NO. A08-1730

State of Minnesota
In Supreme Court

Katherine M. Rucker,

Respondent,

vs.

Steven B. Schmidt and
Rider Bennett, LLP,

Appellants.

RESPONDENT'S BRIEF

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STATEMENT OF THE LEGAL ISSUE

Issue:

Where a wife successfully sues her ex-husband for fraud in their divorce and, while his appeal is pending, they enter into a settlement for less than the wife's actual damages, is the wife precluded by res judicata from subsequently suing the ex-husband's divorce lawyers who knowingly and actively participated in the divorce fraud?

Resolution by the District Court

Relying on cases from foreign jurisdictions and without analyzing whether privity is met under Minnesota law, the District Court held that the lawyers and the ex-husband client were in privity and, therefore, the wife's claims are barred by res judicata.

Resolution by the Court of Appeals

The Court of Appeals reversed the District Court because the lawyers did not control the prior litigation and their interests were not represented in the prior litigation. The Court of Appeals also noted the "astounding lack of analysis" of the foreign jurisdiction cases relied on by the lawyers and the District Court.

Controlling Authorities:

Margo-Kraft Distributors, Inc. v. Minneapolis Gas Co., 200 N.W.2d 45 (Minn. 1972)
Miller v. Northwestern Nat'l Ins. Co., 354 N.W.2d 58, 62 (Minn. Ct. App. 1984)
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STATEMENT OF THE CASE

Respondent Katherine Rucker was defrauded in her divorce by her ex-husband, Bob Rucker ("Rucker"), and his lawyer, Appellant Steve Schmidt ("Schmidt"), who conspired to provide false information to and mislead the neutral expert, Howard Kaminsky, CPA ("Kaminsky"), who was hired to value the Ruckers' marital interest in a company called The Tile Shop ("The Company"). Schmidt held meetings with Company employees to discuss how to devalue the company for purposes of the divorce valuation. In one meeting, Schmidt told the employees they needed to portray a "doom and gloom" scenario for Kaminsky. Schmidt asked them to come up with ways to make the financial condition of the Company look as bad as possible, even though it was thriving. In another meeting, Schmidt, Rucker and other Company employees discussed creating two sets of financial projections – one showing "growth" and one showing "no growth." Consequently, instead of providing Kaminsky with The Company's actual projections that projected $6 million of net income for 2001, Schmidt and his client conspired to create false documents, including projections used solely for the divorce valuation that projected net income for 2001 to be less than $3 million.

In another meeting in early 2001, Schmidt and Rucker discussed the fact that The Company earned more than $6 million in 2000, but they did not want to disclose that much income in the divorce. Accordingly, when The Company closed down a facility in the spring of 2001, it applied a $2.4 million loss retroactively to its 2000 financial statements. However, The Company's controller admitted that they did not actually incur the loss or write it off in 2000.

Kaminsky relied on the fraudulent documents and information, and valued The Company at $14 million. (Appellant's Appendix ("A."), p. 229, ¶ 6). Kaminsky testified that the Divorce projections were misleading. Using the true information, The Company was actually worth approximately $30 million. (A. 273, ¶ 105).

Respondent sued Rucker for fraud in 2003, and the case was tried in March 2005 in Hennepin County District Court (hereinafter the "Rucker Fraud Case"). Rucker was represented by Appellant Rider Bennett, LLP ("Rider Bennett"). The court there found that Rucker committed fraud on the court and awarded Respondent approximately $4.1 million, inclusive of interest from the date of the divorce. While Rucker's appeal was pending, the parties entered into a settlement agreement, pursuant to which Rucker paid $2.6 million to Respondent. The settlement agreement (which Rider Bennett negotiated) expressly acknowledged that Rucker's payment only partially satisfied Respondent's damages, and the agreement expressly reserved all claims against Schmidt and Rider Bennett. (See A. 113-15, ¶¶ 1(B), (C), and (D)).

Respondent subsequently sued Schmidt and Rider Bennett in the present case, alleging that they conspired with Rucker and aided and abetted his fraud. Respondent also asserted a claim against Schmidt and Rider Bennett under Minn. Stat. §§ 481.07 and 481.071, which impose treble damages on an attorney who deceives a court or a party, or who consents to any such deceit or collusion. Appellants each moved for summary judgment, which the District Court granted. The sole basis for the District Court's ruling was that Respondent's claims against Appellants were supposedly barred by res judicata, notwithstanding the fact that Respondent prevailed in the Rucker Fraud Case and that

Appellants were not parties in that case. The District Court acknowledged that no Minnesota case has held that an attorney and client are in privity for purpose of res judicata. However, the District Court relied on inapposite cases from other jurisdictions to hold that an attorney and client are in privity with each other for such purpose. (Appellant's Addendum ("ADD."), pp. 29-37).

Respondent appealed to the Minnesota Court of Appeals, which reversed the District Court's dismissal and held that Appellants were not in privity with Bob Rucker for purposes of res judicata. (ADD. 1-17). Appellants sought further review in this Court, which this Court granted on September 29, 2009. For the reasons set forth herein, this Court should affirm the Court of Appeals' decision on the issue of res judicata and privity.

STATEMENT OF FACTS

The Ruckers and their Marital Interest in The Company.

Respondent was married to Rucker from 1976 until October 2001. (R. 398). The parties owned a 50% interest of The Company and Rucker was the CEO. (R. 130-34, 400). By 2000, The Company had 14 retail tile stores in several different states, including Minnesota, Wisconsin, Michigan, Kansas, Missouri, Ohio, Illinois, and Indiana. (R. 347).

Appellant Steven B. Schmidt

Schmidt is a practicing lawyer with 30 years of experience. (R. 21, p. 8). The focus of his practice was mainly family law, which became his exclusive practice in the early 1990s. (R. 22, pp. 9-10). Schmidt joined Rider Bennett in 1996, became a partner in 1997, and was the head of the firm's family law practice group. (R. 22-23, pp. 11, 13). Schmidt was familiar with different valuation methods for businesses, including the discounted cash flow method, (R. 23-24, pp. 16-17), which was one of the primary valuation methods used in valuing The Company. (R. 372-76, 381-82, 385-90).

The Divorce Commences.

Rucker commenced a marital dissolution proceeding against Respondent on March 29, 2000. (A. 143). Rucker was represented by Schmidt and Rider Bennett.

Schmidt Makes an Early Settlement Offer on Behalf of Rucker on August 3, 2000

On August 3, 2000, early in the proceeding before the parties had completed their normal discovery and valuation procedures, Schmidt made an offer on behalf of Rucker to pay Respondent $2 million for a complete property settlement and waiver of spousal maintenance. (R. 261). Schmidt acknowledged in his letter that it was "extraordinarily unusual" for a party to make such a proposal. (R. 261). Schmidt admits that, in many cases, business-owning husbands want to pay their wife as little as possible in the divorce, and he admits that was probably true with Rucker in his divorce from Respondent. (R. 32, p. 83).

Kaminsky Was Hired to Value The Company; and Schmidt Was Involved in the Process of Providing Information to Kaminsky and Skewing the Valuation

During their divorce, the Ruckers and their attorneys jointly agreed to hire Kaminsky as a neutral appraiser to value The Company for purposes of the property division. (A. 143-54).

In or about September 2000, Kaminsky provided Schmidt with a checklist of information that Kaminsky wanted for his valuation. (R. 27, p. 37; R. 264). One of the items Kaminsky specifically requested was "Projections – internal or given to bank." (R. 264). Schmidt understood that Kaminsky wanted both internal projections and ones given to The Company's bank because people sometimes give a rosy picture of their company to their bank while giving a much less favorable picture to a valuator in a divorce. (R. 27-28, pp. 39-41). Schmidt knew that The Company's projections would have a significant impact on the valuation. (R. 11, pp. 23-24).

In September 2000, Schmidt met with The Company's controller Jim Thompson to explain what documents Kaminsky was requesting. (R. 26, p. 34). Schmidt went through Kaminsky's checklist of requested documents with Thompson. (R. 27, p. 37). Schmidt and Thompson worked together to produce records to Kaminsky. (Id.). Thompson was to get Schmidt the documents and Schmidt would produce them to Kaminsky. (Id.).

The Company's Internal Projections – a/k/a "The Plan"

Annually, The Company prepared internal projections for the coming year, which include, among other things, projections for sales, gross margins, expenses, and net income. These internal projections were sometimes referred to during the Rucker Fraud Case as "the Plan."[1] (See R. 256-60, 309). The Plan was created with input from Company management. (R. 77-78, 80-81, 82, 137-39). The Company used its Plan, which was reviewed by senior management each week, to measure how it was doing on a daily basis and as a tool to compensate management. (R. 87-88).

The Company's June 27, 2000 Projections for 2001, Which Were Provided to Wells Fargo to Obtain a $5.8 million Credit Line for New Stores and a New Distribution Center in 2001.

By June 27, 2000, The Company projections estimated pre-tax net income of $6.9 million for 2001. (R. 256). These projections were given to Wells Fargo on June 27, 2000, as part of the company's request for an increased credit line from $3.9 million to $6 million to finance the opening of six new stores and a new distribution center in 2001. (R. 256). Thompson admitted that the June 27, 2000 projections given to the bank were accurate and realistic. (R. 74, 123. See also R. 53, p. 97, stating that the June 27, 2000 projections were reasonable).

Schmidt received the June 27, 2000 projections and sent them to Kaminsky on September 27, 2000. (R. 29, pp. 46-47; R. 265-66). However, Schmidt informed Kaminsky that these projections were being revised and that the revised projections would be provided

[1] A "projection," a "plan" and a "forecast" are synonymous. (R. 43, p. 73).

to Kaminsky before he toured The Company's facilities. (R. 266, ¶ 8). Thompson, too, told Kaminsky to disregard the June 27 projections and rely on the new ones to be submitted. (R. 129, 228). Based on the Schmidt's and Thompson's representations, Kaminsky ignored and did not place any reliance on the June 27, 2000 projections in performing his analysis of The Company. (R. 39-40, pp. 59-65; and R. 171-72, 187, 189, 192-93).

The Company's 2001 Projections dated February 14, 2001 (the final version of the Plan) Were Not Given to Kaminsky.

The Company's internal projections dated February 14, 2001 were produced from Rider Bennett's file in the Rucker Fraud Case. (R. 309-13). These projections, which were the final version of The Company's Plan for 2001, projected net income of $6.699 million and $56.9 million in existing store sales without new stores or the discontinued Brooklyn Park store. (R. 88-90, 309-13). The February 14, 2001 projections represented the company's most realistic and reasonable projection for 2001. (R. 139, 210).

In his deposition in this case, Schmidt claimed he does not know when he received the February 14, 2001 projections or if he received them at all. (R. 30, pp. 49-50). Schmidt also denied having a meeting at The Company or with anyone from The Company on February 14, 2001, and claimed he did not know whether he met with Rucker that day. (R. 30, p. 49). However, Rider Bennett's divorce billing records produced in September 2004 in the Rucker Fraud Case reflect that Schmidt's paralegal (Loralee A. Berle) met with Schmidt and Rucker on February 14, 2001, but conspicuously absent from those records was any corresponding time entry for Schmidt for that day. (R. 447-48, 462). During Schmidt's June 2008 deposition in the present case, he revealed that he sent Rucker <u>two</u> sets of invoices related to the divorce – some he labeled "Dissolution" and some he labeled "Business Succession." (R. 33, p. 87).

Shortly after Schmidt's June 2008 deposition, and in response to a demand for all of Rider Bennett's billing records for Rucker's divorce, Rider Bennett finally produced for the first time its previously undisclosed billing records. (R. 222). Rider Bennett tried to justify its earlier failure to produce these documents by claiming they were "misfiled." (R. 222). These newly disclosed billing records reveal that Schmidt recorded 4.2 hours of time on February 14, 2001 (the same date as the final projections, R. 309-13) under "Business Succession" with the following notations:

- "**review documents in connection with business valuation**;"
- "**meeting with Bob Rucker to review documents needed for business valuation**/tax returns/other financial information related to dissolution proceeding;"
- "conference opposing counsel concerning business valuation and in lieu of providing copies of all Tile Shop business records requested by Howard Kaminsky to opposing counsel, service of itemized schedule of documents provided to Howard Kaminsky in compliance with his checklist to be sufficient to avoid hundreds of dollars of photocopies to each of the parties personally;"

(R. 224) (emphasis added). Moreover, the February 14, 2001 projections from Rider Bennett's files have a date stamp of "2/14/01" in the bottom corner, indicating the date they were printed. (R. 309-13). Five days later, on February 19, 2001, Schmidt had Metro Legal deliver documents (but not the February 14, 2001 projections) to Kaminsky. (R. 466).

Neither Schmidt, Rucker, nor Thompson ever provided the February 14, 2001 projections (i.e., the Plan) to Kaminsky. (R. 43, p. 74; R. 175, 193). Instead, as discussed below in more detail, they provided Kaminsky with the phony "Divorce" projections – created solely for the purpose of the divorce – that projected net income for 2001 of only $2.9 million, not $6 million. (R.227-55). Had Kaminsky received the February 14, 2001 Plan projecting net income in excess of $6 million, it would have had a material impact on his overall valuation. (R. 43, p. 76; R. 186).

Schmidt Encourages The Company Employees to Provide False Information to Kaminsky – to Portray a "Doom & Gloom" Scenario – and to Create Phony Financial Projections Used Solely for the Divorce Valuation

Although Schmidt was not The Company's corporate attorney, he held meetings with Rucker and senior Company management, including a meeting in the fall of 2000 to discuss the divorce valuation. (R. 31, pp. 53-54). During that meeting, Schmidt informed management that Kaminsky was going to be conducting a valuation of the company as part of the Ruckers' divorce. (R. 31, p. 53). Schmidt gave them an overview of the valuation process, discussed what documents they would have to provide to Kaminsky for his valuation, and told them they would have to prepare projections for the business valuation. (R. 31, p. 54-56).

According to notes prepared by Thompson from a March 8, 2001 meeting with Schmidt and the two owners of The Company (Rucker and Rod Sill), they discussed preparing forecasts for the divorce under "2 scenarios" – "growth" and "no growth." (R. 91-94, 314).

Schmidt also held a meeting in May 2001 with Rucker and Company employees to discuss how to devalue The Company for purposes of the divorce valuation. (R. 48, p. 22; R. 49, p. 27). Rucker and Schmidt asked the employees to come up with ways to make the financial condition and outlook of The Company look as bad as possible to drive down the value of The Company and mislead the business valuator. (R. 50, pp. 34-36; R. 56-57, pp. 160-61). Schmidt asked them to come up with a "doom-and-gloom scenario of The Company with regards to the business valuation that was under way." (R. 49, p. 27; see also R. 147-49, Sill testifying that Schmidt said "we needed to have a quote/unquote, 'gloom and doom scenario' for the business valuator."). Creating such a "doom-and-gloom" scenario meant Rucker would have to pay Respondent less money in the divorce settlement. (R. 51, p. 44). The employees in attendance at that meeting then brainstormed trying to come up with things that would make The Company look less successful than it was. (R. 54, p. 112; R. 149-50). They were having difficulty coming up with reasons because The Company was so successful. (Id.).

Rider Bennett's "Dissolution" billing records produced in the Rucker Fraud Case in September 2004 did not disclose a meeting Schmidt had at The Company in early May 2001, before Kaminsky conducted his May 9, 2001 interview at The Company. (R. 458-61). Likewise, Schmidt testified that he did not believe he had a meeting at The Company on May 7, 2001. (R. 33, p. 85). However, Rider Bennett's supposedly "misfiled" invoices labeled "Business Succession," which Rider Bennett failed to produce until June 2008, reveal that Schmidt had a meeting with the "business valuation team" on May 7, 2001, just two days before Kaminsky's interview with Rucker, Thompson, and Schmidt. (R. 225). On May 10, 2001, Schmidt recorded another time entry under "Business Succession" for a conference he had with Rucker to discuss preparing both a "worst case and best case scenario" for valuation of The Company. (Id.).

The Creation of the "Divorce" Projections

Instead of giving Kaminsky The Company's then-current projections for 2001, which projected net income of $6.669 million, even though they were readily available, Thompson was asked to create a revised projection showing net income of only $2.9 million to give to Kaminsky. (R. 100-03, 110-13). Since The Company's actual net income for the first three months of 2001 was already $1.643 million, Thompson had to lower the projected net income for the remaining nine months to arrive at $2.9 million for the full year. (R. 101-03, 127-28, 244). Thompson was told to use the "plug number" or "end result" of $2.9 million for 2001, and he let the computer allocate the amounts for the remaining months. (R. 127-28). As a result, the "Divorce" projections showed much lower monthly projections than The Company's real projections. (Compare R. 244 with R. 309).

The "Divorce" projections made the following projections for 2001-2003:

Year	Net Income Before Taxes	Sales	Gross Margins - %
2001	$2.9 million	$46.9 million	61.2%
2002	$2.3 million	$48.4 million	56%
2003	$2.3 million	$49.6 million	54%

(R. 232). These are paltry numbers compared to The Company's internal projections, which projected net income of $6.7 million for 2001, $8.8 million for 2002, and $10.5 million for 2003. (307-09).

Schmidt received and reviewed the "Divorce" projections. (R. 35-36, pp. 96-97). Schmidt provided the "Divorce" projections to Kaminsky on or about May 10, 2001.[2] (R. 225-26).

Schmidt again recorded an entry under "Business Succession" on May 16, 2001 for reviewing proformas for "high and low business valuation potential." (R. 226; cf. R. 314, reflecting Schmidt's discussion with Thompson and Rucker to prepare two sets of projections – one with "growth" and one with "no growth").

Representations to Howard Kaminsky In Re: No New Stores From 2001-2003

In May 2001, Rucker represented to Kaminsky that The Company was not going to open any new stores from 2001 through 2003 because of then-current economic conditions. (R. 97, 176, 230). Similarly, the "Divorce" projections that Schmidt gave to Kaminsky did not include any new stores from 2001 through 2003. (R. 176-77, 230). Kaminsky relied on the representation that there would be no new stores or distribution facilities and did not account for any in his valuation. (R. 45-46, pp. 88-89; R. 176-77). To the contrary, though, The Company was planning to open new stores, and these new stores were typically profitable after 12 to 18 months and add tremendous value to the company. (R. 161, 206-07).

[2] Appellants argued in the District Court that Schmidt did not give Kaminsky the "Divorce" projections. However, Rider Bennett's billing records (R. 225-26) contain an entry dated May 10, 2001, the date the "Divorce" projections were given to Kaminsky, which reads: "Accumulate requested information for Howard Kaminsky relative to his business valuation; letter to Howard Kaminsky forwarding the same." Therefore, at a minimum, there is a fact question as to whether Schmidt provided the "Divorce" projections to Kaminsky.

Kaminsky Relied on the "Divorce" Projections, Which Were False and Misleading

Kaminsky relied upon the "Divorce" projections, and though he made some upward adjustments to them, they were critical sources of information for his valuation. (R. 41-42, p. 68-70; R. 170-71, 181, 184-85, 344). Kaminsky was told that the "Divorce" projections were the best estimate and most realistic projection as to the future of The Company, and he assumed that information provided to him was accurate and not misleading. (R. 44, pp. 78-79; R. 180-81, 186).

Kaminsky valued The Company at $14 million, and he testified that his valuation did not in any way approximate the value of a company that was actually making $6 million per year. (R. 43, p. 75; R. 186). Kaminsky was not aware that, as of the date of his valuation, The Company was still using a plan under which The Company would make in excess of $6 million for 2001. (R. 185). He testified that, in light of the fact that The Company had a plan or projection to make $6.699 million net income in its possession as of May 9, 2001, the "Divorce" projections provided to him were false and misleading. (R. 44, p. 77; R. 188).

Had Kaminsky known that The Company's actual projected net income was double the projection given to him, that would have had a material impact on his overall valuation. (R. 43, pp. 75-76; R. 186). In fact, Kaminsky testified that if he had been provided with the company's Plan showing $6 million in net income instead of the "Divorce" projections given to him in May 2001, he likely would not have adjusted downward from the $6 million figure in calculating his ultimate valuation. (R. 44, pp. 77-78; R. 196-97).

It is undisputed that the "Divorce" projections Schmidt gave to Kaminsky were created solely for the divorce and were not provided to The Company's bank. (R. 98). The Company's real projections given to Wells Fargo were never changed to reflect the supposed changed conditions and revised projections given to Kaminsky in May 2001 for purposes of the divorce. (R. 104-05, 112-13). The only projections from 2001 showing gross profit margins decreasing in the future were the ones Schmidt gave to Kaminsky. (R. 107-09).

"The Worse Possible Damn Scenario"

At trial in the Rucker Fraud Case, Rucker made a spontaneous and telling admission regarding the "Divorce" projections given to Kaminsky:

> a forecast is a forecast of, what's the **worse possible damn scenario that it could possibly be**, and that's how I see it. Looking at this from what I see, do I think that's what was asked of Jim? **Yeah, I think that's what was asked of Jim.**

(R. 215-16). (emphasis added). Thompson clearly was asked to prepare false projections for Kaminsky.

Rucker's Plans to Open New Company Stores Prior to the Divorce.

Prior to the divorce, senior management of The Company regularly discussed opening new stores, as The Company was on an aggressive expansion campaign. (R. 133-34, 421). But, once the divorce started, plans for new stores were put on hold until the divorce was finalized. (R. 52, p. 57; R. 135-37). Opening new stores would give the appearance of success, which Rucker did not want to show for purposes of the divorce. (R.

52, p. 57-58). However, as of May 2001, The Company planned to open new stores as soon as the divorce was over. (R. 55, p. 115).

On May 25, 2001, only two weeks after representing to Kaminsky there would be no new stores through 2003, The Company's executive staff held a meeting to discuss plans to open 11 new stores from 2002 through 2004 and a new distribution center in 2002. (R. 55, p. 116; R. 316-34). By May 25, 2001, there was no question that the company would open new stores; it was merely a question of their exact location. (R. 158-60).

The Granite Facility's Backdated Loss

In March 2001, prior to a meeting at The Company, Schmidt received a draft of The Company's 2000 tax return, and he knew that the company had net income of more than $6 million in 2000. (R. 29, pp. 46-47). Schmidt later changed his testimony to say that he meant to say that he had The Company's audited financial statement, not the tax returns. (R. 19, pp. 134-35). During his deposition in the present case, Schmidt again changed his testimony, this time claiming that he did not have either the 2000 draft tax returns or financial statement in March 2001. (R. 34, p. 89-91). In any event, during a meeting in the Spring of 2001 between Schmidt, Rucker, Sill, and Thompson, Rucker stated that he did not want to show $6 million of income for the year 2000 for the divorce and that they needed to eliminate $2 million off the tax statement. (R. 54, p. 10; R. 59, pp. 39-40; R. 60, pp. 49-50). Schmidt also made this statement to Sill. (R. 60, pp. 49-50).

To accomplish the goal of reducing the bottom line for 2000 by $2 million, Rucker and other Company management decided to close down its granite facility, which was not performing as well as its core tile business. (R. 54, p. 110). However, even though the decision to shut down the granite facility was made during the first quarter of 2001, the approximately $2.4 million loss associated with the closing was applied retroactively to the year 2000. (R. 95, 273). Applying the loss to the year 2000 financial statement had the effect of lowering the net income for that year from approximately $6.5 million to $4.1 million. However, the loss was not actually incurred in 2000, nor was it written off in 2000. (R. 72, pp. 81-82; R. 281-306). Kaminsky testified that if the decision to close the granite facility was made in 2001 and was applied retroactively to 2000, it impacted the financial statements for 2000 and therefore lowered the value under the buy-sell formula, which he gave a one-third weight in his valuation. (R. 194-95).

Kaminsky's Valuation of The Company

Kaminsky sent Schmidt a draft of his valuation report in May 2001 and the final version in June 2001. (R. 35, pp. 94-95). Schmidt reviewed each draft when he received it. (Id., p. 95). Kaminsky valued the Ruckers' 50% marital interest in The Company at $7.125 million. (R. 340). After receiving his valuation report in June 2001, both sides agreed to use Kaminsky's value of The Company, as they relied on his expertise and valuation. (R. 35, pp. 96; R. 218, 467-70).

The Rucker's Settlement, the MTA, and the Judgment & Decree

The parties signed a Marital Termination Agreement ("MTA") on September 25, 2001. (A. 82-105). The MTA formed the basis for the Court's divorce decree, entered on October 1, 2001, incorporating its terms. (R. 422-45). Schmidt drafted the MTA and reviewed it with Rucker. (R. 37, p. 101-02).

In the MTA that Schmidt drafted, Rucker falsely represented that he had "made full disclosure and cooperated with discovery, specifically including a neutral appraisal of the parties' business interests in Rucker & Sill, Ltd. [d/b/a The Tile Shop]." (A. 92). This false representation of full disclosure was also incorporated into the divorce decree. (R. 433, ¶ XXXIII). The parties further expressly stipulated in the MTA that "each has relied upon the other party having **fully disclosed** all of his or her assets, both real and personal, all income, including any and all assets or income in the nature of third parties and under their control . . ." (A. 104, ¶ 25, emphasis added).

Respondent and her divorce lawyers relied on Rucker having made complete and accurate disclosures regarding The Company. (R. 219-20, 221). By September 26, 2001, the parties signed the MTA and made the following distributions of property:

- Rucker was awarded (1) the parties' 50% interest in The Company, (2) the parties' homestead in Eden Prairie, (3) the parties' cabin in Wisconsin, (4) the Parties' property in Rochester, and (5) the parties' time share in Cancun. (A. 96-98, ¶ 10(A-E)).
- Respondent was awarded a payment from Rucker of $2.4 million. (A. 101, ¶ 11D).

Had Respondent known that the value of parties' marital interest in The Company was substantially higher than $7.125 million, she would not have accepted a property settlement of only $2.4 million. (R. 221, ¶ 2).

The Rucker Fraud Case

Respondent sued Rucker for fraud in 2003, and the case was tried in March 2005 as a bench trial before Judge Marilyn Justman Kaman of the Hennepin County District Court. (A. 225-79). Rucker was represented by Rider Bennett. Judge Kaman initially ruled in favor of Rucker because of a misunderstanding regarding the "intent" requirement for fraud, but on a motion for amended findings she issued a 55-page Order finding that Rucker had committed fraud on the Court and awarded Respondent approximately $4.1 million, inclusive of interest. (Id.).

Judge Kaman found that the "Divorce" projections given to Kaminsky were "significantly and materially lower than all other financial documentation, known or projected, in The Tile Shop's records." (A. 244, ¶ 40A). She also found "clear evidence of non-disclosure," contrary to the representation of full disclosure in the MTA, (A. 246, ¶ 45); that Schmidt told The Company employees they needed to have a "gloom and doom" scenario for the business valuator, (A. 266-67, ¶¶ 82-84); that Thompson was told to prepare a "worst possible damn scenario forecast" for purposes of the divorce valuation, (A. 268, ¶ 88); and that Rucker "engaged in an intentional course of material misrepresentation and non-disclosure during the marital dissolution proceeding" by failing to give Kaminsky several documents "which showed the true value of The Tile Shop at the time of the valuation." (A. 272, ¶ 101). Judge Kaman concluded that Rucker's 50% interest in The Company was worth $15.367 million (and not $7.125 million per Kaminsky's valuation). (A. 273, ¶ 105).

Rucker appealed Judge Kaman's decision, and while his appeal was pending, the parties entered into a settlement agreement. (A. 113-20). Although Appellants disingenuously assert that Respondent fully recovered her damages and is now seeking a "double recovery" in this case, the settlement agreement (which Rider Bennett negotiated) expressly acknowledges that the payment from Rucker "will only partially satisfy" Respondent's damages and "is not intended as full compensation" for the same. (A. 114-15, ¶ 1(C)). Moreover, the settlement agreement expressly reserved all claims against Appellants Schmidt and Rider Bennett:

> It is the intent of the parties that the release given by Katherine to the Released Parties shall be the broadest possible release allowed by law. However, this Settlement Agreement and Release is given, and is only intended to be given, as a full discharge of the Released Parties; it is specifically understood that <u>this is not an agreement to release, dismiss, or waive the claims or causes of action, if any, that Katherine might have against Steven B. Schmidt and Rider Bennett, LLP (hereinafter referred to as the "Non-Released Party"). Katherine expressly reserves and retains all claims or causes of action, if any, she may have against the Non-Released Party</u>.

(A. 114, ¶ 1(B)) (emphasis added).

The Present Lawsuit Against Schmidt and Rider Bennett

Respondent commenced the present lawsuit against Schmidt and Rider Bennett in September 2006, alleging that they conspired with Rucker and aided and abetted his fraud. Respondent also asserted a claim for treble damages under Minn. Stat. §§ 481.07 and 481.071. Appellants moved for summary judgment, which the District Court granted on August 22, 2008. The sole basis for the District Court's ruling was that Respondent's claims against Appellants were supposedly barred by res judicata. (ADD. 20-38).

The Court of Appeals

Respondent appealed to the Minnesota Court of Appeals, which reversed the District Court. The Court of Appeals concluded that the cases from other jurisdictions cited by Appellants and the District Court did not support the sweeping conclusion that privity is established by the mere existence of the attorney-client relationship. (ADD. 8). The Court of Appeals also noted the "astounding lack of analysis" in those cases. (Id.). In analyzing Minnesota law, particularly this Court's decision in Margo-Kraft Distributors, Inc. v. Minneapolis Gas Co., 200 N.W.2d 45, 47-48 (Minn. 1972), the Court of Appeals determined that Appellants' interests were not represented in the dissolution and that they did not control the dissolution action. (ADD. 15). Therefore, the Court of Appeals held that Appellants were not in privity with Bob Rucker for purposes of res judicata. This appeal followed.

ARGUMENT

I. STANDARD OF REVIEW.

Summary judgment is appropriate when there are no genuine issues of material fact and either party is entitled to judgment as a matter of law. Minn. R. Civ. P. 56.03; Betlach v. Wayzata Condominium, 281 N.W.2d 328, 330 (Minn. 1979). The moving party has the burden of proof. Nord v. Herreid, 305 N.W.2d 337, 339 (Minn. 1981). On review, this Court must view the evidence in the light most favorable to the party against whom the motion for summary judgment was granted. Grondahl v. Bulluck, 318 N.W.2d 240, 242 (Minn. 1982). This Court's function is to determine whether there are genuine issues of material fact and whether the trial court erred in its application of the law.

Betlach, 281 N.W.2d at 330.

This Court does not give deference to the district court's conclusions of law and reviews questions of law de novo. Alpha Real Estate Co. of Rochester v. Delta Dental Plan of Minnesota, 664 N.W.2d 303, 311 (Minn. 2003) (citing Kornberg v. Kornberg, 542 N.W.2d 379, 384 (Minn. 1996); Boldt v. Roth, 618 N.W.2d 393, 396 (Minn. 2000)).

Given the limited issue for which review was sought and granted, and because of the standard of review, this Court must assume for purposes of its privity analysis that Appellants knowingly and actively participated in a fraud upon Respondent.

II. RESPONDENT'S CLAIMS AGAINST APPELLANTS ARE NOT BARRED BY RES JUDICATA.

"The determination of who are privies requires careful examination into the circumstances of each case as it arises." McMenomy v. Ryden, 148 N.W.2d 804, 807 (1967). The existence of privity is a "usually a question of fact that requires a case-by-case determination," Miller v. Northwestern National Ins. Co., 354 N.W.2d 58, 62 (Minn. Ct. App. 1984). This is important because res judicata must not be "rigidly applied." Hauschildt v. Beckingham, 686 N.W.2d 829 (Minn. 2004) (citing Wilson v. Commissioner of Revenue, 619 N.W.2d 194, 198 (Minn. 2000); Johnson v. Consolidated Freightways, Inc., 420 N.W.2d 608, 613 (Minn. 1988)). Instead, the focus should be on whether the application of res judicata would work an injustice on the party against whom the doctrine is urged. Id. This implies an equity analysis; however, it is a well-established maxim that "he who seeks equity must do equity, and that he who comes into equity must come with clean hand." Johnson vs. Freberg, 178 Minn. 594, 597-98, 228

N.W. 159, 160 (1929). Since Appellants knowingly and actively participated in a fraud upon Respondent, they are not entitled to equity.

In any event, the District Court here rigidly applied res judicata without even mentioning the possible injustice of leaving Respondent only partially compensated for her losses. If res judicata applies here, Respondent will be barred from further recourse to the courts for the sole reason that, as permitted by Minnesota law, she sued one tortfeasor without joining his joint tortfeasor-lawyers and then, as also allowed by Minnesota law, settled her claim against the original defendant for less than the full amount of her damages, while specifically preserving her claim against Appellants.

Schmidt's and Rider Bennett's complicity in the underlying fraud was not adjudicated, and applying res judicata here would "blockade unexplored paths that may lead to the truth." Allen v. McCurry, 449 U.S. 90, 94 (1980) (cautioning that res judicata should be invoked only after careful inquiry). In addition to Appellants' liability for Respondent's damages, they are also liable for treble damages under Minn. Stat. §§ 481.07 and 481.071, which impose treble damages on attorneys who are guilty of or consent to any deceit or collusion in connection with a judicial proceeding. Id. By granting summary judgment, the District Court prohibited Respondent from pursuing this remedy, which is only available against attorneys and could not have been pursued against Bob Rucker in the Rucker Fraud Case.

Specifically with respect to res judicata's privity requirement, the District Court acknowledges that Minnesota recognizes three categories of nonparties who will be deemed in privity with a party to a prior adjudication: (1) a nonparty who controls the original action; (2) a nonparty whose interests are represented by a party to the original action; and (3) a successor-in-interest to a party. Margo-Kraft Distributors, Inc. v. Minneapolis Gas Co., 200 N.W.2d 45, 47-48 (Minn. 1972). However, after listing the categories, the District Court goes no further and fails to explain how Appellants fit into any of them. In fact, under the circumstances of this case and as a matter of Minnesota law, Appellants were not in privity with their client. Appellants did not control the underlying litigation, their interests were not represented by their client in the underlying litigation, and they are not successors-in-interest to Rucker. While Appellants counsel argued to the Court of Appeals that Schmidt controlled the dissolution action, the Court of Appeals rejected this argument and correctly pointed out that there was no evidence in the record to support Appellants' claim. (ADD. 15).

Regarding control, Rule 1.2(a) of the Minnesota Rules of Professional Conduct "confers upon the client the ultimate authority to determine the purposes to be served by legal representation." 2005 Comment to Rule 1.2 (emphasis added). More specifically, as noted by the Court of Appeals below, Rule 1.2(a) states, "A lawyer shall abide by the client's decision whether to settle a matter." (Add. 16, citing Minn. R. Prof. Conduct 1.2(a)). Thus, Rucker, not Appellants, controlled the original action and the settlement that supposedly provides the basis for res judicata. Moreover, as attorneys, Appellants were ethically obligated to defer to their client's control and to see that his interests, not their own, were represented. Minn. R. Prof. Conduct 1.7(a)(2) (stating that a lawyer's representation of a client must not be materially limited by a personal interest of the lawyer); see also Ammon v. McCloskey, 655 A.2d 549, 554 (Pa. 1995) (finding no privity between an attorney and his client for purposes of res judicata because the attorney owed complete allegiance to the client and represented the client's interests, not the attorney's own interests). Thus, Rider Bennett's representation of Rucker in the underlying litigation was not the sort of common interest that mandates an application of res judicata.

In addition, recognizing privity here does not advance the reasons underlying the doctrine of res judicata or square with Minnesota's policies that allow a plaintiff to sue joint tortfeasors separately and to settle with one for less than her full damages without relinquishing her claims against the others. Furthermore, it would afford unwarranted preferential treatment to joint tortfeasors who also happen to be lawyers, and it would force a plaintiff to sue a client and his lawyer who colluded to commit fraud at the same time and to refrain from settling with one without settling with the other.

Since before the advent of the Rules of Civil Procedure, Minnesota has held that a plaintiff may sue one, all, or any number of joint tortfeasors without violating the rules of compulsory joinder and may proceed in one action or in separate actions. See, e.g., Kisch v. Skow, 305 Minn. 328, 332, 233 N.W.2d 732, 734 (1975) (stating the rule and providing citations in a footnote to demonstrate its long history); Schneider v. Buckman, 433 N.W.2d 98, 101 (Minn. 1988). See also Temple v. Synthes Corporation, Ltd., 498 U.S. 5, 7 (1990) ("It has long been the rule that it is not necessary for all joint tortfeasors to be named as defendants in a single lawsuit."). As to the issue of privity, the "relationship between joint tortfeasors is not such as to make the one not sued a party by either privity or representation." Hentschell v. Smith, 278 Minn. 86, 95, 153 N.W.2d 199, 206 (Minn. 1967). "Privity does not exist between two joint tortfeasors when only one is sued." Miller v. Northwestern Nat'l Ins. Co., 354 N.W.2d 58, 62 (Minn. Ct. App. 1984). The Hentschell court also rejected the notion that participation in a previous suit makes a person a privy: "Privity depends upon the relation of the parties to the subject matter rather than their activity in a suit relating to it after the event. Participation in the defense because of general or personal interest in the result of the litigation does not make one privy to the judgment." Id. (citations omitted).

Similarly, for at least 50 years, Minnesota has held with respect to a settlement with one but not all joint tortfeasors:

> The just and true rule should be, and we believe is, that, if the injured party has accepted satisfaction in full for the injury suffered by him, the law will not permit him to recover again for the same injury; but if he has not received full satisfaction, or that which the law considers such, he is not barred until he has received full satisfaction. If he receives a part of the damages from one of the wrongdoers, the receipt thereof not being understood to be in full satisfaction of the injury, he does not thereby discharge the others from liability.

Gronquist v. Olson, 242 Minn. 119, 126, 64 N.W.2d 159, 164 (1954) (emphasis added). In Frey v. Snelgrove, 269 N.W.2d 918, 921 (Minn.1978), this Court reinforced and expanded Gronquist by approving the use of Pierringer-type releases as a means of releasing fewer than all joint tortfeasors while preserving claims against those who are not parties to the settlement. The major policy rationale for these rules is the law's strong preference for the compromise and settlement of disputes. See, e.g., Gronquist, 64 N.W.2d at 166.

Whether Respondent's settlement with her ex-husband bars her claim against

Appellants should hinge upon whether Respondent was made whole by the settlement and the intent of the settling parties as expressed in their settlement agreement. Id. at 164. The application of res judicata should not depend solely on a rote determination of attorney-client privity without regard to the circumstances.

In this case, Respondent did everything she was permitted to do and required to do to preserve her claim against Appellants under controlling case law. She elected to sue the joint tortfeasors separately, as was her prerogative under Kisch v. Skow. The settlement agreement in the underlying litigation makes clear that she is receiving less than the full amount of her damages and that she is expressly reserving her claim against Appellants, as required under Gronquist v. Olson. She entered into a Pierringer-type release, as permitted under Frey v. Snelgrove. Appellants omit analysis of this precedent. Instead, Appellants urge a rigid application of res judicata despite the warning in Gronquist to avoid "artificial reasoning and mere technicalities," 64 N.W.2d at 164, as they seek to have the case against them dismissed because they were lawyers. The Court of Appeals recognized that such a ruling would be unjust and contrary to the law.

III. APPELLANTS ARE NOT IN PRIVITY WITH BOB RUCKER.

A. Introduction.

Appellants acknowledge that no Minnesota state court case has held that an attorney and client are in privity for purposes of res judicata. (Schmidt Brief to the Court of Appeals, p. 14). Thus, Appellants resort to cases from other jurisdictions holding that, in circumstances not present or analogous here, attorneys can be in privity with their client for res judicata. (Schmidt Br., p. 15). However, these cases are not analogous to the facts in the present case, contain little or no detailed analysis on attorney-client privity, and generally involve situations where the plaintiff lost in the prior court action.[3]

Perhaps more importantly, Appellants fail to mention, let alone analyze, how they fit into one of the three recognized categories of nonparties under Minnesota law who are in privity with a party to a prior lawsuit. See Margo-Kraft Distributors, Inc. v. Minneapolis Gas Co., 200 N.W.2d 45, 47-48 (Minn. 1972) (holding that the three categories are (1) a nonparty who controls the original action; (2) a nonparty whose interests are represented by a party to the original action; and (3) a successor-in-interest to a party). Appellants argue instead for an application of res judicata that depends solely on a rote determination of privity based upon the mere existence of an attorney-client relationship, without regard to the circumstances.

B. Appellants' Cases From Other Jurisdictions Are Not Controlling Or Instructive.

Appellants' citation to Chaara v. Lander, 45 P.3d 895 (N.M. Ct. App. 2002) is not instructive, even if it had taken into consideration the principles of the foregoing Minnesota cases. In Chaara, the husband sued his ex-wife's divorce attorney but did not make any allegations of collusion, fraud, or joint wrongdoing involving the wife and her attorney. Id. Rather, it involved a mere "oversight" on the part of the attorney in failing to timely deliver passports. Id. at 899. Moreover, the court of appeals, in balancing the competing equitable and policy considerations, determined that the issue of delivering the

[3] In essence, Appellants' cases are more about a plaintiff losing and getting a second chance to prevail – which is not the case here, since Respondent prevailed in the Rucker Fraud Case – than about the compulsory joinder of joint tortfeasors.

passports arose and should have been dealt with in the underlying divorce proceeding. Id. The divorce court in Chaara had the power to resolve the passport issue in the first case. However, in the Rucker Fraud Case, the court had no authority to award damages against Appellants. Therefore, Chaara is not analogous to the present case.

In Fearing v. Lake St. Croix Villas Homeowner's Ass'n, 2006 WL 3231970 (D. Minn.), an unpublished case, a pro se plaintiff brought a federal suit alleging violations of the Fair Housing Act, naming an attorney who represented an adverse party in a prior lawsuit where the court ruled that no violation occurred. Id. The attorney had acted as an attorney but was accused, along with others, of retaliating against the pro se plaintiff. However, there was no allegation that he was somehow involved with his client in the alleged underlying "misconduct." Id. The existence of attorney-client privity there was merely stated without any rationale or explanation, in either the decision itself or in any of the authority cited. Id. Therefore, this case is not instructive.

Similarly, in Johnson v. U.S. Bank, N.A., 2005 WL 1421461 (D. Minn.), another unpublished case, a pro se plaintiff sued several parties and lost in district court. He then sued the same parties and their attorneys, not because the attorneys engaged in any conduct that gave rise to the substantive claims, but only because they represented an adverse party in the first lawsuit. Id. The case did not involve a joint tortfeasor issue, and again there is no analysis of the privity issue in the decision or the cases cited from other jurisdictions. Id. Moreover, the plaintiff lost in the first suit and was trying to obtain a different result the second time. Therefore, this case is not instructive.

The case of Simpson v. Chicago Pneumatic Tool Co., 693 N.W.2d 612 (N.D.

2005) involved a personal injury claim arising out of products liability. The jury found for the defendant manufacturer. The plaintiff then commenced a second action against the defendant and the attorney who represented it in the first action. The attorney was not alleged to have been involved in the underlying tort. The second suit was based on an alleged spoliation-type issue that directly implicated the attorneys; however, the first court had already considered this issue and specifically resolved it against the plaintiff. The court in Simpson would not allow the plaintiff to collaterally attack the previous discovery decision. However, that same risk of collateral attack is not present in this case nor is there an adverse decision where the Respondent is seeking a second chance at a previously defeated claim. Therefore, Simpson is not comparable to the facts here and is not instructive.

Merchants State Bank v. Light, 458 N.W.2d 792 (S.D. 1990) is also inapplicable to the circumstances in this case. There, the attorney wanted to relitigate an issue regarding an asset that had been used, in part, to pay his retainer. The court had ruled in a suit by the client that the asset was subject to the bank's security agreement. The attorney was in effect a successor-in-interest to his client's interest in the asset (proceeds from a sale) to the extent it had been used to pay his fees. Cf. Margo-Kraft, 200 N.W.2d at 47-48 (privity includes a successor-in-interest to a party). The attorney was not allowed to relitigate that issue when the bank sued to recover the retainer. This case is not instructive, as it is so dissimilar and is based on the relationship of successor-in-interest.

In Jayel Corp. v. Cochran, 234 S.W.2d 278 (Ark. 2006), the plaintiff was sued in a previous case by a neighbor, whose attorney filed a lis pendens on the plaintiff's property. In response, the plaintiff filed a counterclaim against the neighbor, alleging that the lis pendens was improper. After the parties settled, the plaintiff sued the attorney who filed the lis pendens. However, the court specifically found that the attorney and client were not joint tortfeasors. 234 S.W. 3d at 282. Furthermore, unlike Minnesota, Arkansas has all but done away with the privity requirement in the context of principal and agent, and instead focuses on whether the plaintiff is attempting to relitigate an issue that has already been decided. Id. In addition, there was no analysis akin to this Court's holding in Margo-Kraft that a party is not in privity unless he controls the earlier litigation, has his interests represented in that litigation, or is a successor-in-interest to a party, none of which apply to Appellants here. Therefore, this case is not helpful to Appellants.

In Verhagen v. Arroyo, 552 So.2d 1162 (Dist. Ct. App. Florida, 3rd Dist. 1989), the court held that where the plaintiff sued a party and lost, the plaintiff was barred by collateral estoppel from suing that party's attorney. However, there was no analysis or reasoned explanation for the application of privity. Nonetheless, Respondent in the present case prevailed in her fraud case against Bob Rucker, so there would be no basis to apply collateral estoppel against her, in any event.

The case of Plotner v. AT&T Corporation, 224 F.3d 1161 (10th Cir. 2000) involved a plaintiff who filed bankruptcy and objected to the sale of her property. When that action was determined adversely to her, she filed a federal court action against various parties and their attorney arising out of the sale, alleging fraud, negligence, and breach of fiduciary duty. The federal court found that the plaintiff failed to allege any affirmative misrepresentations or a duty to disclose, any harm that occurred to the bankruptcy estate, or that the plaintiff could not have obtained an adequate remedy in the bankruptcy case. That ruling was affirmed on appeal. The plaintiff then filed a third case against the same defendants, alleging fraud, tortious interference, and breach of fiduciary duty, all arising from the sale of her property. The court held that res judicata barred the plaintiff's claims against all parties, including the attorneys. However, the plaintiff there lost the first two cases and was trying to obtain a different result in a third suit. Moreover, the court found privity to exist because the attorneys were named "by virtue of their activities as representatives of [their clients]," 224 F.3d at 1169, not because the attorneys were involved as joint tortfeasors in the underlying transaction. As such, Plotner is not analogous to the present case.

In re El San Juan Hotel Corp., 841 F.2d 6 (1st Cir. 1988) did not involve a finding of privity based on the attorney-client relationship, as Appellants suggest. Rather, the court analyzed cases from other jurisdictions where one conspirator was not joined in a prior case against other conspirators. Id. at 10. The court held that because the attorney was "a co-perpetrator," he shared a significant relationship with his client who was sued in the first action and, therefore, should have been named as a defendant in that first action. Id. at 11. However, this case is not instructive here in light of this Court's holdings that a plaintiff may sue joint tortfeasors in separate actions and that the relationship of joint tortfeasors does not create privity between them. Kisch, 233 N.W.2d at 734; Schneider, 433 N.W.2d at 101; Hentschell, 153 N.W.2d at 206; Miller, 354

N.W.2d at 62.

In Geringer v. Union Electric Co., 731 S.W.2d 859 (Mo. Ct. App. 1987), the plaintiff, who was sued by the defendant and defaulted in a prior action, commenced a second action against the defendant alleging malicious prosecution. The plaintiff sought to amend his complaint to add the attorneys who represented the defendant in the first action, but that amendment was denied. The court also dismissed on summary judgment the plaintiff's claims against the defendant. The plaintiff then commenced a third action against the defendant and the attorneys, alleging claims arising from the same circumstances that formed the basis of the first action. The court granted the attorneys' motion to dismiss on the basis of collateral estoppel, not res judicata, because the plaintiff's claims against the defendant were previously dismissed and the plaintiff was seeking to relitigate an issue on which he lost in the first case and obtain a different result. Respondent is not trying to do that here, since she prevailed in the Rucker Fraud Case.

Appellants also cite Proctor v. Metropolitan Money Store Corp., --- F.Supp.2d ---, 2009 WL 2516361 (D. Md.). But that case simply cited to Jones v. Fisher Law Group, PLLC, 334 F.Supp.2d 847, 851 (D.Md. 2004), without independently analyzing the issue of attorney-client privity. Indeed, the court in Jones did not analyze the issue of attorney-client privity either; it just concluded that privity existed. 334 F.Supp.2d at 851. Similar to the other cases cited by Appellants, the plaintiffs in Jones had lost the first case and were attempting to relitigate their claims against the attorneys. Id. In any event, the holding in Jones regarding privity is dicta because the plaintiffs' claim failed to state a cause of action. Likewise, the holding in Verry v. Buratti, 2006 WL 752864 (W.D.Okla.) regarding privity is dicta because that case was decided on other grounds, i.e., there was no merit to the plaintiff's claims against the defendant attorney. Id. at *2. In addition, the plaintiff in Verry lost the first case, which is not the situation with Respondent here.

Appellants' citation to Weinberger v. Tucker, 510 F.3d 486 (4th Cir. 2007) is similarly misplaced because the plaintiff there lost the first case. Moreover, the defendant attorneys' interests were actually represented in the first case in a motion to disqualify the attorneys, which was resolved adversely to the plaintiff. Id. at 493. In Barany-Snyder v. Weiner, 2007 WL 210411 (N.D.Ohio), the plaintiff lost the first case by default and then sued opposing counsel. While the court there did not analyze the privity issue, but instead simply cited to other cases (referenced herein), the court found no res judicata because there were not common facts between the two cases. Id. at *4.

Appellants also cite Hofmann v. Fermilab NAL/URA, 205 F.Supp.2d 900 (N.D.Ill. 2002), but that case, too, simply cites to Henry v. Farmer City State Bank, 808 F.2d 1228 (7th Cir. 1986), without any independent analysis of privity. Id. at 903. Moreover, the plaintiff in Hofmann lost the first case, further distinguishing it from the present case. The case of Zahran v. Frankenmuth Mut. Ins. Co., 114 F.3d 1192, 1997 WL 205381 (7th Cir. 1997), also cites to Henry without any analysis of attorney-client privity. Id. at *3. And the plaintiff in Zahran also lost the first case. Lastly, Plymire v. Cahill, 243 F.3d 549, 2000 WL 1838221 (9th Cir. Alaska) contains no attorney-client privity analysis.

Interestingly, in Henry, which is cited as authority by many of Appellants' foreign jurisdiction cases, the plaintiffs were trying to relitigate an adverse decision in the first case by suing opposing attorneys in a second case. 808 F.2d at 1235-36. The court there held, however, that if the plaintiffs had prevailed in the first case, they would be able to sue the defendants in privity in the second case and the defendants would likely have been barred by collateral estoppel from denying liability. Id. at 1236. Thus, Henry actually supports the conclusion that res judicata does not bar Respondent's claims against Appellants.

C. Appellants' Cases From Minnesota Do Not Support Their Argument that Privity Exists in this Case.

Recognizing the limited value of the foreign jurisdiction cases they cite, Appellants try to bolster their argument by citing to a variety of Minnesota cases, which do not support their position on this appeal. For instance, they cite Anderson v. Werner Continental, Inc., 363 N.W.2d 332 (Minn. Ct. App. 1985), Raatz v. Koerner, 2001 WL 69473 (Minn.App.), Omega Court v. Title Ins. Co. of Minnesota, 1992 WL 15574 (Minn. App.), and Hammann v. Schwan's Sales Enterprises, Inc., 2004 WL 2453302 (Minn.App.). However, those cases do not even involve the issue of privity at all, since in each case the parties were the same in the first and second lawsuits.

The case of Sundberg v. Abbott, 423 N.W.2d 686 (Minn. Ct. App. 1988), which Appellants cite as one of their "controlling" cases, also involves plaintiffs who brought a lawsuit and lost, then sued the same defendants raising a legal theory that could have been but was not raised in the first case. As the court there held, the plaintiffs' "failure to succeed does not entitled them to a second chance." Id. at 690. Moreover, the court in Sundberg did not address or even mention privity in its decision.

Appellants also cite Brunsoman v. Seltz, 414 N.W.2d 547 (Minn. Ct. App. 1987), but the court of appeals there found privity to exist because the defendant in the second case controlled the first case and was protecting his self-interest in the first case, which is not the situation with Appellants here. The same is true for SMA Services, Inc. v. Weaver, 632 N.W.2d 770 (Minn. Ct. App. 2001), another one of Appellants' supposed "controlling" cases. There, the plaintiff in the second action was a company owned and controlled by the wife who previously brought the same claim against her husband during their marital dissolution proceeding. Though the dissolution court ordered the husband to return $25,000 he had converted from the company, the parties settled without addressing his debt to the company. The company's subsequent suit against the husband for return of the money was barred by res judicata because the wife was in privity with the company by virtue of her ownership and control of it. Id. at 774.

Likewise, in Towle v. Boeing Airplane Co., 364 F.2d 590 (8th Cir. 1966), the court found privity to exist because the defendants in the second lawsuit controlled the first lawsuit. And in Montana v. United States, 440 U.S. 147 (1979), the United States Supreme Court found privity to exist because the non-parties there controlled the earlier litigation and sought to personally benefit from such control. Id. 154-55. Similar to this Court's holding in Margo-Kraft, the Supreme Court in Montana held that "[o]ne who prosecutes or defends a suit in the name of another to establish and protect his own right, or who assists in the prosecution or defense of an action in aid of some interest of his own

. . . is as much bound . . . as he would be if he had been a party." Id. at 154 (quoting Souffront v. Compagnie des Sucreries, 217 U.S. 475, 486-87 (1910)).

In another case cited by Appellants, Bogenholm v. House, 388 N.W.2d 402 (Minn. Ct. App. 1986), the Court of Appeals cited to both Margo-Kraft and Montana for the proposition that privity does not exist unless the nonparty "so controls an action in advancing her own interests that the nonparty has had her day in court." Id. at 406. The Bogenholm court further held, "To have control of litigation a person must have an effective choice as to the legal theories to be advanced on behalf of the party and have control over the opportunity to obtain review. It is not sufficient that the person merely contributed advice in support of the party, testified as a witness or participated in consolidated pretrial proceedings." (citations omitted).

Appellants also cite this Court's decision in Scott-Peabody & Associates v. Northern Leasing Corp., 140 N.W.2d 614 (Minn. 1966). There, the plaintiff brought a quiet title action but failed to raise the issue of a fraudulent conveyance, which the plaintiff raised in the second action. The quiet title action necessarily determined all claims to the premises, thus barring the plaintiff's claims in the second lawsuit. Id. at 616. This Court conducted no analysis of privity. Therefore, this case is not helpful to Appellants.

Finally, Appellants cite Gammel v. Ernst & Ernst, 72 N.W.2d 364 (Minn. 1955). However, the plaintiff in that case lost the first case and sought to sue different defendants in an attempt to avoid the preclusive effect of the earlier adverse decision. Again, that is not the case here, since Respondent prevailed in the Rucker Fraud Case.

D. Cases From Other Jurisdictions Have Found No Privity Between an Attorney and a Client.

While Appellants repeatedly contend that the jurisdictions to consider the issue have overwhelmingly found privity to exist between an attorney and a client, they omit any reference to those that do not. Indeed, courts in other jurisdictions have held that privity does not exist between an attorney and the client. See Ammon v. McCloskey, 655 A.2d 549, 554 (Pa. 1995) (holding no privity to exist between an attorney and his client for purposes of res judicata because the attorney owed complete allegiance to the client and represented the client's interests, not the attorney's own interests); Marshall v. Fenstermacher, 388 F.Supp.2d 536, 563-64 (E.D. Penn. 2005) (holding that attorneys who conspired with their client to defraud the plaintiff were not considered to be in privity); Boyles v. Smith, 759 P.2d 518 (Alaska 1988) (holding that attorneys were not in privity with client for purposes of collateral estoppel); Branning v. Morgan Guaranty Trust Co. of New York, 739 F.Supp. 1056, 1063-64 (D. South Carolina 1990) (citing Roberts v. Porter, Davis, Saunders & Churchill, 389 S.E.2d 361 (Ga. 1989)); Continental Savings Assoc. v. Collins, 814 S.W.2d 829, 832 (Tex. Ct. App. 1991) (holding that attorney not in privity with client for purposes of res judicata); In the Matter of Curry, 113 B.R. 546, 551 (D. Neb. 1990) (holding that attorneys were not in such close relationship bordering on near identity so as to render them in privity thereby invoking the doctrine of res judicata).

In summary, the foreign cases cited by Appellants do not analyze Minnesota law – or in most cases, any law – on the issue of privity and a plaintiff's right to sue joint tortfeasors in separate cases. Such cases are readily distinguishable either because the attorney was not a joint tortfeasor, the plaintiff lost in the underlying case against the attorney's client and was trying to relitigate to obtain a different result, or they apply res judicata based on privity without rationale or explanation. Similarly, Appellants' Minnesota cases either do not address privity at all, find privity to exist because the defendant in the second action controlled the first action, or involve a plaintiff trying to relitigate an adverse ruling in the prior case.

In addition, rigid application of privity merely because of the existence of an attorney-client relationship would run contrary to this Court's dictate that the focus should instead be on whether the application of res judicata would work an injustice on the party against whom the doctrine is urged. Hauschildt v. Beckingham, 686 N.W.2d 829 (Minn. 2004). In this case, the rigid application proposed by Appellants would leave Respondent only partially compensated for her damages and allows a party – an attorney, no less – who knowingly participated in a fraud to escape liability (including for treble damages mandated by statute) simply because he was not joined as a defendant in the first fraud lawsuit. This is especially repugnant since this Court allows joint tortfeasors to be sued separately.[4]

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[4] Interestingly, Appellants argue that *they* will suffer substantial injustice unless privity applies to bar Respondent's claims against them. (App. Br., pp. 40-41). Appellants assert that they are "saddled with a finding on an essential element of a claim against them that arose out of a proceeding in which they were not named as a party and had no opportunity to participate." (Id., p. 41). This is a clear admission that Appellants did not "control" the fraud litigation. More importantly, in making this argument, Appellants are conceding that Respondent can use the decision in the fraud litigation offensively to bind them for purposes of collateral estoppel, a position to which they elsewhere strenuously

Accordingly, this Court should affirm the Court of Appeals' decision.

IV. EVEN IF THIS COURT CONCLUDES THAT PRIVITY EXISTS BETWEEN AN ATTORNEY AND CLIENT FOR PURPOSES OF RES JUDICATA, THIS COURT'S HOLDING SHOULD ONLY APPLY PROSPECTIVELY.

As a general rule this Court's decisions are given retroactive effect. Kmart v. County of Stearns, 710 N.W.2d 761, 767 (Minn. 2006) (citing State v. Baird, 654 N.W.2d 105, 110 (Minn. 2002)). However, this Court has recognized exceptions in which the decision will only be applied prospectively. Id. As coined by this Court, the "purely prospective ruling" doctrine requires three factors be present:

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, * * * or by deciding an issue of first impression whose resolution was not clearly foreshadowed * * *. Second, it has been stressed that 'we must * * * weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation.' * * * Finally, we have weighed the inequity imposed by retroactive application, for '[w]here a decision of this court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of non-retroactivity.'"

Id. (quoting Hoff v. Kempton, 317 N.W.2d 361, 363 (Minn. 1982), quoting Chevron Oil Co. v. Huson, 404 U.S. 97, 106-07, 92 S.Ct. 349, 30 L.Ed.2d 296 (1971)). See also Bendorf v. Comm'r of Public Safety, 727 N.W.2d 410, 414 (Minn. 2007) (stating, "Even without specific reference to Chevron, we have ruled that our decision announcing a new rule would apply only prospectively.") (citing State v. Scales, 518 N.W.2d 587, 593 (Minn. 1994)).

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object. (App. Br., pp. 27-29).

In the present case, if this Court holds that attorneys are in privity with their clients, such a holding should only be applied prospectively and not to the present case. Such a decision would be announcing a new principle of law because this is an issue of first impression in this state whose resolution was not clearly foreshadowed. Before the Court of Appeals rendered its decision, there were no reported or unreported Minnesota state court cases holding that attorneys are in privity with their clients. Moreover, such a decision would actually change the law espoused in Margo-Kraft, supra, because attorneys and clients (including Appellants and Bob Rucker) do not fit within any of the categories of parties in privity as recognized by this Court, i.e. they did not control the original action, their interests were not represented by a party to the original action, and are they are not successors-in-interest to a party.

As to the second prong identified in Kmart, prospective application would not undermine the operation of the rule. Although res judicata promotes efficiency, this Court has already recognized a plaintiff's right to sue joint tortfeasors in separate lawsuits. See Kisch v. Skow, 305 Minn. 328, 332, 233 N.W.2d 732, 734 (1975); Schneider v. Buckman, 433 N.W.2d 98, 101 (Minn. 1988). Moreover, there is no chance of a double recovery in this case because Respondent was not made whole in the Rucker Fraud Case, as she accepted partial payment of her damages in settlement. Respondent is seeking to recover from Appellants the unpaid portion of her damages.[5] Lastly, since Appellants do not meet any of the prongs set forth in Margo-Kraft, applying any ruling

[5] Respondent also has a claim for treble damages under Minn. Stat. §§ 481.07 and 481.071, but such damages are in addition to, not duplicative, of Respondent's monetary damages.

prospectively will not undermine this state's law regarding privity.

The third prong of Kmart is also satisfied since a retroactive application of a res judicata here would lead to a substantial inequitable result. Respondent was entitled to rely on this Court's ruling in Margo-Kraft that Appellants were not in privity with Bob Rucker for the reasons stated above. Respondent was also entitled to rely on this Court's holdings in Kisch and Schneider that joint tortfeasors do not have to be joined in a single lawsuit. As a result, Respondent settled her case with Rucker without having been made whole and she specifically reserved her claims against Appellants to allow her to be made whole. On the other hand, a retroactive ruling here would allow a culpable party to escape any liability – a "free pass," as Appellants put it – for actively and knowingly participating in a fraud. Accordingly, if this Court disagrees with the Court of Appeals' decision regarding privity, this Court's ruling should be applied prospectively only.

CONCLUSION

For the reasons set forth herein, this Court should affirm the Court of Appeals in all respects.

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STATE OF MINNESOTA
IN THE SUPREME COURT

Katherine M. Rucker,

Respondent,

vs.

CERTIFICATE OF BRIEF LENGTH

Steven B. Schmidt and Rider Bennett, LLP,

Appellants.

Appellate Court Case No.: A08-1730

I hereby certify that this brief conforms to the requirements of Minn. R. Civ. App. P. 132.01. subds. 1 and 3, for a brief produced with a proportional font. The length of this brief is 11,650 words, and the font size is 13 point. This brief was prepared using Microsoft Word 2003 software.

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