in the participation agreements between the disclaimer language of ¶17 and the duties of disclosure under ¶¶10 and 18. Defendants argue that ¶17 relieves them of any duty to disclose or any liability for failure to disclose any information regarding borrowers' credit standing or any other matters in connection with the loan. Defendants further point to the language that states that Home Federal is not relying upon the judgment of MetaBank. Yet ¶¶10 and 18 clearly impose a duty upon MetaBank to disclose complete and current credit information regarding any factual information bearing on the borrowers' continuing credit worthiness or any change in financial condition of any Obligor under the Loan which will have a material adverse effect upon continuation of payments under the Loan or its repayment on default.

Under Defendants' interpretation, ¶¶10 and 18 are superfluous because even if MetaBank fails to comply with its duties under these paragraphs, Defendants are insulated from liability by ¶17. A contract is to be construed and interpreted so that no part of it is superfluous. Jones v. Siouxland Surgery Center, 2006 SD 97, ¶15, 724 N.W.2d 340, 345. A contract is to be interpreted to give reasonable, lawful, and effective meaning to all of its terms and to avoid an interpretation which leaves a part of the contract unreasonable, unlawful, or of no effect. *Id*. Since the clauses under Defendants' interpretations could not be reconciled without rendering ¶¶10 and 18 superfluous, there is an inherent ambiguity and extrinsic evidence would be admissible to assist the jury in determining the intent of the parties by their agreement.

Considering the above precedent in light of the instant case, the disclaimer language in the Participation Agreement does not defeat Plaintiff's fraud claim as a matter of law. There has been evidence produced by Plaintiff supporting its position that it was fraudulently induced to enter into the October 2004 extension by not being informed of the Iowa Attorney General's investigation. If a fraudulent inducement did in fact occur, the contractual disclaimer cannot act to preclude Plaintiff's ability to recover for its alleged damages. The disclaimer is evidence that a jury can consider in determining whether the investigation was material, whether MetaBank fraudulently misrepresented or concealed this information and whether Home Federal justifiably relied upon any such misrepresentation or concealment to its detriment.

Lastly, the Defendants contend that Home Federal waived its fraud claim due to its conduct after learning of the Attorney General investigation in January 2005. They argue that by continuing to perform under the October 2004 Participation Agreement and then later allegedly extending its participation in April 2005, Home Federal relinquished its fraud claim.

"Waiver is a volitional relinquishment, by act or word, of a known, existing right conferred in law or contract." A-G-E Corp. v. State, 2006 SD 66, ¶ 22, 719 N.W.2d 780, 787 (quoting Harms v. Northland Ford Dealers, 1999 SD 143, ¶ 17, 602 N.W.2d 58, 62). A waiver of a contractual right occurs "where one in possession of any [contractual] right . . . and of full knowledge of the material facts, does or forbears the doing of something inconsistent with the existence of the right or of his intention to rely upon it[.]" *Id*. (quoting Western Cas. & Sur. Co. v. American Nat. Fire Ins. Co., 318 N.W.2d 126, 128 (S.D. 1982)). "Whether a waiver has occurred is a mixed question of law and fact." Johnson v. Light, 2006 SD 88, ¶10, 723 N.W.2d 125, 127. *See* Subsurfco, Inc. v. B-Y Water Dist., 337 N.W.2d 448, 455 (S.D. 1983) (holding that the issue of contractual waiver should have been submitted to the jury). "To support the defense of waiver, there must be a showing of a clear, unequivocal and decisive act or acts showing an intention to relinquish the existing right." Action Mechanical, Inc. v. Deadwood Historic Preservation Comm'n., 2002 SD 121, ¶ 18, 652 N.W.2d 742, 749 (quoting Norwest Bank South Dakota v. Venners, 440 N.W.2d 774, 775 (S.D.1989)). *See also* Culhane v. Michels, 2000 SD

101, ¶14, 615 N.W.2d 580, 585 ("Waiver requires a clear, unequivocal, and decisive act or acts showing an intention to relinquish an existing right.").

Turning to the case at hand, there is evidence that Home Federal continued its involvement in the Nelson credit, and even advanced $590,000 to Nelson's entities, after the expiration of the October 2004 Participation Agreement on April 1, 2005. There is also evidence, however, that Home Federal's continued participation in the Nelson credit was an effort to mitigate the losses it believed it either already may have incurred or may thereafter sustain due to the Iowa Attorney General's lawsuit if it discontinued making additional loans and declared a default. A jury could reasonably find that it was unlikely that any other lender would be willing to step in and become a participant once the lawsuit was filed by the Iowa Attorney General. A jury could also reasonably find that Home Federal at that point was faced with two alternatives. One was to terminate the participation and call the loan, which would have probably meant the immediate default and probable failure of the borrowers. The other was to continue to finance the borrowers at some reasonable level in the hope that the lawsuit would be terminated favorably to the borrowers or the borrowers somehow would have found the necessary means to weather the immediate crisis and successfully continue in business to pay off the loans. Whether Home Federal's actions were reasonable under the facts and circumstances is an issue for the jury. It cannot be said as a matter of law that Home Federal's conduct after learning of the lawsuit by the Attorney General in January 2005 amounts to the "clear, unequivocal and decisive"

actions necessary to constitute waiver. *See Action Mechanical,* 2002 SD 121, ¶18, 652 N.W.2d at 749. Furthermore, Home Federal argues that even in January 2005 it still was unaware of the alleged fraudulent misrepresentation and fraudulent concealment of the investigation back in September or October 2004. It is for the jury to determine whether Home Federal knew of the alleged misrepresentation or concealment in January 2005. One can hardly waive fraudulent conduct of which one is unaware at the time of the alleged waiver. Therefore, it will be for the jury to consider Home Federal's actions and determine whether they amount to a waiver of its fraud claim.

For these reasons, I hold that the Defendants' motion for summary judgment is denied as to Home Federal's fraud claim.

2. Negligent Misrepresentation

Plaintiff's negligent misrepresentation claim stems from the warranties found within the loan documents executed between Nelson and MetaBank, which warranted there were no pending government investigations which could materially affect Nelson's businesses.[3] These documents were provided by MetaBank to Home

[3] As set forth above, the "Amended and Restated Loan and Security Agreement," provided:

> [t]o induce Lender to enter into this Agreement, Borrower, and each Guarantor . . . represent and warrant that:
>
> Section 7.5 Litigation and Judgments. There is no action, suit, *investigation* or proceeding before or by any court, *governmental authority*, or arbitrator pending, or to the knowledge of Borrowers and Guarantors, *threatened against or affecting Borrowers or Guarantors, that would, if adversely determined, have a material adverse effect on its business, condition (financial or otherwise), operations, prospects or properties of Borrowers or Guarantors or the ability of Borrowers or Guarantors to pay and perform the Obligations.* There are no outstanding judgments against Borrowers or Guarantors. (Emphasis added).

Federal, along with the proposed Participation Agreement, in October 2004. The Defendants argue that, if anything, this is a negligent *nondisclosure* case rather than a negligent misrepresentation case, as the warranty in the security agreement simply does not amount to a representation of a past or existing fact. And because there is no cause of action in South Dakota for negligent nondisclosure, the Defendants argue that Plaintiff's claim fails. *See Taggart*, 462 N.W.2d at 504 (providing that South Dakota does not recognize a cause of action for negligent nondisclosure). In addition, the Defendants assert that even if the Court determines that the security agreement made a representation, that representation was pertaining to *future* events which, under South Dakota law, typically cannot form the basis for a negligent misrepresentation claim.

In South Dakota, the tort of negligent misrepresentation occurs when a party makes: (1) a misrepresentation, (2) without reasonable grounds for believing the statement to be true, (3) with the intent to induce a particular action by another party, (4) the other party changes position with actual and justifiable reliance on the statement, and (5) suffers damage as a result. Fisher v. Kahler, 2002 SD 30, ¶ 10, 641 N.W.2d 122, 126-27. "Generally, representations as to future events are not actionable and false representations must be of past or existing facts." Bayer v. PAL Newcomb Partners, 2002 SD 40, ¶ 11, 643 N.W.2d 409, 412 (quoting Meyer v. Santema, 1997 SD 21, ¶9, 559 NW2d 251, 254). "A party cannot justifiably rely upon conjecture about future events." *Id.* ¶ 14 (quoting Gatz v. Frank M.

October 2004 Loan Security Agreement.

Langenfeld & Sons Constr., Inc., 356 NW2d 716, 718 (Minn. Ct. App. 1984)). This general rule, however, has one exception: "a misrepresentation as to a future event may be actionable where the parties to the transaction are not on equal footing but where one has or is in a position where he should have superior knowledge concerning the matters to which the misrepresentations relate." *Id.* ¶ 16 (quoting Reitz v. Ampro Royalty Trust, 75 S.D. 167, 171-72, 61 N.W.2d 201, 203 (1953)).

First, I do not find persuasive the Defendants' argument that the loan documents provided to Home Federal by MetaBank do not amount to a representation that there was no *existing* government investigation being conducted regarding Nelson's businesses. The plain language of the warranty provision at issue represents exactly that—that the Attorney General of Iowa was not, at the very time this representation was being transmitted by MetaBank to Home Federal, then investigating a wide range of the business practices of Nelson's entities. There is evidence, if believed by the jury, that Defendants knew that this representation was false and passed this false information to Home Federal with the intent to cause Home Federal to act to its detriment. It is undisputed that the Defendants knew about this investigation prior to sending the loan documents and Participation Agreement to Home Federal in October 2004. The fact that Home Federal was not a party to this particular loan document does not preclude its negligent misrepresentation claim, as this information was supplied by MetaBank in an effort to obtain a six-month extension to the participation agreement between

MetaBank and Home Federal. *See generally Fisher,* 2002 SD 30, ¶ 10, 641 N.W.2d at 126-27.

The Defendants also argue that, even if it is determined that the warranty in the security agreement amounts to a representation, Home Federal's negligent misrepresentation claim must fail because that representation pertained to a *future* fact. As indicated, the tort of negligent misrepresentation generally requires the misrepresentation to pertain to a past or existing fact rather than a future fact. *See* Bayer*,* 2002 SD 40, ¶ 11, 643 N.W.2d at 412. This argument, however, ignores the caveat to this rule: a misrepresentation as to a future fact is still actionable "where the parties to the transaction are not on equal footing but where one has or is in a position where he should have superior knowledge concerning the matters to which the misrepresentations relate." *Id.* ¶ 16.

In this case, there is no dispute MetaBank was the lead bank, and as such, took on certain responsibilities to keep participating lenders such as Home Federal informed about information regarding the borrowers. MetaBank was contractually obligated by the Participation Agreement to hold and maintain "all writings concerning the Loan." October 2004 Participation Agreement, ¶ 10. In addition, MetaBank had the obligation to, "from time to time provide [Home Federal] with complete and current credit information" relating to the Nelson credit. *Id.* A brief examination of the Participation Agreement gives rise to a conclusion that the parties certainly were not on equal footing when it came to obtaining and evaluating information pertinent to the Nelson credit. The very purpose of having a

lead lender is because the lead lender, as the bank with the relationship with its borrower and in order to spread the risk, agrees to service the loan and to keep the participating lenders informed of information which it receives from its borrower or otherwise regarding the *continuing* creditworthiness of the borrower or any change in financial condition. Thus, even if the warranty in the October 2004 Loan Security Agreement is deemed to constitute a representation as to a "future fact," Home Federal's negligent misrepresentation claim may proceed. A jury could reasonably find that MetaBank was in possession of information as a result of its superior position as lead lender which it had a duty to disclose to the participating lenders who were not privy to the same information as the lead lender.

For the above reasons, the Defendants' motion for summary is denied as to Home Federal's negligent misrepresentation claim.

3. Breach of Fiduciary Duty

Plaintiff argues that, as the lead bank, MetaBank owed a fiduciary duty to Home Federal in performing under the lending arrangement. This fiduciary duty, Plaintiff asserts, was breached when the Defendants failed to timely disclose the existence of the Attorney General investigation. According to Plaintiff, this fiduciary duty was created: (1) by the terms of the Participation Agreement, or (2) because the Defendants were in a position of superior knowledge regarding the Nelson credit. *See* Banque Arabe Et Internationale D'Investissement v. Maryland Nat. Bank, 57 F.3d 146, 155 (2nd Cir. 1995).

In support of their motion for summary judgment, Defendants highlight that generally there is no fiduciary relationship between parties involved in a participatory lending arrangement. Further, they assert that the October 2004 Participation Agreement did not give rise to a fiduciary duty. Instead, they argue, the agreement simply provided that *if* such a duty was included within the contract, it would be enforceable. According to the Defendants, a review of the entire contract makes clear that no such duty was created by the parties.

"The existence of a fiduciary duty and the scope of that duty are questions of law for the court." Bienash v. Moller, 2006 SD 78, ¶ 12, 721 N.W.2d 431, 434. "Most often, deciding whether a fiduciary relationship was breached is properly left to the trier of fact." Ward v. Lange, 1996 SD 113, ¶ 14, 553 N.W.2d 246, 250 (citing American State Bank v. Adkins, 458 N.W.2d 807, 811 (S.D.1990)). In South Dakota, the law surrounding a fiduciary relationship has been extensively discussed by our highest Court:

> [a] fiduciary relationship is founded on a "peculiar confidence" and trust placed by one individual in the integrity and faithfulness of another. When such relationship exists, the fiduciary has a "duty to act primarily for the benefit" of the other. "Generally, in a fiduciary relationship, the property, interest or authority of the other is placed in the charge of the fiduciary." South Dakota law reflects "the traditional view that fiduciary

> duties are not inherent in normal arm's-length business relationships, and arise only when one undertakes to act primarily for another's benefit. The law will imply such duties only where one party to a relationship is unable to fully protect its interests and the unprotected party has placed its trust and confidence in the other."

Bienash, 2006 SD 78, ¶ 11, 721 N.W.2d at 434 (quoting *Ward*, 1996 SD 113, ¶ 12, 553 N.W.2d at 250) (internal citations omitted).

South Dakota has not addressed whether a fiduciary relationship is created in the context of a loan participation agreement between a lead bank and a participating bank. Other courts, however, have held that no such fiduciary duty is created between a lead bank and a participating bank *unless* the contract creates such a duty. As one court explained:

> "[u]nlike the automatic, status-based fiduciary duty which exists, for example, between attorney and client*, fiduciary duties among loan participants depend upon the terms of their contract*. . . . In the context of loan participation agreements among sophisticated lending institutions, we are of the opinion that fiduciary relationships should not be inferred absent unequivocal contractual language.

Banco Espanol de Credito v. Security Pacific Nat'l Bank, 763 F.Supp. 36, 45 (S.D.N.Y. 1991) (emphasis added) (quoting First Citizens Fed. Savings & Loan

Ass'n v. Worthen Bank & Trust Co., 919 F.2d 510 (9th Cir. 1990)). As between a lead bank and a participating bank, "[a] fiduciary duty arises where one party reposes special confidence in a second party and the second party is bound in equity and good conscience to act in good faith with due regard for the first party's best interests." Royal Bank of Canada v. Interfirst Bank of Fort Worth, N.A, 1988 WL 192369 (N.D. Tex. 1988). "To establish a fiduciary relationship, the evidence must show that the dealings between the parties are such 'that one party is justified in relying on the other to act in his best interest.'" *Id.* (quoting Gonzales v. City of Mission, 620 S.W.2d 918, 921-22 (Tex. App. 1981). When a participation agreement is unambiguous, its meaning is properly ascertained on a motion for summary judgment. *Banco Espanol,* 763 F.Supp. at 45.

In the case at hand, the October 2004 Participation Agreement provides that one of the "qualifying events" for removal of MetaBank as the administrator of the loan is if MetaBank "fails to comply with [its] *fiduciary*, contractual, or legal obligations as provided under this Agreement or by state or federal law." October 2004 Participation Agreement, ¶ 19 (emphasis added). As indicated by the relevant precedent, a fiduciary duty will exist between a lead bank and a participating bank *if that language is included in the parties' participation agreement. See Banco Espanol,* 763 F.Supp. at 45. Here, such language is present. Therefore, I find that a fiduciary relationship did indeed exist between Home Federal and MetaBank based upon confidence and trust with regard to the Nelson credit. Whether that duty was breached is a question for the jury.

Even in the absence of this express language creating a fiduciary relationship, other language supports the finding of a fiduciary relationship. Unlike the participation agreements in this case, the participation agreement in the *Banco Espanol* case did not include language imposing disclosure obligations upon the lead lender, Security Pacific, after execution of and during the term of the participation agreement. The duty was imposed upon the participating lenders to keep themselves informed of the borrower's condition. *Id*. at 39. The participation agreement exonerated any negligence of Security Pacific for failing to act on any financial information coming to its attention that might be deemed to affect the borrower's creditworthiness. *Id*. Security Pacific adopted no obligation to any of the participating lenders. *Id*. Contrast this complete absence of duty including absence of any duty to disclose with the duties and disclosure obligations of MetaBank under ¶¶10 and 18 of the participation agreements.

In making its decision in *Banco Espanol* and particularly its decision to give effect to the disclaimer language and grant summary judgment to Security Pacific, the district court expressly noted that there were no allegations of fraud or misrepresentations of material facts made against Security Pacific. *Id*. at 38, 46. The court therefore upheld the disclaimer language insulating Security Pacific for any error in judgment or for any action taken or omitted to be taken by it except for gross negligence or willful misconduct. *Id*. at 38-39, 45. In contrast to *Banco Espanol*, Home Federal does allege fraud and deceit and thus the disclaimer language of §12B pertaining to bad faith and willful misconduct would not insulate

MetaBank from liability if willful misconduct is proven to the satisfaction of the jury. The participation agreements did impose fiduciary obligations upon MetaBank by the language used in the agreements in addition to the express description of the relationship as being of a fiduciary nature found in ¶20.

For these reasons, the Defendants' motion for summary judgment is denied as to Home Federal's breach of fiduciary duty claim.

4. Conspiracy

Plaintiff argues that the record supports the proposition that Haahr, MetaBank, and Nelson agreed to commit fraud, deceit, or breach of fiduciary duty, and that this conspiracy caused it damages. To establish a prima facie claim of civil conspiracy in South Dakota, Plaintiff must prove:

> (1) two or more persons;
>
> (2) an object to be accomplished;
>
> (3) a meeting of the minds on the object or course of action to be taken;
>
> (4) the commission of one or more unlawful overt acts; and
>
> (5) damages as the proximate result of the conspiracy.

Setliff v. Akins, 2000 SD 124, ¶ 32, 616 N.W.2d 878, 889. Civil conspiracy is not an independent cause of action, but is "sustainable only after the underlying tort claim has been established." *Id.* (quotations omitted) (citing Hanten v. School District of Riverview Gardens, 183 F.3d 799, 809 (8th Cir.1999)).

The Defendants argue that, because Home Federal cannot recover on any of its other causes of action, it cannot sustain a claim for civil conspiracy. Because of my rulings herein allowing Plaintiff's claims to proceed, this argument has no merit. As such, summary judgment is denied as to Home Federal's conspiracy claim.

5. Breach of Duty of Good Faith and Fair Dealing

In its complaint, Home Federal asserts that MetaBank breached its duty of good faith and fair dealing by allegedly misrepresenting the truth about Nelson's business entities. "Every contract contains an implied covenant of good faith and fair dealing which prohibits either contracting party from preventing or injuring the other party's right to receive the agreed benefits of the contract." Garrett v. BankWest, Inc., 459 N.W.2d 833, 841 (S.D. 1990) (citing Restatement (Second) of Contracts, § 205 (1981)).

> The application of this implied covenant allows an aggrieved party to sue for breach of contract when the other contracting party, by his lack of good faith, limited or completely prevented the aggrieved party from receiving the expected benefits of the bargain. A breach of contract claim is allowed even though the conduct failed to violate any of the express terms of the contract agreed to by the parties.

Id. In *Garrett,* the South Dakota Supreme Court noted that "good faith is not a limitless duty or obligation." *Id.* "The implied obligation 'must arise from the language used or it must be indispensable to effectuate the intention of the parties.'" *Id.* (quoting Sessions, Inc. v. Morton, 491 F.2d 854, 857 (9th Cir.1974)). Therefore, "[i]f the express language of a contract addresses an issue, then there is no need to construe intent or supply implied terms" under the implied covenant. Farm Credit Services of America v. Dougan, 2005 SD 94, ¶ 10, 704 N.W.2d 24, 28.

In *Garrett,* the Court for the first time addressed whether the implied covenant of good faith and fair dealing amounts to an independent cause of action in tort. It held that it does not. The Court determined that there is no tort for breach of good faith "independent of contract or duty arising under contract." *Garrett,* 459 N.W.2d at 842. *See also* Nygaard v. Sioux Valley Hospitals & Health System, 2007 SD 34, ¶ 19, 731 N.W.2d 184, 193**.** According to the Court:

> [i]n contract law before a party can sue for breach of good faith, a contract must be proven. Contract law does not recognize a breach of good faith separate from a contract. A review of the cases . . . fails to find any decision where breach of good faith in common law was not predicated upon an existing contract. . . . Thus, even in the context of traditional contract law, *the failure to prove an existing contract is fatal to any claim for breach of a good faith obligation to perform a contract.*

Garrett, 459 N.W.2d at 843 (emphasis added).

Considering this precedent, I hold that Plaintiff's claim for breach of the duty of good faith and fair dealing may proceed. South Dakota case law does not suggest, as the Defendants argue, that an implied good faith claim fails *unless* Plaintiff *also* asserts a breach of contract claim. While it is true South Dakota does not recognize an "independent" tort claim for breach of the implied duty of good faith and fair dealing, it is not necessary that such a claim be pled alongside a breach of contract claim. The South Dakota Supreme Court has made clear that a claim for breach of the implied duty of good faith and fair dealing cannot be asserted as an independent tort, meaning that it cannot be claimed without the *existence* of a valid contract between the parties upon which the claim is based. In this case, there is no dispute there was an October 2004 Participation Agreement executed between the parties. This agreement imposed upon MetaBank a duty to disclose certain information as provided in the agreement. Home Federal claims that it relied upon this duty of disclosure and that MetaBank breached this duty of disclosure when it concealed the investigation by the Iowa Attorney General. Home Federal asserts that the information which was concealed and not disclosed was material regarding the continuing creditworthiness and financial condition of the borrowers. Home Federal also claims that a reasonable lender could conclude that the investigation may have a materially adverse effect upon the borrowers and their ability to repay the loans. Plaintiff is not attempting to assert an independent claim for breach of

the implied covenant of good faith and fair dealing. Its claim derives from the parties' contract.

For these reasons, the Defendants' motion for summary judgment is hereby denied as to Plaintiff's claim of breach of the implied duty of good faith and fair dealing.

6. Exemplary Damages

The Defendants correctly point out that a claim for punitive damages is not a separate cause of action, but is allowed only as a separate element of damages if Plaintiff is awarded compensatory damages. McDowell v. Citicorp U.S.A., 2007 SD 53, ¶ 12, 734 N.W.2d 14, 18 (noting that the ability to obtain punitive damages is "dependent upon an award of compensatory damages."); Hoaas v. Griffiths, 2006 SD 27, ¶ 18, 714 N.W.2d 61, 67 ("We have consistently held that punitive damages are not allowed absent an award of compensatory damages."). In order for the issue of punitive damages to be submitted to the jury, the proponent of those damages must establish by clear and convincing evidence that there is a reasonable basis to believe that a party's conduct was willful, wanton, or malicious. Boomsma v. Dakota, Minn., & E. R.R. Corp., 2002 SD 106, ¶ 37, 651 N.W.2d 238, 246.

Because of the dependent relationship between compensatory damages and the ability to obtain punitive damages, it is premature to hold, as a matter of law, that Plaintiff cannot obtain such damages. As such, the issue of punitive damages will be properly addressed at a later time pending compliance with the statutes

governing discovery related to punitive damages and submission of such issue to the jury. Summary judgment is therefore denied as to the issue of punitive damages.

B. Motion to Exclude Attorney Testimony, or in the Alternative, to Extend Discovery Deadline

The Defendants have filed a motion to exclude the testimony of various attorneys named as potential witnesses by Home Federal. Specifically, the Defendants seek to exclude the testimony of: (1) Scott Abdallah (Abdallah); (2) A. Russell Janklow (Janklow); (3) Rob Junso (Junso); (4) Matthew Haindfield (Haindfield); and (5) Roger Damgaard (Damgaard). According to the Defendants, the testimony sought to be obtained by these witnesses is either not relevant to the issues at hand, or is unnecessarily cumulative to the evidence already presented, and therefore is not admissible.

As an initial matter, I find that the testimony of attorney Abdallah should not be excluded. Abdallah's testimony allegedly will relate to the nature of the relationship between Nelson and Haahr—an issue relevant to this litigation. His testimony will purportedly relate to events he observed in a social setting wherein Nelson and Haahr were present. There is no attorney-client privilege at issue, as Abdallah did not represent any of the parties to this lawsuit. As such, Abdallah may be called as a witness, and he may be deposed by the Defendants prior to trial.

Next, I turn to the attorney witnesses who may have an attorney-client relationship with parties involved in this lawsuit. In South Dakota, the attorney-client privilege is codified in SDCL § 19-13-3. The statute provides:

> [a] client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client:
>
> (1) Between himself or his representative and his lawyer or his lawyer's representative;
>
> (2) Between his lawyer and the lawyer's representative;
>
> (3) By him or his representative or his lawyer or a representative of the lawyer to a lawyer or a representative of a lawyer representing another party in a pending action and concerning a matter of common interest therein;
>
> (4) Between representatives of the client or between the client and a representative of the client; or
>
> (5) Among lawyers and their representatives representing the same client.

SDCL § 19-13-3. However, the privilege can be waived if "the holder of the privilege voluntarily discloses or consents to disclosure of any significant part of the privileged matter." State v. Catch the Bear, 352 N.W.2d 640, 647 (S.D. 1984). "Thus a lawyer-client privilege may be waived if the client voluntarily or through his attorney discloses the contents of the communication or advice to someone outside that relationship." *Id.*

While South Dakota has not addressed a "limited waiver" of the attorney client privilege in a situation similar to that now before me, our state's Supreme Court has acknowledged the existence of a limited waiver. In Kaarup v. St. Paul Fire & Marine Insurance Company, the Court addressed a limited waiver in the context of the "advice of counsel" defense. 436 N.W.2d 17, 21 (S.D. 1989). The Court provided that it did not agree with the expansive approach taken by some courts, which permits a waiver of the privilege as to "all communications between a client and counsel concerning the transaction for which counsel's advice was sought." *Id.* Instead, the Court preferred a more limited application of waiver: "[w]e find that the attorney/client privilege is waived only to the extent necessary to reveal the advice given by an attorney *that is placed in issue* by the defense of advice of counsel." *Id.* (emphasis added).

"The scope of an express waiver is not limited to the communications disclosed but applies to 'other communications relating to the same subject matter.'" Pucket v. Hot Springs School Dist. No. 23-2, 239 F.R.D. 572, 580 (D.S.D. 2006) (holding that the waiver of the attorney-client privilege as to certain letters between an attorney and client *only* waive the privilege as to the subject matter contained in the disclosed letters) (quoting John Morrell & Co. v. Local Union 304A of the United Food and Commercial Workers, AFL-CIO, 913 F.2d 544, 556 (8th Cir.1990)). *See also* United States v. Workman, 138 F.3d 1261, 1263 (8th Cir.1998) ("Voluntary disclosure of attorney client communications expressly waives the privilege [and][t]he waiver covers any information directly related to that which was actually

disclosed."). While waiver applies to "all communications on the same subject matter," the waiver does not apply to other documents or subjects that are insufficiently linked to documents or subjects on which a waiver occurred. PaineWebber Group, Inc., v. Zinsmeyer Trust Partnership, 187 F.3d 988, 992 (8th Cir. 1999); Squealer Feeds v. Pickering, 530 N.W.2d 678, 684 (SD 1995) ("Any waiver is limited to attorney-client communications on the matter disclosed or at issue."); S.B. McLaughlin & Co., Ltd. v. Cochrane, 1993 WL 231672 (Minn. App. 1993) (holding that the trial court did not err in suppressing additional communications between a client and his attorneys when the client's limited references to discussions he had with his attorneys did not constitute a complete waiver of the attorney-client privilege, and his attorney testified and was cross-examined only about the topics the client had opened for discussion). "There is no bright line test for determining what constitutes the subject matter of a waiver, rather courts weigh the circumstances of the disclosure, the nature of the legal advice sought and the prejudice to the parties of permitting or prohibiting further disclosures." Fort James Corp. v. Solo Cup Co., 412 F.3d 1340, 1349-50 (Fed. Cir. 2005).

Turning to the instant case, I find that the testimony of attorney Haindfield is certainly relevant, as it relates to whether the Defendants knew or believed the Attorney General investigation to be a serious matter and therefore material. Haindfield, who represented Nelson in Iowa in relation to the Attorney General investigation, allegedly spoke with Haahr in October 2004 about the seriousness of

the investigation. Thus, Haindfield's testimony regarding his conversation or conversations with Haahr is not covered by the privilege.

Attorney Junso was in-house counsel for Nelson during the times relevant to this lawsuit. It is unclear what evidence Plaintiff seeks to elicit from Junso. Assuming either a full or limited waiver of the attorney-client privilege, Junso's testimony is not excluded.

Attorney Janklow was formerly an attorney for Nelson and/or one or more of Nelson's business entities. He allegedly has information pertaining to the relationship between Nelson and Haahr and when Nelson informed Haahr and MetaBank of the Iowa Attorney General's investigation, which is certainly a disputed material issue of fact in this litigation. The testimony sought to be solicited by Plaintiff relates in part to a September 23, 2004 meeting at Theo's Restaurant wherein Nelson and his employees allegedly discussed the serious nature of the investigation and whether or not to disclose such investigation to the Defendants. Upon waiver of the attorney-client privilege by Nelson and/or Nelson's business entities, either full or limited, the testimony of attorney Janklow is not excluded.

Attorney Damgaard was retained by Home Federal in January 2005 to provide legal counsel after Home Federal learned of the Iowa Attorney General investigation. Damgaard was also present during the June 2005 conference call when the Defendants revealed they had known about the investigation since September or October of 2004. Home Federal has represented that it is prepared to

provide a limited waiver of the attorney-client privilege with respect to Damgaard's involvement on behalf of Home Federal in its participation with MetaBank on the Nelson credit. After reviewing the relevant precedent, I hold that, pursuant to a limited waiver of Home Federal's attorney-client privilege, Damgaard may testify as to his involvement after he was retained by Home Federal in January 2005. As with Janklow, the waiver of the privilege is limited to the subject matter of which Damgaard will testify.

While a client may make a limited as opposed to a full waiver, clarification of the term "limited waiver" is required. When used by me, a limited waiver means that the attorney can be compelled to give testimony regarding all otherwise privileged communications regarding all issues in the case and touching upon the knowledge of the attorney regarding all such issues in the case. As an example, if there is a limited waiver of the privilege with respect to attorney Janklow, attorney Janklow will not be permitted to restrict his testimony only to the precise matters discussed at the meeting with Nelson and his employees on September 23, 2004. Janklow will also be required to testify regarding all information of which he has knowledge touching upon any of the issues in this case. He cannot be compelled to testify regarding privileged communications about other business of Nelson or his business entities if not related to the parties and issues in this case.

Similarly, attorney Damgaard, if given a limited waiver by Home Federal, will have to answer all questions related to his representation of Home Federal with respect to the parties and issues in this case. The waiver would not be applicable to

any privileged communications regarding other matters handled by him for Home Federal involving issues and parties other than those in this case.

C. Motion to Exclude Expert Witness Testimony and Strike Expert Reports

The Defendants move to exclude certain portions of the testimony and reports of Plaintiff's experts Mike McNeil (McNeil) and Greg Clausen (Clausen). According to the Defendants, the opinions given by McNeil and Clausen are improper for one or more of the following reasons: (1) they invade the province of the jury, as they relate to the credibility of certain witnesses; (2) they are without proper basis, as they are not related to any "discernable standard"; (3) they are speculative; and (4) they are legal conclusions. In addressing the opinions to which the Defendants object, I will refer to the opinions as they are designated in the Defendants' "Motion to Exclude Expert Witness Testimony and Strike Expert Reports." After reviewing the record and the specific opinions of each expert, I hold that the Defendants' Motion to Exclude Expert Testimony is granted in part and denied in part.

The admission of expert testimony is governed by SDCL 19-15-2 (Rule 702 of the Federal Rules of Evidence). According to Rule 702, "[i]f scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise." SDCL 19-15-2.

> Under this rule, before a witness can testify as an expert, that witness must be "qualified." Furthermore, "[u]nder *Daubert,* the proponent offering expert testimony must show that the expert's theory or method qualifies as scientific, technical, or specialized knowledge" as required under Rule 702. Before admitting expert testimony, a court must first determine that such qualified testimony is relevant and based on a reliable foundation. The burden of demonstrating that the testimony is competent, relevant, and reliable rests with the proponent of the testimony. The proponent of the expert testimony must prove its admissibility by a preponderance of the evidence.

Burley v. Kytec Innovative Sports Equip. Inc., 2007 SD 82, ¶13, 737 N.W.2d 397, 402-03 (internal citations omitted).

McNeil is currently President/CEO/Director of HMN Financial, Inc., and has served in similar roles at other banking institutions since 1984. He has been involved in the banking industry since 1973. He has a degree in economics from the University of Minnesota. He has been involved in hundreds of loan participation arrangements worth hundreds of millions of dollars throughout his 35 years in the banking industry.

Clausen is a Certified Public Accountant, and is a shareholder at Roth & Company, P.C. in Des Moines, Iowa where he provides audit, accounting, and consulting services for banks. He leads the company's "loan review consulting practice" which works with 25 banks in Iowa. This position involves evaluating the accuracy of bank assigned credit risk ratings in addition to consulting clients on how to improve a bank's loan and credit administration processes. Clausen has over 24 years of experience working with financial institutions, and has a degree in finance from the University of Iowa.

After a review of the experts' opinions, I hold they may render their opinions as to certain areas of inquiry. Specifically, I hold that the opinions weighing upon the materiality of the Iowa Attorney General investigation to a bank engaged in the Nelson credit arrangement are admissible. The experts' specialized knowledge with regard to a participatory lending relationship will assist the jury in evaluating whether the investigation was material to the lending arrangement between Home Federal and MetaBank. As discussed, the experts certainly have the knowledge, skill, training, and education in order to properly testify as to the issue of materiality. Similarly, the opinions relating to the appropriate industry standard are appropriately based upon McNeil and Clausen's substantial experience in the banking industry, especially with regard to the relationship between a lead bank and a participating bank. These opinions are well within the expertise and qualifications of these experts.

However, the opinions given by McNeil and Clausen amounting to legal conclusions, such as their interpretation of the parties' Participation Agreements or other loan documents, are not properly within the realm of opinions which the experts may render. Similarly, the experts are prohibited from opining as to the credibility of witnesses or parties involved in this lawsuit. Such a determination is not properly within the expertise of an expert witness, and invades the province of the jury.

Therefore, my rulings on the Defendants' Motion to Exclude, separated by their specific objections as provided in their "Motion to Exclude Expert Witness Testimony and Strike Reports", are as follows:

1. **Original Report of McNeil:**
    a. Denied
    b. Denied
    c. Granted
    d. Denied
    e. Granted
    f. Granted
    g. Granted
    h. Granted
2. **Rebuttal Report of McNeil:**
    a. Granted
    b. Granted

c. Denied

d. Denied

e. Granted

3. Original Report of Clausen:

a. Denied

b. Denied

c. Denied

d. Denied

e. Granted

f. Granted

g. Denied

h. Denied

i. Denied

j. Denied

k. Granted

l. Granted

m. Denied

n. Denied

o. Granted

p. Denied

q. Denied

r. Denied

s. Granted

4. **Rebuttal Report of Clausen**

a. Granted

b. Denied

c. Denied

d. Denied

D. Defendant's Motion to Strike Affidavits

The Defendants move to strike the affidavits of David A. Brown (Brown) and Gregg Harrell (Harrell), which were received by the Defendants on or about May 21, 2008. The Defendants argue that these affidavits contradict and seek to change testimony given in Harrell's Rule 30(b)(6) deposition and in the personal depositions of Harrell and Hage.[4] The Defendants assert that the recent affidavit of Harrell seeks to change or improperly add to the testimony he provided in the Rule 30(b)(6) deposition. In addition, the Defendants contend that Plaintiff is attempting to

[4] Rule 30(b)(6) of the Federal Rules of Civil Procedure is codified in South Dakota as SDCL § 15-6-30(b)(6). According to the rule,

> [a] party may in the notice and in a subpoena name as the deponent a public or private corporation or a partnership or association or governmental agency and describe with reasonable particularity the matters on which examination is requested. In that event, the organization so named shall designate one or more officers, directors, or managing agents, or other persons who consent to testify on its behalf, and may set forth, for each person designated, the matters on which the person will testify. A subpoena shall advise a nonparty organization of its duty to make such a designation. The persons so designated shall testify as to matters known or reasonably available to the organization. This subdivision does not preclude taking a deposition by any other procedure authorized in these rules.

SDCL § 15-6-30(b)(6).

assert a better version of facts than previously given, in an effort to circumvent summary judgment.[5]

The gravamen of the testimony to which the Defendants object relates to whether Home Federal extended its participation in the Nelson credit from April 1, 2005 to June 30, 2005. In both his 30(b)(6) deposition and his personal deposition, Harrell testified that on April 25, 2005, Home Federal orally informed MetaBank that it would extend its participation until June 30, 2005. He further provided that Home Federal signed the participation agreement to extend to June 30, but that Home Federal did not send that document back to MetaBank. Hage's deposition testimony is consistent with these statements.

In opposition to the Defendants' motion to strike affidavits, Home Federal argues that, at the time of his deposition, Harrell was not presented with all of the documents necessary to accurately set forth the timeline of events in April and May of 2005. As such, they assert that Harrell's affidavit simply utilizes these documents in order to explain the confusion and uncertainty during his deposition as to when the relevant events took place.

In South Dakota, a party cannot "assert a better version of the facts than his prior testimony and 'cannot now claim a material issue of fact which assumes a conclusion contrary to [his] own testimony.'" Loewen v. Hyman Frieghtways, Inc., 1997 SD 2, ¶ 16, 557 N.W.2d 764, 768 (quoting Petersen v. Dacy, 1996 SD 72, ¶ 16, 550 N.W.2d 91, 95). Further, an "eleventh-hour" affidavit cannot be used to create

[5] The Defendants do not point to any deposition testimony of Brown which is allegedly contradictory to his affidavit.

a material issue of fact which would preclude entry of summary judgment, barring an explanation for the affiant's change in testimony or a showing that affiant's previous answers were ambiguous and that the affidavit clarified them. *Taggart*, 462 N.W.2d at 503. *See also* Camfield Tires Inc. v. Michelin Tire Corp., 719 F.2d 1361, 1365-66 (8th Cir.1983) ("If testimony under oath, however, can be abandoned many months later by the filing of an affidavit, probably no cases would be appropriate for summary judgment. A party should not be allowed to create issues of credibility by contradicting his own earlier testimony.").

In the case at hand, I find that the affidavits of Harrell and Brown do not attempt to change, contradict, or otherwise alter previous deposition testimony. Instead, the record indicates that, especially in the case of Harrell, the affidavits are attempting to clarify the previous testimony due to the review of documents not before Harrell at the time of his previous depositions. Thus, it cannot be said that these affidavits are attempting to "assert a better version of facts than his prior testimony[.]" *Loewen,* 1997 SD 2, ¶16, 557 N.W.2d at 768. The Defendants' Motion to Strike Affidavits is therefore denied.

IV. CONCLUSIONS

As previously discussed, the motions before me are decided as follows:

1. Defendants' Motion for Summary Judgment is hereby denied;
2. Plaintiff's Motion for Partial Summary Judgment is granted to the extent that duty is a question of law and to the extent that the duty of Defendants was addressed in my discussion and

decision on the Defendants' Motion for Summary Judgment; whether Defendants breached any duty is a question of fact for the jury;

3. Defendants' Motion to Exclude Attorney Testimony, or in the Alternative, to Extend Discovery Deadline, is hereby denied in part, granted in part;
4. Defendants' Motion to Exclude Expert Testimony and Strike Expert Reports is hereby denied in part, granted in part;
5. Defendants' Motion to Strike Affidavits is hereby denied.

Counsel for Plaintiff shall prepare an order consistent with this decision.

Sincerely,

Stuart L. Tiede
Circuit Judge