

A06-1238

STATE OF MINNESOTA

IN SUPREME COURT

Scott D. Augustine, M.D.,

Appellant,

vs.

Arizant, Inc., et al.,

Respondents.

**BRIEF OF AMICUS CURIAE STATE OF MINNESOTA**

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## LEGAL ISSUE

Is a corporate official who pleaded guilty to a crime of dishonesty precluded from obtaining indemnification from the corporation under Minn. Stat. § 302A.521 for the resulting criminal fine when the corporate official made sworn admissions of intentional fraud in connection with his guilty plea?

The district court denied the corporation's motion for summary judgment and its motion for judgment notwithstanding the verdict or a new trial. The Court of Appeals reversed, holding that the corporate official's indemnification claim fails as a matter of law.

Minn. Stat. § 302A.521 (2006)

Minn. Stat. § 302A.011, subd. 13 (2006)

*State v. Lemmer*, 736 N.W.2d 650 (Minn. 2007)

*State v. Pendleton*, 706 N.W.2d 500 (Minn. 2005)

*Bansbach v. Zinn*, 801 N.E.2d 395 (N.Y. 2003)

*Lowery v. Stovall*, 92 F.3d 219 (4th Cir. 1996),  
*cert. denied*, 519 U.S. 1113 (1997)

## STATEMENT OF THE CASE AND FACTS<sup>1</sup>

The salient facts are straightforward. Appellant Dr. Scott Augustine was the chief executive officer of one of the Respondent corporations. Augustine was convicted in federal court of defrauding the Medicare program after entering into a plea agreement. In connection with his guilty plea, Augustine made sworn admissions of intentional fraud. Augustine was sentenced to three years of probation and a fine of two million dollars.

Augustine then sued his former corporation demanding indemnification for his criminal fine under Minnesota's corporate indemnification statute, Minn. Stat. § 302A.521. The district court denied the corporation's motions that sought to have the claim denied as a matter of law. The Court of Appeals reversed, holding that Augustine's indemnification claim fails as a matter of law "[b]ecause both the undisputed evidence of [Augustine's] sworn admission that he acted with fraudulent intent and [Augustine's] conviction conclusively establish that he did not act in good faith and because good faith is an essential element of an indemnification claim." *Augustine v. Arizant, Inc.*, 735 N.W.2d 740, 744 (Minn. Ct. App. 2006).

This Court granted review on the issue of "whether [Augustine's] guilty plea conclusively bars indemnification." Order (Sept. 26, 2007).

The Court is otherwise referred to the statements of the case and facts set forth in the parties' briefs.

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<sup>1</sup> Pursuant to Minn. R. Civ. App. P. 129.03, it is certified that no person other than counsel for the State of Minnesota authored any part of this brief and that no person or entity other than the State made a monetary contribution to the preparation or submission of this brief.

## STANDARD OF REVIEW

Statutory construction is a question of law reviewed de novo. *Vlahos v. R&I Constr. of Bloomington, Inc.*, 676 N.W.2d 672, 679 (Minn. 2004). Whether a form of estoppel applies is also reviewed de novo. *State v. Lemmer*, 736 N.W.2d 650, 659 (Minn. 2007) (collateral); *State v. Pendleton*, 706 N.W.2d 500, 507 (Minn. 2005) (judicial).

## ARGUMENT

### **I. A CORPORATE OFFICIAL WHO MAKES SWORN ADMISSIONS OF INTENTIONAL FRAUD IN CONNECTION WITH PLEADING GUILTY TO A CRIME OF DISHONESTY IS PRECLUDED FROM OBTAINING CORPORATE INDEMNIFICATION UNDER MINN. STAT. § 302A.521.**

The governing statute, Minn. Stat. § 302A.521 (2006), sets forth the circumstances under which a corporate official is entitled to indemnification from the corporation. The statute requires the corporate official to establish that he “acted in good faith” with respect to the conduct for which indemnification is sought. *Id.* at subd. 2(a)(2); *see also id.* at subd. 6(a) (placing burden on person seeking indemnification). The Court should confirm that the “good faith” requirement is plainly not satisfied by intentional fraud.

The threshold question in this case is whether estoppel precludes indemnification when the corporate official made sworn admissions of intentional fraud in connection with a guilty plea to a crime of dishonesty. The Court should hold that collateral estoppel or judicial estoppel precludes indemnification in such cases. This holding is consistent with the statute and case law, and strongly supported by public policy. If the Court concludes that estoppel does not apply, it should affirm the denial of indemnification on other grounds set forth in the Court of Appeals opinion or Respondents’ Brief.

**A. Intentional Fraud Cannot Constitute The “Good Faith” Required For Indemnification Under Section 302A.521.**

As used in Section 302A.521, “good faith” is defined as “honesty in fact in the conduct of the act or transaction concerned.” Minn. Stat. § 302A.011, subd. 13 (2006). The Reporter’s Note for this statutory definition states that its source is a provision of the Minnesota Uniform Commercial Code, the Comment to which explains: “A thing is done ‘in good faith’ within the meaning of this chapter when it is in fact done honestly, whether it be done negligently or not.” The Reporter’s Note for Section 302A.521 itself leaves no doubt that “good faith” requires honest conduct, by stating unequivocally that “[o]nly honest behavior is protected by indemnification.”

Clearly, “good faith” should be interpreted as requiring honest conduct such that the requirement is not met when indemnification is sought for intentional fraud or other dishonest acts. This interpretation is in accord with decisions interpreting other states’ corporate indemnification statutes. *See, e.g., Bansbach v. Zinn*, 801 N.E.2d 395, 398, 403-04 (N.Y. 2003) (holding that corporate official’s sworn admissions to knowing and willful violation of campaign finance laws, made in guilty-plea allocution, “leave no room” for finding that official satisfied “good faith” requirement of statute).

Augustine does not dispute that indemnification is unavailable for intentional fraud. Thus, accepting his claim would mean that corporate officials convicted on a guilty plea are not bound by their sworn admissions of intentional fraud negating good faith but rather can obtain indemnification by renouncing those admissions. As discussed below, this result is not supported by the law and is contrary to public policy.

**B. Subdivision 2(b) Of Section 302A.521 And The Case Law Do Not Prevent Giving Estoppel Effect To Such Sworn Admissions.**

Augustine correctly notes that the legislature sets the criteria for indemnification, as it did by limiting indemnification to conduct done in good faith. It is the Court, however, not the legislature, that decides whether to give estoppel effect to the sworn admissions of corporate officials made in connection with guilty pleas to crimes of dishonesty. *See State v. Lemmer*, 736 N.W.2d 650, 656-59 (Minn. 2007) (holding that collateral estoppel is a procedural matter governed by the Court, not the legislature).

Augustine relies on Subdivision 2(b) of Section 302A.521, which states: “The *termination of a proceeding* by judgment, order, settlement, *conviction*, or upon a plea of nolo contendere or its equivalent does not, *of itself*, establish that the person did not meet the criteria [for indemnification] set forth in this subdivision.” Minn. Stat. § 302A.521, subd. 2(b) (2006) (emphasis added). This provision does not prevent the Court from giving estoppel effect to Augustine’s sworn admissions, for at least two reasons.

First, Subdivision 2(b) simply says that a conviction, “of itself” -- i.e., the mere fact of a guilty plea, by itself -- does not automatically bar indemnification. The provision does not go further and purport to say that sworn admissions made in connection with a guilty plea are incapable of precluding indemnification. Subdivision 2(b) otherwise merely reflects the fact that not all convictions are for dishonest actions that negate good faith and thereby preclude indemnification. For example, convictions for strict liability crimes, such as certain federal environmental crimes, are based on unintentional violations and therefore might not involve dishonest conduct.

Second, apart from the limited scope of its plain language, Subdivision 2(b) cannot be read as denying this Court's constitutional power to decide that estoppel effect should be given to sworn admissions such as those made by Augustine. *See, e.g., Hince v. O'Keefe*, 632 N.W.2d 577, 582 (Minn. 2001) (stating established principle that statutes must be interpreted to avoid constitutional defects). Indeed, nothing suggests that Subdivision 2(b) was intended to usurp this power by using the phrase "termination of a proceeding by ... conviction." This is underscored by the fact that no one can doubt a corporate official's conviction after trial precludes indemnification if the conduct constituting the crime is intentional fraud or other dishonest action that negates the requisite good faith. *See Travelers Ins. Co. v. Thompson*, 281 Minn. 547, 163 N.W.2d 289 (1968) (giving collateral estoppel effect to husband's conviction for murdering his wife so as to bar his claim as a beneficiary of insurance policies on her life).

Nor is there any controlling case law that prevents the Court from giving estoppel effect to Augustine's sworn admissions. This Court's decision in *Glen Falls Group Ins. Corp. v. Hoiium*, 294 Minn. 247, 200 N.W.2d 189 (1972), does not hold that such admissions cannot be given collateral estoppel effect, as Augustine contends. Rather, *Glen Falls* held that a guilty plea to aggravated assault did not, by itself, preclude the criminal defendant from arguing in a subsequent civil suit that his conduct was not an intentional tort. *Id.* Unlike the situation here, *Glen Falls* did not involve or address the effect of a pleading defendant's unequivocal, sworn admissions of criminal intent. Moreover, *Glen Falls* concerned an attempt by the crime victim to recover damages, *id.* at 251-52, 200 N.W.2d at 192, not an attempt by the wrongdoer to escape a criminal fine.

Augustine is also mistaken in relying on *Ohio v. Johnson*, 467 U.S. 493, 104 S. Ct. 2536 (1984), as that case dealt only with the effect of a guilty plea on continuing prosecution of the defendant for related crimes. The United States Supreme Court has elsewhere made clear that a conviction based on a guilty plea is a final judgment on the merits. See *United States v. Broce*, 488 U.S. 563, 569, 109 S. Ct. 757, 762 (1989) (“A plea of guilty and the ensuing conviction comprehend all of the factual and legal elements necessary to sustain a binding, final judgment of guilt and a lawful sentence.”). Equally misplaced is Augustine’s reliance on *Haring v. Prosise*, 462 U.S. 306, 103 S. Ct. 2368 (1983). This case held that, under Virginia law, a guilty plea did not bar a later damages action challenging the legality of the police search because no sworn admissions made in connection with the plea, or the plea itself, concerned the legality of the search. *Id.* at 308-17, 103 S. Ct. at 2370-75. As there is no contrary Supreme Court precedent, numerous state and federal decisions have given preclusive effect to sworn admissions made in connection with guilty pleas. See, e.g., *Bansbach*, 801 N.E.2d at 398, 403-04; *Robinson v. Globe Newspaper Co.*, 26 F. Supp.2d 195, 199-200 (D. Me. 1998).

If the Court does not apply collateral estoppel, it should conclude that judicial estoppel precludes corporate indemnification in cases such as this. “Judicial estoppel is an equitable doctrine that prevents a party from assuming inconsistent positions in the course of litigation.” *Illinois Farmers Ins. Co. v. Glass Serv. Co.*, 683 N.W.2d 792, 800 (Minn. 2004). “The doctrine ‘is not reducible to a pat formula,’ but ‘is intended to protect the courts from being manipulated by chameleonic litigants who seek to prevail, twice, on opposite theories.’” *State v. Pendleton*, 706 N.W.2d 500, 507 (Minn. 2005)

(quoting *Levinson v. United States*, 969 F.2d 260, 264 (7th Cir. 1992)); see also *Zedner v. United States*, 126 S. Ct. 1976, 1987 (2006) (reiterating that judicial estoppel “cannot be reduced to a precise formula or test” but “generally prevents a party from prevailing in one phase of a case on an argument and then relying on a contradictory argument to prevail in other phase”) (citations omitted).

Judicial estoppel is related to, but in important respects different than, collateral estoppel and equitable estoppel, which courts also can apply to prevent such attempted abuse of the judicial process. *Lowery v. Stovall*, 92 F.3d 219, 223 & n.3 (4th Cir. 1996), *cert. denied*, 519 U.S. 1113 (1997). With judicial estoppel, there is no requirement that the issue raised by the estopped party was actually litigated in the prior proceeding or that the opposing party in the subsequent proceeding suffered detrimental reliance. See *id.*; *Pendleton*, 706 N.W.2d at 507-08; *State v. Profit*, 591 N.W.2d 451, 462 (Minn. 1999).

Courts have applied judicial estoppel to preclude a criminal defendant from taking a position in subsequent civil litigation that, as with Augustine, is contrary to sworn admissions the criminal defendant made in pleading guilty under a plea agreement by which he received a reduced sentence. See *Lowery*, 92 F.3d at 224-25; *Robinson*, 26 F. Supp.2d at 200. Judicial estoppel is particularly appropriate in such a situation. As the Fourth Circuit observed in *Lowery*:

Particularly galling is the situation where a criminal convicted on his own guilty plea seeks as a plaintiff in a subsequent civil action to claim redress based on a repudiation of the confession. The effrontery or, as some might say it, chutzpah, is too much to take. There certainly should be an estoppel in such a case.

*Lowery*, 92 F.3d at 225 (quoting Geoffrey Hazard, *Revisiting the Second Restatement of Judgments; Issue Preclusion and Related Problems*, 66 Cornell L. Rev. 564, 578 (1981)).

Thus, judicial estoppel is clearly available to prevent “abuses of the judicial system wherein a party asserts one theory to prevail at one time [by obtaining a reduced criminal sentence], then cynically switches to an inconsistent theory to win in a subsequent proceeding [by obtaining corporate indemnification].” *Pendleton*, 706 N.W.2d at 508.

In sum, nothing in the corporate indemnification statute or controlling case law prevents the Court from giving collateral estoppel or judicial estoppel effect to sworn admissions such as those made by Augustine in connection with his guilty plea. The Court is, therefore, free to determine that public policy considerations weigh in favor of applying estoppel to bar indemnification of convicted corporate officials in such cases.

**C. Public Policy Supports Precluding Convicted Corporate Officials From Obtaining Indemnification In Such Cases.**

The Court weighs public policy considerations in deciding whether estoppel should be applied. *See Lemmer*, 736 N.W.2d at 664; *Thompson*, 281 Minn. at 555-58, 163 N.W.2d at 294-96. Barring indemnification in cases such as this surely does not work an injustice on the convicted corporate official. *See Lemmer*, 736 N.W.2d at 659 (noting that the Court “will not apply collateral estoppel if its application would work an injustice on the party to be estopped”). On the other hand, strong policy reasons support precluding corporate officials from repudiating their sworn admissions made in guilty-plea proceedings in order to obtain indemnification for criminal fines. Allowing such indemnification would undermine enforcement of the criminal law in several respects.

First and foremost, relieving convicted corporate officials of having to pay substantial fines imposed as part of their sentence undermines the goals of individual punishment and specific deterrence. Such indemnification frees the corporate official from having to suffer the consequences of his criminal actions and allows him to avoid responsibility for those actions. Simply put, the effectiveness of the criminal justice system is weakened if those found to have engaged in intentionally fraudulent conduct cannot be held personally and financially accountable for their actions.

Second, indemnification of corporate criminals undermines the goal of general deterrence. Allowing a convicted corporate official to escape entirely a heavy criminal fine lessens the deterrent effect on other corporate officials who might be tempted to engage in similar fraud. The legal system should not send a message that reduces the incentive to comply with the law. *See, e.g., United States v J & D Enters. of Duluth*, 955 F. Supp. 1153, 1159-61 (D. Minn. 1997) (refusing indemnification of civil penalties for violations of Clear Air Act because it would remove incentive to comply with law).

Third, indemnification of convicted corporate officials not only sends the wrong message, it also fosters a dual system of criminal justice:

[T]his indemnification separates corporate executives from other criminal defendants. With someone else paying their litigation expenses and fines or penalties, corporate executives do not feel the pain or stigma of a criminal verdict and sentence as do other criminal defendants. Thus, indemnification and insurance not only contribute to a corporate culture that encourages corporate crime but also perpetuate two levels of justice.

Pamela H. Bucy, *Indemnification of Corporate Executives Who Have Been Convicted of Crimes: An Assessment and Proposal*, 24 Ind. L. Rev. 279, 342 (1991).

Fourth, eliminating the effect of criminal fines on corporate officials lessens the flexibility of prosecutors in determining the appropriate sanctions to pursue or recommend in a case. The prospect of indemnification could prompt prosecutors in both state and federal courts to seek the sanction of imprisonment in lieu of fines that officials would pass on to their corporations. The public interest is not served by compelling law enforcement to demand incarceration as a condition of resolving criminal investigations because fines have become meaningless sanctions due to corporate indemnification.

In addition, such indemnification shifts to the corporation and its shareholders the financial burden of a criminal punishment imposed for the dishonest actions of an individual corporate official, even though these actions may already have depressed share values. Imposing this harm on innocent shareholders and employees of a corporation is unjustified, particularly when it results in a loss of millions of dollars. Public policy weighs against requiring Minnesota employees and citizens to effectively bear the burden of financial punishment that a sentencing court imposes on dishonest corporate officials.

Finally, precluding indemnification in such cases would not produce either of the public policy concerns invoked by Augustine: (1) dissuading qualified persons to serve as corporate officials; or (2) chilling settlement efforts. As indicated in the Reporter's Note to Section 302A.521, indemnification is intended to encourage "responsible business men" to take corporate positions that they might otherwise forgo due to risk of liability for their own conduct. Denying indemnification to those who engage in intentional fraud is fully consistent with this purpose because "responsible" business persons do not engage in such conduct and, thus, need not fear losing their right to financial protection.

Augustine's concern about chilling settlement efforts is equally unfounded. With respect to criminal matters, it wrongly assumes that corporate officials can make sworn admissions to facts that are untrue, such that they can choose to make false admissions in order to secure a plea agreement while preserving a claim for corporate indemnification. Moreover, contrary to Augustine's suggestion in the Court of Appeals, it is unnecessary for prosecutors to include a waiver of indemnification in a plea agreement when the corporate defendant is admitting under oath to facts that negate good faith. As for civil suits, precluding corporate indemnification for admitted acts of intentional fraud does not chill settlement efforts because a civil settlement can deny any wrongdoing.

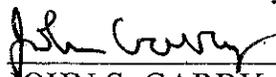
#### CONCLUSION

The Court should hold that a corporate official is estopped or otherwise precluded from obtaining corporate indemnification under Minn. Stat. § 302A.521 for a criminal fine that is based on sworn admissions of intentional fraud made in connection with the official's guilty plea to a crime of dishonesty.

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