
State of Minnesota
In Court of Appeals

PROGRESSIVE INSURANCE COMPANY,

Appellant,

vs.

EDGAR VILLAFANA PALLARES,

Respondent.

APPELLANT'S BRIEF AND APPENDIX

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STATEMENT OF LEGAL ISSUES

- I. Whether the district court erred in awarding sanctions on a motion that was untimely pursuant to Minn.Stat. §549.211 and Rule 11.

Trial Court's Ruling: The Trial Court did not rule on this issue. Appellant did raise the issue.

Apposite Cases:

- 1) Gibson v. Coldwell Banker Burnet, 659 N.W.2d 782 (Minn.App. 2003)

Apposite Statutes:

Minn.Stat. §549.211
Minn.R.Civ.Proc., Rule 11

- II. Whether the district court abused its discretion in awarding attorney fees based on a frivolous claim and without a specific finding of bad faith. .

Trial Court Ruling: The Trial Court ruled that Appellant's action to vacate the arbitration award based on fraud was frivolous.

Apposite Cases:

- 1) Uselman v. Uselman, 464 N.W.2d 130, 142-43 (Minn.1990), superseded by statute on other grounds.
2) Gibson v. Trustees of Minn. State Basic Buildin Trades Fringe Benefits Funds, 703 N.W.2d 864, 869 (Minn.Ct.App. 2005)

Apposite Statutes:

Minn.Stat. §549.211
Minn.R.Civ.Proc., Rule 11

STATEMENT OF THE CASE

The motion for sanctions was heard in Hennepin County District Court before the Honorable Kevin S. Burke on November 10, 2005. Respondent brought a motion for sanctions against Appellant pursuant to Minn.Stat. §549.211, subd. 2 and Minnesota Rules of Civil Procedure, Rule 11 asserting sixteen alleged violations that supported the request for sanctions surrounding Appellants motion to vacate the arbitration award and request to stay the proceedings involving the arbitration award rendered on December 21, 2004 due to the filing of a federal court Complaint against the Respondent's treating chiropractor and clinic that was filed on May 18, 2005.

Appellant defended the motion for sanctions based on the fact the motion was untimely and did not follow the procedures provided in Rule 11.02(a) or Minn.Stat. §549.211. Appellant also defended against the sixteen (16) specific allegations as they were baseless and without merit. Respondent served his first notice of a Motion for Sanctions (unexecuted) on August 17, 2005 after the district court issued its Order on the issues on August 8, 2005. Appellant appealed the August 8, 2005 Order on October 11, 2005.

Respondent brought the motion for sanctions on for hearing for October 27, 2005 but withdrew the motion. Respondent then rescheduled the hearing for November 10, 2005. The Trial Court conducted a contentious hearing on November 10, 2005 against Appellant. On November 28, 2005, the Trial Court issued an Order granting in part Respondent's motion for attorney fees, costs and sanctions in the amount of \$1,500 against Appellant's attorney and incorporated an attached memorandum. The trial court

held that Appellant's action to vacate the arbitration award based on fraud was frivolous as the basis for the award. This appeal was consolidated with two other related appeals, A05-2020 and A06-59 by Order for this Court on January 27, 2006. The record on this appeal was fully indexed for appeal A05-2020 which will be referenced in Appellant's Statement of Facts in this brief along with the supplemental record indexed in this appeal.

STATEMENT OF FACTS

This appeal arises out of an Order granting Respondent's motion for sanctions against Appellant for its attempt to vacate an arbitration award rendered on December 21, 2004 in the amount of \$9,400.00 and to stay the proceedings. The first motion in this case was brought by Respondent seeking to confirm the award and to dismiss the application to vacate the arbitration award. The matter was scheduled for May 25, 2005 at 1:30 p.m.

On May 18, 2005, just seven days prior to this hearing, Appellant brought a motion in the United States District Court, District of Minnesota before the Honorable Paul A. Magnuson for an order to file a Complaint under seal and an ex parte request for a temporary restraining order to seize evidence. (R. at A-466 to A-469.) A hearing was held that afternoon and Judge Magnuson signed the Proposed Temporary Protective Order to file Motion Documents Under Seal and added in language providing that "Progressive Northern Insurance Company is authorized to file its Civil RICO Complaint and any accompanying documents under seal." (R. at A-470 to A-471.)

Appellant then filed the Civil RICO Complaint in Federal Court captioned as Progressive Northern Insurance Company, et. al. vs. Alivio Chiropractic Clinic, Inc.;

Joshua Jason Anderson, D.C.; Alexis Alarcon Aguilar; Andrea Kay Bongart, individually and d/b/a Sunshine Clinical Bodyshop; and Mark Anthony Karney, attorney at law, d/b/a Karney & Associates. (R. at A-70 to A-235.) The purpose of filing this Complaint and all other documents under seal was to obtain evidence involving a surveillance tape and for the protection of one of Appellant's insured, known as Claimant #51. (R. at A-472 to A-475.)

An ex parte Temporary Restraining Order (TRO) was issued by Judge Magnuson under seal on May 19, 2005 to Los Gallos for the surveillance tapes. (R. at A-476 to A-478.) The TRO required Los Gallos to deposit the surveillance tape with the District Court within 3 business days. Id. On May 25, 2005, the date of the first hearing the surveillance system had not been deposited with the federal district court and the federal case was still under seal. (R. at A-480.)

At the May 25, 2005 hearing Appellant requested a stay of the hearing and an ex parte in camera review of supporting documents for its request and requested to deposit the amount of the arbitration award with the Court as security for the stay. (SR. at A-1 to A-12.) The Honorable Kevin S. Burke had the Honorable Judge E. Ann McKinsey hear the ex parte submission to determine whether the grounds for the stay were frivolous. Id. Appellant disclosed the reasons for the request and provided Judge McKinsey with the documents to support the request. (SR. at A-13 to A-27.) At no time did Appellant ever hint, imply or state to either judges, either in open court or ex parte, that the Respondent or his attorney were involved in the fraudulent activity. Id. Judge McKinsey sealed the transcript and documents for the May 25, 2005 ex parte hearing. Id.

On May 25, 2005, Judge Burke granted Appellant's request to stay and deposit the amount of the award until such time as the Protective Order was lifted. (R. at A-38.) The TRO issued by the federal court was ignored by Los Gallos and on May 31, 2005 Appellant moved the Honorable Judge Donovan Frank for an Order to Show Cause against Los Gallos that was heard on June 2, 2005. (R. at A-480 to A-482.) Judge Frank ordered that Appellant be given excess to the surveillance tape and continued the hearing until June 7, 2005. Id. Appellant was given access and the evidence was retained. On June 7, 2005, a hearing was conducted in federal court to unseal the filing of the Complaint which was granted that day. (R. at A-483 to A-484.)

Appellant then called the state district court to schedule a motion for July 8, 2005. Appellant then sought to consolidate the eight additional arbitration awards that needed to be addressed involving Alivio Chiropractic Clinic that had transpired prior to the filing of the federal action and on June 27, 2005, Appellant sent a letter to Judge Burke requesting to consolidate the case and for a continuance of the July 8, 2005 hearing. (R. at A-41 to A-43.) On June 28, 2005, this Court addressed the issue of consolidated, which Appellant received on Friday, July 1, 2005. (R. at A-49.)

On July 6, 2005, Appellant received a letter from Respondent addressed to Judge Burke and dated June 28, 2005 requesting the hearing move forward. (R. at A-45 to A-46.) On June 30, 2005, Appellant sent Respondent a letter addressing his contentions regarding the Protective Order and the issues involved in this case. (R. at A-491 to A-503.) On July 6, 2005, Appellant sent a letter to this Court requesting a continuance of the July 8, 2005 hearing in order to consolidate the motions to vacate/stay further

proceedings on the medical bills from Defendant Alivio Chiropractic Clinic, Inc. pursuant to Minnesota General Rules of Practice, Rule 113.03 as the district court suggested in its June 28, 2005 letter and to request the release of \$6,757.00 from the \$9,400 that was deposited to the Respondent to satisfy the medical expense benefits awarded to the other medical providers not subject to the federal action. (R. at A-50 to A-51.) On July 7, 2005, Judge Burke issued an Order denying Appellant's request and requiring the parties to appear at the hearing on July 8, 2005. (R. at A-55.)

The hearing occurred on July 8, 2005 in which the grounds for vacating the arbitration award were discussed. (SR. at A-28 to A-53.) The hearing ended with an offer to settle the dispute to Respondent and he was given until July 13, 2005 to decide whether to accept the offer as noted by the district court or to pursue further litigation on the motion to vacate. Id. It was not until July 18, 2005 that Respondent sent a letter to Judge Burke rejecting the offer. (R. at A-269 to A-271.)

On August 8, 2005, Judge Burke issued its Order denying Appellant's motion to vacate the arbitration award. (R. at A-272 to A-275.) On August 12, 2005, Respondent sent a letter to the district court requesting that judgment be entered and enclosed a proposed order. (R. at A-283 to A-285.) On August 15, 2005, the district court issued the entry of judgment. (R. at A-301.) On August 16, 2005, Appellant requested a motion for reconsideration of the August 8, 2005 Order. (R. at A-286 to A-300.) On August 17, 2005, Appellant received an unsigned Notice of Motion and Motion for Sanctions from Respondent. (R. at A-304 to A-305).

On August 22, 2005, Respondent submitted his response to Appellant's request for reconsideration at the request of the district court. (R. at A-306 to A-308.) The "request for a motion for reconsideration" was denied on September 6, 2005. (R. at A-309 to A-312.) On October 10, 2005 Respondent brought a motion for sanctions scheduled for hearing on October 27, 2005. (R. at A-319 to A-447.) Appellant had filed a notice of appeal of the August 8, 2005 Order on October 11, 2005. (R. at A-316 to A-318.) Respondent then withdrew the motion set for October 27, 2005 but rescheduled the motion for November 10, 2005. (R. at A-528.)

The district court then conducted a contentious hearing against Appellant on November 10, 2005. (SR. at A-54 to A-68.) Judge Burke in addressing Appellant at the hearing informed them that he was "close to reporting Progressive to the Commissioner of Commerce" and that he believed Appellant engaged in a calculated attempt to do "scorched earth litigation tactics on a small claim". (Id. at A-58 to A-59.) On November 28, 2005, Judge Burke issued an Order granting Respondent's motion for sanctions finding that Appellant's action to vacate the arbitration award based on fraud was frivolous. (SR. at A-69 to A-73.)

ARGUMENT

I. THE DISTRICT COURT ERRED IN AWARDING SANCTIONS ON A MOTION THAT WAS UNTIMELY PURSUANT TO MINN.STAT. §549.211 AND RULE 11.

In 2000 the Minnesota Rules of Civil Procedure, Rule 11 was amended to conform to the federal rules, Rule 11. Minn.R.Civ.P., Rule 11 (2000 advisory comm.. cmt.) The Minnesota Legislature also provided statutory authority for sanctionable conduct that

mirrors the federal court Rule 11 requirement. Minn.Stat. §549.211 Rule 11 requires that a moving party follow the procedure provided in Rule 11.03(a) or sanctions will be rejected. See Gibson v. Coldwell Banker Burnet, 659 N.W.2d 782, 789 (Minn.Ct.App. 2003); citing Thompkins v. Cyr, 202 F.3d 770, 788 (5th Cir. 2000); Morganroth & Morganroth v. Delorean, 123 F.3d 374, 384 (6th Cir. 1997); Hedges v. Yonkers Racing Corp., 48 F.3d 1320, 1328-29 (2d Cir. 1995); Herr & Haydock, supra, §11.6; 5A Charles Alan Wright & Arthur R. Miller, Federal Practice and Procedure § 1337 (Supp.2002). Motions brought after the conclusion of a matter must be rejected precisely because the alleged offending party is unable to withdraw any alleged improper papers or otherwise rectify the situation. Id; citing Wright & Miller, supra, §1337; see also Fed.R.Civ.P. 11 1993 advisory comm.. cmt. (stating that given the safe-harbor provisions, a party cannot delay serving its rule 11 motion until conclusion of the case or “judicial rejection of the offending contention’); Barber v. Miller, 146 F.3d 707, 710-11 (9th Cir. 1998).

In the present case, the District Court issued its Order denying Appellant’s motion to vacate on August 8, 2005. Respondent served the unexecuted Notice of Motion for Sanction which was received on August 17, 2005 for alleged conduct that occurred before the August 8, 2005 Order. Even if there was somehow sanctionable conduct, the motion is untimely pursuant to Rule 11 and Minn.Stat. §549.211 and it asked Appellant and its counsel to perform actions that were not possible to do or correct at the time. While Appellant presented this issue before the court in its brief in opposition to the motion, Judge Burke did not rule on the timeliness of the motion.

II. THE DISTRICT COURT ABUSED ITS DISCRETION IN AWARDING ATTORNEY FEES BASED ON A FRIVOLOUS CLAIM AND WITHOUT A SPECIFIC FINDING OF BAD FAITH.

A party or its attorney may be sanctioned if counsel violates his or her duty to make sure that “the claims, defenses, and other legal contentions are warranted by existing law or by a non frivolous argument for the extension, modification, or reversal of existing law or the establishment of new law.” See Gibson v. Trustees of Minn. State Basic Buildin Trades Fringe Benefits Funds, 703 N.W.2d 864, 869 (Minn.Ct.App. 2005); citing Minn.Stat. §549.211, subds 2-3, See Minn.R.Civ.P. 11.03, 11.03. “Whether to award sanctions requires determining whether counsel had an objectively reasonable basis for making the factual or legal claim.” Id.; citing Uselman v. Uselman, 464 N.W.2d 130, 142-43 (Minn.1990), superseded by statute on other grounds, Minn.Stat. §549.21 (1990)(repealed 1997).

“The presence of bad faith can be considered when deciding whether to award sanctions.” Id.; see also Peterson v. Hinz, 605 N.W.2d 414, 417 (Minn.App.2000). The purpose behind sanctions under the statute and rule is deterrence. Id. Therefore, the statute and rule should be construed narrowly. Id. An appellate court reviews a district court’s decision regarding whether to award sanctions under these provisions under an abuse of discretion standard.” Id. However, sanctions should not be imposed where the law is unsettled and a party makes an argument that is not a frivolous application of the law. Id.

In the present case, Judge Burke found that Appellant's action to vacate the arbitration award based on fraud was frivolous and cited to Minn.Stat. §549.211 subd. 2(2) and Rule 11. Minn.Stat. §549.211 subd. 2(2) provides that it is sanctionable conduct if an attorney presents to the court upon information and belief formed after a reasonable inquiry under the circumstances that "the claims, defenses, and other legal contentions are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law." Minn.Stat. §549.211 subd. 2(2). However, what makes Judge Burke's findings in support of sanctions against Appellant so incredible is the fact that it is blatantly inconsistent with his previous Orders and statements made on the record.

The record reflects that on May 25, 2005 when Appellant requested a stay of the motion due to a protective order that was issued in federal court that Judge Burke did the proper thing by having another judge hear the ex parte evidence that prompted the request and make a determination as to whether such request was frivolous. While Judge Burke continues to assert that this implied that the Respondent or his counsel had something to do with the fraud, the record is devoid of any implication to that effect. In fact, Appellant apologized to the Court and Respondent's counsel for the imposition at the hearing:

And I do apologize to Mr. Schmidt. We've had conversations I believe on Monday about this, the fact that I can't disclose our grounds, and I apologize to this Court for that reason. But I can assure you that I would not have gone into Federal Court and done this if it wasn't absolutely necessary. I wouldn't be doing this here today if it wasn't absolutely necessary.

Hrg. Transcr. at A-8, ¶¶ 1-7 (May 25, 2005).

When Appellant's counsel presented its evidence in the ex parte disclosure to Judge McKinsey, at no point did Appellants imply that Respondent or his counsel was involved and specifically identified the reasons for not disclosing the federal court case. Judge Burke had asked Judge McKinsey to make a determination as to whether the grounds for the relieve Appellant requested was legitimate and after the ex parte hearing Judge Burke did in fact issue the Order. However, the record is absolutely devoid on even the slightest indication that Respondent or his counsel was involved and at no time did the Court or the Respondent ever request whether that was the case.

The first time that issue even came up was at the hearing on July 8, 2005. Appellant responded in open court that it was not accusing Respondent or his counsel of being involved in the fraud and had informed counsel prior to the hearing that this was not the case. Hrg. Transcr. at A-38 to A-39 (July 8, 2005). Therefore, Judge Burkes continued reference to this issue is not supported by the records or statements made by Appellant and has been expressly denied on numerous occasions.

The second inconsistency between the Order awarding sanctions and the record is the contention that Appellant's action to vacate the arbitration award based on fraud is frivolous. Judge Burke in the July 8, 2005 hearing stated the following in regards to the issue of vacating an arbitration award based on submission of fraudulent evidence:

THE COURT: Yes, but at least there is this other part, which is, some of the - - and this is an allegation, some of the evidence presented to the arbitrator was fraudulent. That is what they are arguing. Unknowing by you, but fraudulent by them. That's at least a novel legal issue, that we can end up spending a lot of time on, when there's no - there's no reason for you and me and your client to be involved in that. I'm telling you, I don't know, as a matter of law, if you had somebody who committed perjury in

an arbitration, that that doesn't at least raise a spectre that the arbitration award should fall.

So, for example, in Martha Stewart, the government didn't know that it's major witness was committing perjury, but in fact they ended up indicting the person. So surely, at least conceptually, somebody could raise a spectre that a - - that you weren't involved in putting perjured testimony on, but the fact of the matter is, the foundation of the arbitration award was perjured testimony, and I don't know that a court isn't going to at least say, "I would like to have briefs on that," and that's kind of where we're going to go, although I don't see personally - - although I understand, because this is a little unseemly about last minute dropping stuff on you, and certainly from my perspective, I read, albeit erroneously, that they at least suggested you had something to do with it, which they now say you didn't, but if you want, we'll have briefs. So I think it makes more sense for you just to take the money and run, but if you don't want to, then we'll keep the money in the District Court, and we'll continue with the litigation.

Hrg. Transcr. at A-45 to A-46 (July 8, 2005).

However, when Respondent attempted to argue at the July 8, 2005 hearing that Appellant's were making a "mockery out of our whole system", which is what Judge Burke's memorandum in support of sanctions implies, Judge Burke had a much different response:

THE COURT: But that's the point where you and I differ. I am not pleased with the dumping two inches of stuff on me at 4:00 o'clock, and other things like that. I can certainly understand where you were upset, because frankly I read this stuff, that they thought you had done something wrong, and now that's clearly not it. So I understand you're upset. That's not an issue, but the legal issue, which I could easily see myself saying, okay, brief this, is simply this: As a matter of law, if there is perjured testimony presented to an arbitrator, when neither the lawyer nor the client knew it was perjured, is that a basis for vacating it? It is the same principle issue that went to the second circuit in the Martha Stewart case. Obviously that's a different thing, but it warrants research, briefing and stuff.

You may end up winning at the trial court level. You may end up losing at the trial court level and winning at the appellate court level, on that narrow little legal issue, which is the one that I see as the viable thing for doing this.

Hrg. Transcr. at A-49, ¶¶ 2-25 (July 8, 2005). In fact, Judge Burke' Order on August 8, 2005 does not reference any issue involving Appellant's position being frivolous or any action that would have lead to an award of sanctions. (R. at A-272 to A-275.)

If in fact, the award of sanctions requires determining whether counsel had an objective reasonable basis for making the factual or legal claim then the award of sanctions in this case is certainly an abuse of discretion by Judge Burke who previously argued and acknowledged the objective reasonable basis for making the factual and legal claim that Appellant's have asserted and now appeal. Judge Burke's Order for sanctions is clearly based on a subjective and unsupported contention rather than any type of objective standard. Therefore, it must be overturned.

Lastly, Judge Burke while he speculates as to the alleged "tactics" involved did not make a finding of bad faith by Appellant or its counsel. While Judge Burke concedes that he can not award monetary sanctions against a represented party pursuant to Minn.Stat. §549.211, subd. 5(5) he does so against Appellant's attorney in an attempt to circumvent the requirement of an order to show cause and without a specific finding of bad faith by Appellant's attorney. This award is clearly an abuse of discretion and creates a chilling effect in combating fraud in the State of Minnesota by sanctioning attorneys and insurance companies who pursue the type of activities against fraudulent medical clinics as alleged in the federal court case.

CONCLUSION

Appellant requests that the Trial Court's Order for sanctions be overturned as the request was untimely and the trial court abused its discretion in awarding sanctions under the objective standard and specifically without a finding of bad faith.

Dated: 8 April 06

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STATE OF MINNESOTA
IN COURT OF APPEALS
CASE NO. A06-58

Progressive Insurance Company,

Appellant,

**CERTIFICATION
OF BRIEF LENGTH**

vs.

Edgar Villafana Pallares,

Respondent.

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 Times New Roman font. The length of this brief is 3,681 words. I certify that the word processing program has been applied specifically to include all text, including headings, footnotes, and quotations. This brief was prepared using Microsoft Office Word 2003.

DATED: 8 April 06

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2) (with amendments effective July 1, 2007).