

Appellate Case No. A06-1238

APPELLATE COURT

OCT 27 2006

FILED

STATE OF MINNESOTA
IN COURT OF APPEALS

Arizant, Inc., Arizant Healthcare, Inc.,
and Augustine Medical, Inc.,

Appellants,

v.

Scott D. Augustine, M.D.,

Respondent.

RESPONDENT'S BRIEF

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INTRODUCTION

Respondent asserted two claims against Appellants – a claim for indemnification under Minn. Stat. §302A.521, and a claim for breach of contract. After a two-week trial, the jury returned its verdict in favor of Respondent. Appellants assert that the trial Court erred by (a) misinterpreting the law, (b) making improper evidentiary rulings and (c) giving improper jury instructions. As set forth below, the law and the record do not support Appellants' arguments.

In addition, the United States and the State of Minnesota have filed Briefs as Amicus Curiae. However, both focus on only one issue that was also addressed by the Appellants: was Respondent collaterally estopped from proving that he acted in good faith? All three failed to address the fact that, under Minnesota law, a guilty plea cannot serve as the basis for collateral estoppel.

STATEMENT OF FACTS RELATING TO INDEMNIFICATION CLAIM

I. RESPONDENT FOUNDED AUGUSTINE MEDICAL.

Respondent is an anesthesiologist and an inventor of products designed to improve patient care. T. 747, 3-5 (RA 92); 749, 10-20 (RA 94).¹ He invented a heated surgical blanket called the "Bair Hugger." T. 750, 15-751, 13 (RA 95-96). The device is used to warm the patient during and after surgery, which results in less discomfort, faster healing time, and less risk of infection. T. 751, 22-752, 20 (RA 96-97). In 1987, he gave up his anesthesiology practice and founded Augustine Medical to further develop the product.

¹ "T" refers to the page and line of the trial transcript. "Tr. Ex." refers to trial exhibit. "A" refers to Appellants' Appendix. "RA" refers to Respondent's Appendix.

T. 754, 12-755, 6 (RA 99-100). Bair Hugger has been very successful, and now reflects the standard of care in operating rooms throughout the country. T. 752, 18-753, 2 (RA 97-98).

Respondent served as the CEO of Augustine Medical until July 2002. T. 769, 10-14 (RA 101). During that time, he continued his work inventing new healthcare devices. Among his inventions is a medical device designed to manage chronic wounds by maintaining consistent levels of heat and moisture, called "Warm-Up Wound Therapy" ("Warm-Up"). T. 785, 10-786, 22 (RA 102-103).

II. UNDER RESPONDENT'S LEADERSHIP, AUGUSTINE MEDICAL HIRED EXPERTS TO HELP IT UNDERSTAND THE MEDICARE RULES.

Unlike the Bair Hugger, which is used primarily in hospitals, Warm-Up is designed for use primarily in settings such as nursing homes, home healthcare, and outpatient rehabilitation facilities. T. 785, 1-7 (RA 102). This distinction made the rules governing Medicare reimbursement for Warm-Up substantially more complicated than those that applied to the Bair Hugger blanket. *Id.* Respondent does not have legal training, and his experiences as an anesthesiologist and inventor did not provide him with the background needed to understand the complexities of the Medicare system associated with obtaining reimbursement for a device such as Warm-Up. T. 791, 18-792, 2 (RA 108-109).

Under Respondent's leadership, Augustine Medical took steps to further its understanding of the Medicare rules. T. 791, 18-792, 2 (RA 108-109); 864, 3-23 (RA 120); 201, 6-202, 9 (RA 14-15); 617, 15-618, 7 (RA 75-76). It created the position of

Director of Reimbursement and hired Paul Johnson to fill the position. T. 792, 18-22 (RA 109). The Company retained Philip Zarlengo – an outside consultant who specialized in Medicare reimbursement for medical devices – to provide guidance on reimbursement for Warm-Up. T. 793, 4-17 (RA 110). Randy Benham, Augustine Medical’s in-house lawyer, who had previously worked at Oppenheimer, Wolff and Donnelly, LLP (“Oppenheimer”), also became involved in developing the Company’s approach to Medicare reimbursement for Warm-Up. T. 1071, 4–1072, 6 (RA 171-172).

Through Mr. Benham, Augustine Medical hired Oppenheimer to serve as its primary outside counsel on Medicare reimbursement issues, with the Vinson & Elkins law firm serving as counsel on certain issues. T. 864, 11-23 (RA 120). The attorneys provided a series of detailed advice letters and oral opinions to Augustine Medical about reimbursement for Warm-Up under the Medicare Program. Id.

III. IN 2002, RESPONDENT ENTERED INTO A SEPARATION AGREEMENT WITH THE COMPANY, AND THE COMPANY AGREED TO INDEMNIFY RESPONDENT.

Respondent left the Company in December 2002. At that time, Respondent entered into a Separation and Release Agreement (“Separation Agreement”) with the Company. Tr. Ex. 81 (RA 203).

Paragraph 13 of the Separation Agreement provides that Augustine Medical will indemnify Respondent consistent with Minnesota law:

Indemnification. The Company agrees to indemnify and hold Augustine harmless from and against all attorney’s fees, costs, disbursements and damages that he may incur as a result of and relating to any act or omission that he allegedly committed while serving as an officer, director and/or employee of the Company to

the extent, and subject to the exceptions, that Minnesota law provides.

Tr. Ex. 81, p. 10 ¶ 13 (RA 212).

IV. IN JANUARY 2003, THE COMPANY WAS INDICTED FOR MEDICARE FRAUD.

Notwithstanding the steps that Augustine Medical took to obtain guidance from legal counsel and expert consultants on the Medicare laws applicable to Warm-Up, the Company became the target of a federal criminal investigation into the advice it had given its customers regarding Medicare reimbursement for the device.² On January 24, 2003, the United States charged Augustine Medical, Philip Zarlengo, Paul Johnson, and Timothy Hensley (the Company's National Sales Manager) with five felony counts including conspiracy to defraud the United States and mail fraud ("the Federal Case"). Respondent was not charged at that time. Six months later, however, on June 29, 2003, the United States filed a Superseding Indictment adding Arizant, Inc. ("Arizant"), Mr. Zarlengo's consulting business, Mr. Benham and Respondent to the Federal Case. Tr. Ex. 114 (RA 225).

V. ON MAY 10, 2004, THE COMPANY PLEAD GUILTY TO A FELONY.

On May 10, 2004, on the eve of trial, Augustine Medical finalized a plea agreement with the government. Tr. Ex. 239 (RA 255). Under the terms of that agreement, Augustine Medical plead guilty to conspiracy to defraud the United States as charged in the Superseding Indictment – a felony. (Id.) Augustine Medical paid criminal

² The Company subsequently became aware that the government had targeted "thousands" of healthcare companies and had recovered billions of dollars in fines relating to Medicare. T. 620, 22-621, 13 (RA 78-79).

and civil fines in the total amount of \$12,750,000. T. 622, 23-623, 21 (RA 80-81); 214, 11-15 (RA 20).

The remaining defendants (including the Respondent) proceeded to contest the charges at trial. T. 788, 17 (RA 105).

VI. ON JUNE 29, 2004, RESPONDENT PLEAD GUILTY TO A MISDEMEANOR.

The trial was scheduled to last three to four months. T. 788, 23-24 (RA 105). However, after seven weeks of testimony – before the prosecution had rested its case and before the defense called a single witness – the government offered to dismiss the felony indictment against Respondent in exchange for his plea to a misdemeanor. T. 789, 1-16 (RA 106); 868, 22-869, 19 (RA 121-122).

On June 29, 2004, Respondent agreed to plead guilty to the misdemeanor count.

His plea was based on the following factual stipulation:

(3) On or about June 27, 2000, [Augustine] received a letter from TriSpan Health Services, a fiscal intermediary of the Medicare program which had earlier approved coverage for WarmUp. TriSpan had now determined that WarmUp was investigational. [Augustine] believed that this determination was material.

(4) Shortly thereafter, [Augustine] knowingly and intentionally aided and abetted others in deciding not to disclose the June 27th letter to Southern Medical Distributors.

Tr. Ex. 298 (RA 301). Respondent pled guilty to participating in the decision not to disclose the June 27, 2000 letter from TriSpan. The letter has been referred to as the “TriSpan letter.” This narrow factual basis excluded the majority of the allegations

originally asserted against Respondent in the Superseding Indictment. Under the terms of his plea agreement, Respondent paid a fine of \$2 million.³

Respondent requested that the Company indemnify him pursuant to Minnesota's indemnification statute, Minn. Stat. §302A.521, which specifically provides that a criminal conviction does not, of itself, bar the right to indemnification. The Company refused to indemnify the Respondent. Therefore, Respondent filed this action. After a two-week trial, the jury found that Respondent met the elements of the indemnification statute. The jury found that Respondent acted in good faith, did not receive a personal benefit from his actions, had no reasonable cause to believe his conduct was unlawful, and reasonably believed his conduct was in the best interest of the Company. The overwhelming weight of the evidence supports the jury's verdict. For example, the evidence showed the following:

- The June 27, 2000 Trispan letter said that Warm-Up was "investigational." Tr. Ex. 39 (RA 195).
- The term "investigational" means that the product has not been approved by the Food and Drug Administration. T. 875, 23-876, 16 (RA 128-129).
- It is undisputed that Warm-Up had been approved by the Food and Drug Administration and, therefore, Warm-Up was not investigational. In other words, the letter was wrong. T. 875, 23-876, 16 (RA 128-129).

³ At trial, Appellants tried to argue that the size of Respondent's fine had some independent significance. However, the evidence showed that the Company believed that the government was asking for large fines because it knew that Augustine Medical was going to be sold and that the money the shareholders were to be paid for their shares would be available to pay fines. T. 192, 19-195, 13 (RA 8-11).

- Trispan had previously informed Augustine Medical that Trispan would reimburse for Warm-Up. T. 632, 9-11 (RA 90); 877, 10-23 (RA 130). The June 27 letter was silent on the issue.
- On June 27, 2000, Respondent provided copies of the Trispan letter to the executive management team. Tr. Ex. 42 p. 2 (RA 197).
- The executive management team, which included Augustine Medical's lawyer, discussed the letter. Tr. Exs. 42, 43 45, 46 (RA 196-200).
- The executive management team was confused by the letter. T. 632, 9-16 (RA 90).
- The executive management team decided not to distribute the letter because it was inaccurate. T. 878, 23-24 (RA 131).
- Respondent spoke on the telephone with the author of the letter, Dr. May, and discussed the letter. T. 879, 12-13 (RA 132).
- Respondent subsequently sent a letter to Dr. May confirming that Warm-Up was not investigational. T. 879, 12-880, 19 (RA 132-133); Tr. Ex. 52.
- When Respondent met with Southern Medical, Respondent told Southern Medical that Augustine Medical received the letter and that the letter said Warm-Up was investigational. T. 883, 4-883, 23 (RA 136). In other words, while Respondent participated in the decision not to distribute the letter, he told Southern Medical exactly what was in the letter.

STATEMENT OF FACTS RELATING TO STOCK CLAIM

I. PURSUANT TO THE SEPARATION AGREEMENT, THE COMPANY AGREED TO PROVIDE RESPONDENT WITH A BONUS THAT WAS CALCULATED BASED ON THE VALUE OF “PHANTOM STOCK.”

“Phantom Stock” is a mechanism that some companies use to pay bonuses. The company grants the employee a number of “phantom” shares (no actual stock is transferred) and an annual bonus is calculated based on the increase in value in the company’s actual stock from one fiscal year to the next. T. 321, 19–323, 16 (RA 30-32).

For example, assume Augustine Medical grants an employee 10,000 “phantom” shares in 2001 when one share of the Company’s stock is valued at \$1.00. In 2002 the stock increases in value to \$5.00 per share. Under these facts, the employee would be entitled to a “phantom stock payment” in 2002 of \$40,000 (\$4.00 x 10,000 shares). *Id.*

Augustine Medical’s fiscal year ran from April 1 through March 31.⁴ T. 252, 2-12 (RA 23). Respondent’s Separation Agreement provides that he is entitled to receive ten phantom stock payments beginning on March 31, 1998 and ending on March 31, 2007. Tr. Ex. 81 p. 3 ¶ 5 (RA 205). The Separation Agreement provides that the Company must obtain an appraisal of the Company’s stock after the end of each fiscal year for the purpose of calculating the phantom stock payment. *Id.* at ¶5(b)(i). In addition, the Separation Agreement included a provision for how the bonus is calculated in the event of a sale of the Company. If that happened, the March 31 value prior to the sale would be used in calculating any future bonus (through 2007). *Id.* at ¶ 5(d).

⁴ For example, fiscal year 2004 ran from April 1, 2003 to March 31, 2004.

II. IN THE FALL OF 2003, THE COMPANY WAS MARKETED FOR SALE.

In the fall of 2003, the Company engaged JP Morgan for the purpose of having JP Morgan solicit bids for the sale of the Company. T. 393, 12-16 (RA 40).

A. In the Fall of 2003, the Company Received a Bid Equal to \$71.78 Per Share.

In November 2003, JP Morgan received bids from 18 parties. The bids ranged as high as \$200 million. The \$200 million bid translated to approximately \$71.78 per share. T. 259, 17-261, 20 (RA 24-26).

III. ON MAY 11, 2004, THE COMPANY MYSTERIOUSLY SWITCHED FROM JP MORGAN TO HARRIS NESBITT FOR ITS MARCH 31, 2004 VALUATION.

Because of the pending sale of the Company, the March 31, 2004 appraisal of the stock became very significant to the calculation of Respondent's bonus through 2007. Initially, the Company retained JP Morgan to conduct its March 31, 2004 appraisal. T. 399, 23-400, 6 (RA 41-42). JP Morgan had agreed to perform the appraisal free of charge as part of their engagement to sell the Company. T. 276, 1-4 (RA 27); 1159, 24-1160, 13 (RA 177-178). On May 11, 2004, however, the Company abruptly switched to Harris Nesbitt for the appraisal. T. 277, 17-20 (RA 28). Instead of getting the appraisal for free, the Company paid Harris Nesbitt \$150,000 for the appraisal. T. 1184, 9-14 (RA 185). The Company's CFO testified that the Company fired JP Morgan because of "incompetence." T. 1175, 6-1176, 3 (RA 180-181). JP Morgan testified that it refused to perform the March 31 valuation. T. 456, 11-13 (RA 43); 457, 23-459, 4 (RA 44-46).

IV. ON MAY 20, 2004, HARRIS NESBITT COMPLETED ITS VALUATION.

On May 20, 2004, even though the Company had been receiving bids for as much as \$71.78 per share, Harris Nesbitt issued a report that stated that the value of the stock as of March 31, 2004 was between \$37 and \$41 per share. Tr. Ex. 268, p. 4 (RA 290). Curiously, the valuation report stated that Harris Nesbitt did not consider the pending sale in conducting the appraisal. *Id.* p. 3-4.

The Company's Board approved a March 31, 2004 value of \$39.00 per share. T. 283, 8-13 (RA 29). The Company used the \$39.00 value to calculate Respondent's bonus. Respondent asserted in this lawsuit that Harris Nesbitt was not independent. In addition, Respondent asserted that Harris Nesbitt did not conduct the appraisal pursuant to accepted accounting principles and that the appraisal was not accurate.

A. The Evidence Showed that the Company's Appraisal (a) was not Conducted by an Independent Appraiser, and (b) was not Conducted Pursuant to Proper Applicable Appraisal Process.

It soon became clear why the Harris Nesbitt appraisal was so low. First, the undisputed evidence showed that Harris Nesbitt was not an independent appraiser. Preston Luman, the Company's Chief Financial Officer, admitted that Harris Nesbitt had been loaning money to the Company. Luman admitted that Harris Nesbitt was not "independent." T. 1174, 5-15 (RA 179).

Second, Paul Majerus, the Harris Nesbitt employee who was responsible for the appraisal, testified that Harris Nesbitt is not in the appraisal business. T. 465, 21 (RA 49); 466, 1-13 (RA 50); 471, 23-472, 16 (RA 51-52). Third, Mr. Majerus admitted that he did not conduct the appraisal pursuant to accepted appraisal standards. T. 473, 4-24

(RA 53); 474, 5-11 (RA 54). For example, Respondent's expert testified that the appraisal should have been conducted pursuant to the Uniform Standards of Professional Appraisal Practice (USPAP). T. 520, 17-521, 7 (RA 64-65); 526, 20-527, 19 (RA 70-71). Mr. Majerus testified that he does not even know what USPAP is. T. 473, 4-8 (RA 53).

B. The Evidence Showed that the Appraisal was Flawed and Inaccurate.

The evidence showed that Harris Nesbitt's appraisal was seriously flawed. First, the Company improperly instructed Harris Nesbitt on how to conduct the appraisal. T. 477, 24-479, 6 (RA 57-59). In a draft engagement letter, Harris Nesbitt wrote that the Company's Management had instructed and directed Harris Nesbitt to not consider the potential sale of the Company in completing the valuation:

In valuing the Stock of the Company on a privately held minority basis considering the Company as an ongoing business enterprise as of the Valuation Date, the Company has directed Nesbitt to apply appropriate discounts for minority ownership and for lack of liquidity, and not to take into consideration any proposed or possible acquisition of the Company. . . . In valuing the Stock of the Company on a privately-held minority basis, Nesbitt will at the instruction of and with the consent of the Company consider the Company as an ongoing business

Tr. Ex. 248, p. 3 (RA 281). Harris Nesbitt followed the instructions. T. 1140, 2-9 (RA 176). The Company acknowledged at trial that it is improper for a Company to instruct an appraiser how to do the appraisal. T. 199, 9-12 (RA 199).

Second, the Company disclosed to Harris Nesbitt that the appraisal would have a "significant impact" on Respondent's bonus. T. 1178, 1-1179, 6 (RA 182-183). The Company could not articulate a legitimate reason for providing such information to Harris Nesbitt. T. 1178, 18-1179, 6 (RA 182-183).

Third, before the appraisal was completed, the Company actually told Harris Nesbitt that the Company had already “accrued” for the Respondent’s bonus based on a stock value of \$39 per share. T. 1183, 12–1184, 8 (RA 184-185); Ex. 83 p. 10 (RA 224). In other words, the Company told Harris Nesbitt what value they wanted. Harris Nesbitt then issued an opinion that valued the stock at \$37-\$41 per share.

Fourth, at the time the Company was taking the position that the stock was worth \$39 per share, it had already received offers to purchase the stock for as high as \$71.78 per share. T. 259, 17–261, 20 (RA 24-26).

Fifth, Respondent’s appraisal expert testified that the Harris Nesbitt appraisal was flawed. T, 516, 17–520, 16 (RA 60-64); 523, 20-21 (RA 67); 524, 10-13 (RA 68). He testified that Harris Nesbitt should have considered the fact that the Company was for sale in conducting its appraisal. T. 525, 4–528, 2 (RA 69-72). He offered his own opinion that the stock was worth \$63.50 per share. T. 523, 20–21 (RA 67).

Sixth, Appellants’ appraisal expert refused to offer his own opinion on the value of the stock. T. 1325, 6–12 (RA 188) In addition, he testified that he did not know whether he agreed with Harris Nesbitt’s analysis. T. 1330, 10-22 (RA 189).

The Company’s attitude toward Respondent was summed up by Mr. Luman, the Company’s CFO in an email he sent to the CEO before Harris Nesbitt issued its opinion:

We are so many moves ahead of him (Augustine) in this chess match that he doesn’t even have an inkling.

Tr. Ex. 167 (RA 253).

V. ON JUNE 14, 2004, THE COMPANY ENTERED INTO AN AGREEMENT TO SELL FOR \$72 PER SHARE.

By June 3 (two weeks after the Company approved a valuation of \$39.00 per share), three bidders submitted final bids ranging from \$207.5 million (\$66 per share) to \$225 million (\$72 per share). T. 76, 17–78, 3 (RA 3-5) By June 14, 2004, the Company entered into a merger agreement with Citigroup Venture Capital (“CVC”) for a sale price of \$225 million, or \$72 per share. Tr. Ex. 295 (RA 291).

ARGUMENT

I. THE TRIAL COURT PROPERLY ALLOWED RESPONDENT TO PROVE THAT HE ACTED IN GOOD FAITH REGARDING HIS CLAIM FOR INDEMNIFICATION.

A. Minnesota’s Indemnification Statute Specifically Provides that a Conviction does not Bar Eligibility for Indemnification.

Section 302A.521 of the Minnesota Statutes provides that a corporation must indemnify any director, officer or employee for costs incurred in connection with his or her conduct if the person:

- (1) Has not been indemnified by another organization . . . for the same [costs] . . . incurred by the person in connection with the proceeding with respect to the same acts or omissions;
- (2) Acted in good faith;
- (3) Received no improper personal benefit . . . ;
- (4) In the case of a criminal proceeding, had no reasonable cause to believe the conduct was unlawful; and
- (5) . . . reasonably believed that the conduct was in the best interests of the corporation

Minn. Stat. §302A.521, subd. 2(a). The statute requires indemnification for “judgments, penalties, fines, . . . settlements, and reasonable expenses, including attorneys’ fees and

disbursements. . .” Minn. Stat. §302A.521, subd. 2(a). In addition, Section 302A.521 expressly provides that a conviction does not bar eligibility for indemnification:

The termination of a proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent does not, of itself, establish that the person did not meet the criteria. . . .

§302A.521 subd. 2(b).

The General Comment to §302A.521, confirms that one who is convicted and pays a fine is entitled to an “independent determination” of whether he is entitled to indemnification:

Subdivision 2(b) merely states that an unsuccessful defense of a proceeding does not automatically bar eligibility for indemnification. Instead, an independent determination of whether or not the criteria for eligibility have been satisfied is to be made as set forth in subdivision 6.

B. The Doctrine of Collateral Estoppel Does Not Apply in this Case.

The doctrine of collateral estoppel precludes a party from litigating an issue when four elements exist: 1) the issue is identical to an issue in a prior adjudication; 2) there was a final judgment on the merits; 3) the estopped party was a party or in privity with a party to the prior adjudication; and 4) the estopped party had a full and fair opportunity to litigate the issue. Ellis v. Minneapolis Comm’n on Civil Rights, 319 N.W.2d 702, 704 (Minn. 1982); 3 Douglas D. McFarland & William J. Keppel, *Minnesota Civil Practice* §2538 (3d ed. 1999). An issue “must have been distinctly contested and directly determined in the earlier adjudication for collateral estoppel to apply.” Hauschildt v. Beckingham, 686 N.W.2d 829, 837-38 (Minn. 2004); Nevada v. United States, 463 U.S.

110, 130 n.11 (1983) (“[Collateral estoppel] can be used only to prevent relitigation of issues actually litigated in a prior lawsuit.”) (internal quotations omitted).

Appellants assert that Respondent’s guilty plea collaterally estopped him from establishing that he acted in good faith. Appellants’ argument fails for two reasons. First, under Minnesota law, a guilty plea cannot be the basis for collateral estoppel. Second, the issue of Respondent’s good faith was never addressed in the Federal Case.

1. Under Minnesota Law, Because Respondent’s Conviction was Based on a Plea Agreement Rather than a Trial on the Merits, Collateral Estoppel Cannot Apply.

When an individual pleads guilty, “no issue [is] ‘actually litigated’ ... since [the defendant has] declined to contest his guilt in any way.” Haring v. Prosise, 462 U.S. 306, 316 (1983). “[T]he taking of a guilty plea is not the same as an adjudication on the merits after full trial . . .” Ohio v. Johnson, 467 U.S. 493, 500 n.9 (1984). The rationale for a different standard for guilty pleas is that “[p]ersons plead guilty for many reasons—pangs of conscience, remorse, desire to get the ordeal over with, a hope for leniency and other innumerable reasons....” Ford v. United States, 418 F.2d 855, 859 (8th Cir. 1969).

Minnesota courts have drawn a clear distinction between the collateral estoppel effect of a conviction based on a guilty plea and a conviction after a trial on the merits. Compare Traveler’s Ins. Co. v. Thompson, 163 N.W.2d 289 (Minn. 1968) (holding that conviction after trial on the merits had collateral estoppel effect in subsequent civil case) with Glens Falls Ins. Co. v. Hoium, 200 N.W.2d 189, 192 (Minn. 1972) (holding that plea of guilty to assault in criminal case did not have preclusive effect on issue of intent in subsequent civil case); see also Illinois Farmers Ins. Co. v. Reed, 647 N.W.2d 553, 559

(Minn. Ct. App. 2002) (drawing clear distinction between the collateral estoppel effect of a conviction based on a full trial on the merits and a conviction based on a plea agreement), rev'd on other grounds, 662 N.W.2d 529 (Minn. 2003).

In Glens Falls, an insured was sued for injuries he had caused in a bar fight. He tendered the claim to his insurance company, Glens Falls Group. Glens Falls argued that the insured's policy did not cover intentional torts, and that the insured's prior guilty plea to aggravated assault collaterally estopped him from litigating the issue of whether the injuries were inflicted intentionally or through his negligence. Id. The Court rejected Glens Falls' argument and held that the insured's guilty plea was not conclusive evidence that he intentionally inflicted the injury. Id. at 252. The Court stated that "[t]he considerations which govern a plea of guilty as distinguished from a vigorously contested prosecution ... may be quite different." Id. at 249. Therefore, the insured was entitled to (a) explain "the inducements which led him to enter his plea," and (b) attempt to prove that he did not act intentionally. Id. at 252.

In Illinois Farmers, plaintiffs sued their son's daycare provider, who had been convicted (after a trial on the merits) of assault and malicious punishment of a child. The daycare provider tendered the defense to its insurance company under the daycare provider's homeowner's policy. The insurance policy included an "intentional acts" exclusion. The insurance company argued that, because of the conviction, the daycare provider was collaterally estopped from denying it acted intentionally. The Court held that because the daycare provider was convicted after a trial on the merits, collateral

estoppel applied. In so holding, the Court discussed the distinction between a conviction after trial on the merits, and a conviction based on a guilty plea:

[T]he collateral-estoppel effect of a judgment of conviction based on a guilty plea is a completely separate question from the collateral estoppel effect of a judgment of conviction after trial. This is because a fundamental requirement of collateral estoppel is that the issue sought to be precluded in the subsequent proceeding must have been ‘actually litigated’ in the former proceeding, and a conviction based on a guilty plea can never satisfy that requirement.

Id. at 559.

2. Appellants Take the Position that their own Plea did not Collaterally Estop them from Seeking Indemnification from their Insurance Company.

Appellants specifically acknowledged the validity of Glens Falls in connection with a claim against their own insurer to recover the costs and fines paid in connection with their own guilty plea in the Federal Case. In the Stipulation of Facts associated with Augustine Medical’s guilty plea, Augustine Medical agreed that:

By entering into this Stipulation of Facts, the Defendant AMI admits that the facts set forth herein above establish that it knowingly and intentionally committed the offense of conspiracy to defraud the United States and its agencies

Tr. Ex. 239, p. 8, ¶ 23 (RA 273). Appellants subsequently filed a claim against their insurer, Chubb, to recover amounts paid in connection with their crime. T. 207, 10-25 (RA 16); 626, 19-628, 21 (RA 84-86). Chubb refused to provide coverage based on an “intentional acts” exclusion in the policy.

Augustine Medical told Chubb that it had pled guilty to avoid a “high profile and costly trial.” Citing Glen Falls, Augustine Medical argued that, even though it plead

guilty to “knowingly and intentionally” committing the crime, it did not knowingly or intentionally violate the law. Id. (RA 292). In other words, Augustine Medical took the position that, under Minnesota law, it was not collaterally estopped from seeking indemnification from its insurer. Augustine Medical now takes the opposite position.

3. The Minnesota Cases Cited by Appellants do not Support Appellants’ Position.

Appellants rely on Travelers Ins. Co. v. Thompson, 163 N.W.2d 289 (Minn. 1968). Appellants’ Brief p. 25. However, as set forth above, Thompson involved a full trial on the merits – not a plea. Therefore, it does not support the Appellants’ position.

Appellants also cite Nevins v. Christopher Street, Inc., 363 N.W.2d 891 (Minn. Ct. App. 1985). This case does not support Appellants’ argument. Patricia Nevins was employed by Christopher Street, Inc. Nevins was arrested while at work and charged with felony theft for sending erroneous billings for payment. Nevins was suspended from her employment. She pleaded guilty to theft. Nevins applied for unemployment benefits. The Commissioner determined that Nevins’ plea constituted a presumption of “gross misconduct,” which disqualified her from unemployment benefits. The Commissioner relied on Minn. Stat. §268.09, which addressed the right to unemployment benefits, and which provided:

If an individual is convicted of a felony or gross misdemeanor for the same act or acts of misconduct for which the individual was discharged, the misconduct is conclusively presumed to be gross misconduct if it was connected with his work.

Nevins v. Christopher Street, Inc., 363 N.W.2d 891, 892 (Minn. Ct. App. 1985). The statute specifically provided that a conviction is conclusively presumed to be gross

misconduct, which results in disqualification from benefits. Here, the indemnification statute specifically provides the opposite – that a conviction is not dispositive of whether an individual is eligible for indemnification. Minn. Stat. §302A.521, subd. 2(b).

Finally, Appellants cite one Eighth Circuit decision (Williams v. Schario), and one unreported decision from the District of Minnesota (P.C.B., Jr. v. Cha). These cases do not support the Appellants' position.

In Williams v. Schario, an individual pled guilty to burglary. 93 F.3d 527 (8th Cir. 1996). He subsequently filed a civil action (based on 42 U.S.C. §1983) alleging that the police arrested him without probable cause. In affirming dismissal of the claim, the Court relied on Malady v. Crank, 902 F.2d 10, 11 (11th Cir. 1990) for the well-established rule that a guilty plea forecloses a §1983 claim challenging the basis for the arrest. In other words, the decision was not based on collateral estoppel. In fact, the Williams Court did not even mention collateral estoppel. In Malady, the Court specifically stated that its decision was based on a common-law rule, and not on the doctrine of collateral estoppel:

We do not reach the collateral estoppel question and instead affirm the order of the district court because Malady's conviction of the offense for which he was arrested is a complete defense to a §1983 action asserting that the arrest was made without probable cause.

Id. at 11.

In P.C.B., Jr. v. Cha, an individual pled guilty to disorderly conduct. No. Civ. 03-6368 MJDJGL, 2005 WL 14214965 (D. Minn. June 17, 2005). He subsequently brought a claim for false imprisonment against the arresting police officers. The Court relied on

Williams in concluding that an individual who is convicted of a crime may not challenge the basis for the arrest:

Plaintiff's false imprisonment claim is indistinguishable from the Eighth Circuit decisions that refuse to allow a plaintiff to re-litigate the basis for the for arrest.

Id. at *5. Once again, the Court's decision was not based on collateral estoppel.

4. Other Jurisdictions also Recognize that a Guilty Plea Cannot be the Basis for Collateral Estoppel in a Subsequent Civil Action.

Other jurisdictions have also determined that a guilty plea does not constitute full and fair litigation of the issues and, therefore, cannot serve as the basis for collateral estoppel. See e.g., 20th Century Ins. Co. v. Schurtz, 92 Cal. App. 4th 1188, 1196 (Cal. Ct. App. 2002) (collateral estoppel does not bar litigation of an issue necessarily decided in a prior criminal case where that issue was determined by a guilty plea); E. Rawling, Jr. v. City of New Haven, 537 A.2d 439, 445 (Conn. 1987) (a criminal judgment based on a plea of guilty has no preclusive effect in subsequent civil litigation); Brohawn v. Transamerica Ins. Co., 347 A.2d 842, 848 (Md. 1975) (noting that an insured who pleads guilty to a criminal charge may later litigate issues established by her admission of guilt); Aetna Cas. & Sur. Co. v. Niziolek, 481 N.E.2d 1356, 1363 (Mass. 1985) (“doctrine of collateral estoppel does not apply to preclude the former criminal defendant from litigating in subsequent civil case issues involved in the criminal proceeding in which he pleaded guilty”); N.W. Nat. Cas. Co. v. Phalen, 597 P.2d 720, 727 (Mont. 1979) (stating that the insured's guilty plea to criminal charges based on the same issue as the later civil action was not conclusive); Prudential Prop. & Cas. Ins. Co. v. Kollar, 578 A.2d 1238,

1240-41 (N.J. Super. Ct. App. Div. 1990) (stating that a plea proceeding is not a full and fair litigation of the issues and thus has no preclusive effect on subsequent litigation); Stidham v. Millvale Sportsmen's Club, 618 A.2d 945, 954 (Pa. Super. Ct. 1993) (holding that guilty plea to third degree murder did not preclude the insured from litigating the issue of intent in a subsequent civil action); Safeco Ins. Co. of Am. v. McGrath, 708 P.2d 657, 660 (Wash. Ct. App. 1985) (stating that an insured who pleads guilty to a criminal charge is not later barred from litigating those issues established by his admission of guilt); Peterson v. Maul, 145 N.W.2d 699, 704 (Wis. 1966) (injured third party is not precluded from litigating in a civil action an issue that was established by an insured's guilty plea).

5. The Cases from Other Jurisdictions Cited by Appellants are Distinguishable.

Appellants cite cases from other jurisdictions that they assert support their argument that Respondent's guilty plea should have precluded him from litigating the issue of his good faith here. Appellants' Br. pp. 22-24. These cases, however, are distinguishable. In each of the cases addressing whether a corporate director is entitled to indemnification for conduct that resulted in a prior criminal conviction, the underlying criminal proceeding involved a trial on the merits in which the issue of fraud or bad faith was actually litigated or there was a sworn admission of knowledge of unlawfulness. See Globus v. Law Research Serv., Inc., 418 F.2d 1276, 1279 (2d Cir. 1969) (jury trial); Bansbach v. Zinn, 801 N.E.2d 395, 769 N.Y.S.2d 175 (N.Y. Ct. App. 2003) (sworn admission of knowledge of unlawfulness of conduct); Equitex, Inc. v. Ungar, 60 P.3d

746, 748 (Colo. Ct. App. 2002) (jury trial); Biondi v. Beekman Hill House Apt. Corp., 94 N.Y.2d 659, 662, 731 N.E.2d 577, 578, 709 N.Y.S.2d 861, 862 (N.Y. Ct. App. 2000) (jury trial).

Moreover, unlike the Minnesota indemnification statute, the indemnification laws of New York, Delaware and California provide for *permissive* rather than *mandatory* indemnification, and affirmatively prohibit indemnification in some cases. See Landmark Land Co. v. Cone, 76 F.3d 553 (4th Cir. 1996) (arising under the permissive California indemnification statute); McLean v. Alexander, 449 F. Supp. 1251 (D. Del. 1978) (same); Equitex, Inc. v. Ungar, 60 P.3d 746, at 750-51 (Colo. Ct. App. 2002) (arising under the permissive indemnification law of Delaware). These distinctions reflect differences in the policies adopted by other state legislatures. Minnesota law *requires* corporations to indemnify their directors, officers and employees in much broader circumstances than many other jurisdictions. As the State of Minnesota acknowledges in its Brief, “Minnesota’s indemnification statute is arguably more favorable for corporate officials seeking indemnification than the comparable statutes in some states.” State of Minnesota’s Brief p. 6, note 5.

C. In Any Event, the Issue of Respondent’s Good Faith was not Litigated in the Federal Case.

Collateral estoppel also does not apply because the fundamental requirement that the issues in the two cases be identical is not met. Hauschildt, 686 N.W.2d at 837. Minnesota courts have repeatedly declined to apply collateral estoppel in cases involving fact issues that are similar, but distinct, from those resolved in prior cases. See, e.g.,

Town & Country State Bank v. First State Bank, 358 N.W.2d 387, 395-96 (Minn. 1985) (First State Bank was not collaterally estopped from contesting its alleged bad faith towards Heritage Bank, even though a jury had previously determined that the same conduct towards Town & Country State Bank supported a finding of bad faith); and In re: Nielsen, Nos. 96-47257, 97-4114, 1998 WL 386384, *6 (Bankr. D. Minn. July 9, 1998) (collateral estoppel did not bar debtors in bankruptcy from litigating the issue of whether they intended to cause harm even though a similar, but distinct, issue – intent to act without a good faith belief in the truth of statements made – had been resolved by a prior judgment).⁵ As illustrated by these cases, it is not appropriate to apply collateral estoppel to issues that are merely similar or closely related. Instead, the issues in the present and prior cases must be identical.

The only issues that were actually determined in the Federal Case as to Respondent are those addressed in the factual basis for his misdemeanor plea. Respondent's good faith was not addressed. Because the plea did not address the issue of good faith, the plea did not collaterally estop Respondent from establishing his good faith in the subsequent civil action.

D. Contrary to the United States' Position, the Trial Court did not Undermine the Criminal Law.

The United States takes the position that, by allowing Respondent to prove that he acted in good faith, the trial Court “undermines the federal criminal law enforcement scheme ...” United States' Brief p. 1. However, it is not clear how the law enforcement

⁵ A copy of this unpublished decision is located at RA 304.

scheme is undermined. First, the federal Court could have required Respondent to waive his right to indemnification as part of his plea. Second, Minnesota's indemnification statute specifically provides that a criminal conviction does not, of itself, bar indemnification. In other words, the Minnesota legislature decided that an individual who is convicted of a crime is not automatically barred from seeking indemnification. The fact that the United States does not like the result in this case is not a basis for overturning the jury's verdict.

II. THE TRIAL COURT DID NOT EXCLUDE ADMISSIBLE EVIDENCE REGARDING AUGUSTINE'S GOOD FAITH.

Appellants argue that the trial Court improperly excluded evidence regarding Respondent's good faith. Appellants' Brief p. 27-35. This argument is not supported by the record.

As a preliminary matter, it should be noted that Appellants' theory of the case was based upon the assertion that Mr. Hensley pled guilty to withholding a material fact from Southern Medical during a meeting on August 16, 2000, and that Respondent aided and abetted Hensley in withholding that fact. Therefore, Appellants intended to introduce evidence of Hensley's crime and then argue that Respondent was responsible in some way for that crime.

Appellants' premise was false. Respondent's Misdemeanor Information charges that "on or about July 7, 2000... Scott D. Augustine knowingly and willingly aided and abetted others in causing to be withheld from Southern Medical Distributors a material fact for use in deciding rights to benefits" Tr. Ex. 299 ¶ 2 (RA 303). Respondent was

not at the August 16, 2000 meeting. T. 944, 25-945, 6 (A 681-682). In addition, Respondent never admitted, in his plea or at any other time, to knowing of or participating in Hensley's conduct at the August 16, 2000 meeting.

During the trial, Appellants examined Respondent regarding his knowledge of Hensley's actions. Respondent testified, consistent with his deposition, that he was not at the August 16 meeting that was the subject of Hensley's plea. In an effort to introduce what Hensley said at the August 16 meeting, Appellants attempted to ask Respondent if he was aware of what the prosecutor asked Hensley during Hensley's plea hearing, which took place on June 29, 2004 – four years after the August 16, 2000 meeting:

Q. (By Mr. Potter) It's very possible you talked to Tim Hensley about what to do with Southern Medical prior to him meeting with Southern Medical in Atlanta, isn't it?

A. It's very possible that I talked about Southern Medical with Tim Hensley, but I don't think I talked to him about what to do at a meeting.

Q. And you don't recall what Mr. Hensley and the team told you after that meeting on August 16th 2000 in Atlanta, do you?

MS. DUKE: Objection, foundation.

A. I'm not aware that they told me anything.

THE COURT: Sustained.

Q. In fact, sir, you know that Tim Hensley did not disclose the Tri-Span letter from Dr. May at that August 16, 2000 meeting in Atlanta, don't you?

MS. DUKE: Objection, foundation.

THE COURT: Sustained.

Q. Are you denying that you ever learned from any source that Tim Hensley admitted he had not disclosed the Tri-Span letter at the August 16, 2000 meeting in Atlanta?

MS. DUKE: Objection, Your Honor. May we approach?

THE COURT: Yes.

(Discussion at the Bench out of the hearing of the reporter and the jury)

Q. (By Mr. Potter) Dr. Augustine, you appeared in federal court on June 29th 2004, didn't you?

A. I have to assume I did. I don't know.

Q. And you do remember appearing in front of Federal Judge Montgomery to enter your plea of guilty to your crime, correct?

A. Yes, I do.

Q. And you remember that at that particular hearing Tim Hensley also entered his plea as to the crime he committed?

A. I believe he did, yes.

Q. And you were there when he entered his plea, weren't you?

A. I believe I was.

Q. And sir, on that date Tim Hensley was asked if on or about August –

MS. DUKE: Objection, Your Honor, hearsay.

THE COURT: Sustained.

T. 947, 24-949, 12 (RA 154-156). If Appellants had called Hensley, they could have asked Hensley about what Hensley admitted to during the June 29, 2004 plea hearing. It was not appropriate to ask Respondent if he knew what the prosecutor asked Hensley in 2004 – four years after the event in question. Such evidence was inadmissible hearsay.

In addition, the fact that Respondent learned in 2004 what Hensley said in a meeting in 2000 is not relevant to whether Respondent acted in good faith in 2000.⁶

Based on the above theory, Appellants argue that the Court erred in excluding four kinds of evidence. As set forth below, none of Appellants' arguments are supported by the record.

A. Respondent's Deposition Testimony.

Appellants argue that the Court erred when it did not allow Appellants to read Respondent's deposition testimony. In other words, Appellants argue that they should have been allowed to impeach Respondent with his deposition testimony. Appellants' Brief. p. 29-30. However, Appellants have not identified where in the record Respondent testified in a way that was inconsistent with his deposition and where Appellants tried and were not allowed to use the inconsistent deposition testimony.

B. The Tape/Transcript of the August 21, 2000 Telephone Call Between Hensley and Southern Medical.

Appellants argue that they should have been able to impeach Respondent with the recording/transcript of an August 21, 2000 telephone call between Hensley and Southern Medical. Appellants' Brief. p. 29-30. As a preliminary matter, it should be noted that Respondent did not participate in the call. Therefore, it is hard to see how Respondent

⁶ The indemnification statute requires that the person seeking indemnification establish five factors "with respect to the acts or omissions of the person complained of in the proceeding." Minn. Stat. § 302A.521, subd. 2(a). Respondent's plea related to conduct that occurred in the summer of 2000. Therefore, evidence regarding his knowledge and conduct in 2000, not 2004, is relevant.

could be “impeached” with the tape of the call. In addition, there is a nothing in the transcript of the call that is inconsistent with Respondent’s trial testimony.

Appellant’s true motive was to introduce the tape of Hensley’s call and then try to associate Respondent with Hensley’s conduct during the call. However, the trial Court ruled that the tape was inadmissible for four reasons.⁷

First, the Court in the criminal proceeding excluded the tape. Therefore, the tape did not serve as a basis for Respondent’s plea.⁸ If the tape was excluded in the criminal proceeding (and, therefore, not relevant to the plea), it is hard see how it could be relevant in the civil proceeding to determine whether Respondent acted in good faith in connection with the crime to which he pled guilty. In fact, the trial Court specifically addressed this issue in its Order denying Appellants’ motion for judgment as a matter of law and for new trial:

Defendants Arizant assert that the Court erred by excluding audio recordings from an August 16, 2000 meeting between Southern Medical Distributors, a United States’ government shell business created by for a governmental Medicare sting operation, and Timothy Hensley . . .

⁷ Evidentiary rulings fall within the sound discretion of the trial Court and a ruling will be reversed only if the trial Court clearly abused its discretion. Foust v. McFarland, 698 NW2d 24, 33 (Minn. Ct. App. 2005), citing Kronig v. State Farm Auto Ins. Co., 567 NW2d 42, 45-46 (Minn. 1997). Evidentiary error is only prejudicial, however, if it “might reasonably be said to have changed the result of the trial.” Foust, 698 NW2d at 33 (citations omitted).

⁸ During the trial, Appellants represented to the trial Court that the Federal Court denied Respondent’s motion to exclude the tapes. That representation was false. The Federal Court excluded the tapes. T. 827, 18-828, 14 (RA 115-116); 891, 13-894, 7 (RA 141-144).

The Court properly excluded the Southern Medical audio recordings based on relevance: (1) because the recordings were excluded from the U.S. District Court criminal case against Plaintiff Augustine, they were not part of the factual basis for Plaintiff Augustine's misdemeanor plea, and therefore, could not be relevant to whether Plaintiff Augustine acted in good faith regarding the decision not to disclose the TriSpan letter; (2) the recorded conversations were related to a meeting between Augustine Medical, Inc. and a fiscal intermediary in Florida, and were not probative of whether Plaintiff Augustine acted in good faith regarding the decision not to disclose the TriSpan letter; and (3) the statements made by the agent pretending to be an employee of Southern Medical were scripted and, therefore, by definition, they were irrelevant. Minn. R. Evid. 401; Bernhardt v. State, 684 N.W.2d 465, 476 (Minn. 2004).

A. 425-6. Appellants have not addressed the Court's Order. They should not be allowed to do so in their Reply Brief. See McLaughlin v. Heikkila, 697 N.W.2d 231, 233, note 1 (Minn. Ct. App. 2005) ("issues not raised or argued in an appellant's principal brief may not be revived in a reply brief").

Finally, the Court also excluded the recording because Appellant (a) could not prove it was lawfully recorded, (b) could not lay proper foundation, and (c) the recording consisted of hearsay:

Additionally, the Court excluded testimony regarding the August 16, 2000 . . . conversations because Defendants Arizant could neither prove that the conversations were lawfully recorded as required by Minnesota law, nor lay a proper foundation for the recordings. Minn. Stat. § 626A.04, Furley Sales & Assoc., Inc. v. N. Am. Auto Warehouse, Inc., 325 N.W.2d 20, 28 (Minn. 1982). The August 16, 2000, August 21, 2000 . . . conversations also contained inadmissible hearsay in the form of false statements made by a law enforcement officer who was not available to testify at trial. Bernhardt v. State, 684 N.W.2d 465, 476 (Minn. 2004).

A. 426. Once again, Appellants have not addressed the Court's Order. They should not be allowed to do so in their Reply Brief. McLaughlin v. Heikkila, 697 NW2d 231, 233,

note 1 (Minn. Ct. App. 2005). Appellants have failed to establish that the trial court clearly abused its discretion in making its evidentiary ruling

C. Testimony from the June 29, 2004 Change of Plea Hearing.

As set forth above, Appellants attempted to introduce evidence of Hensley's plea by asking Respondent if he was aware of what the prosecutor asked Hensley during the plea hearing on June 29, 2004 – four years after the events in question:

Q: And you remember that at that particular [June 29, 2004] hearing Tim Hensley also entered his plea as to the crime he committed?

A: I believe I was.

Q: And sir, on that date Tim Hensley was asked if on or about August -

Duke: Objection, your Honor, hearsay.

Court: Sustained.

T. 949, 1-12 (RA 156). As set forth above, it was not appropriate for Appellants to introduce through Respondent what the prosecutor asked Hensley at Hensley's plea hearing. Such evidence was irrelevant and hearsay. The trial court did not clearly abuse its discretion in making its ruling.

D. The Transcript of the January 21, 2001 Telephone Call Between Respondent, Hensley, and Southern Medical.

Appellants argue that they should have been able to impeach Respondent with the tape/transcript of the January 21, 2000 telephone call between Respondent, Hensley, and Southern Medical. However, Respondent's trial testimony was not inconsistent with the

transcript of the tape. In fact, the transcript supports Respondent's testimony. It reflects that Respondent told Southern Medical about the TriSpan letter:

AUGUSTINE: Um, TRISPAN denied it, as I recall, and I don't know if this was the final or just someplace along the way, but they denied it, saying that it was experimental. Well, clearly, or investigational. Not experimental. And, and investigational in, in the FDA use of the word is very specific, and we weren't that, and, and investigational in the HCFA use of the word in specific, and we weren't that, yet they just called it investigational because it's fairly new...

A. 61.⁹ In any event, the Court held that the transcript was not admissible for the same four reasons the August 16, 2000 transcript was not admissible. A425-6. Appellants have not addressed the Court's ruling. They should not be allowed to do so in their Reply Brief. McLaughlin v. Heikkila, 697 NW2d 231, 233, note 1 (Minn. Ct. App. 2005). The trial court did not abuse its discretion.

III. THE TRIAL COURT GAVE THE "GOOD FAITH" INSTRUCTION THAT APPELLANTS ARGUE SHOULD HAVE BEEN GIVEN.

Appellants have represented to this Court that "[t]he trial court gave no instruction on the legal definition of "good faith." Appellants' Brief p. 36. Appellants argue as follows:

In this case, "good faith" is specifically defined by Minn. Stat. §302A.011, Subd. 13 as "honesty in fact." The definition contained therein should have been the only "yardstick" by which the jury measured Augustine's actions. Failing to instruct the jury as to the meaning of good faith under this statute was reversible error.

⁹ Appellants argue they should have been able to explore the date of the conversation. Appellants' Brief p. 29. However, Appellants never asked the question.

Appellants' Brief pp. 36-37.

However, the record clearly shows that the trial Court provided the following instruction to the jury:

Good faith: Good faith means honesty in fact in the conduct of the act or transaction concerned.

T. 1348, 6-8 (RA 190); A. 386. In other words, the trial Court gave the exact instruction Appellants argue should have been given. Therefore, Appellants' argument should be rejected out of hand.

IV. THE TRIAL COURT DID NOT ABUSE ITS DISCRETION IN AWARDING RESPONDENT ATTORNEYS' FEES FOR HIS INDEMNIFICATION CLAIM UNDER MINN. STAT. §302A.467.

A. The Trial Judge has Broad Discretion to Award Attorneys' Fees.

Section 302A.467 of the Minnesota Statutes, entitled "equitable remedies," provides trial court judges with discretion to award attorneys' fees for any violation of Chapter 302A that would be just and reasonable under the circumstances. Section 302A.467 provides:

If a corporation or an officer or director of the corporation violates a provision of this chapter, a court in this state may, in an action brought by a shareholder of the corporation, grant any equitable relief it deems just and reasonable in the circumstances and award expenses, including attorneys' fees and disbursements, to the shareholder.

The General Comment to section 302A.467 emphasizes the trial Court's "complete discretion" to award fees:

This section recognizes that situations in which equitable relief may be appropriate are not readily definable in advance, as they often present novel fact situations, and it therefore adopts a broad rule

which gives the court complete discretion in ordering whatever relief it deems just and reasonable in the circumstances.

Id., Reporter's Notes – 1981, Gen. Cmt. See also Powell v. Anderson, No. C5-99-1755, 2003 WL 22705878 at *12 (Minn. Ct. App. Nov. 18, 2003) (inviting district court to exercise its discretion in awarding attorneys' fees and costs under §302A.467).¹⁰

An award of attorneys' fees under §302A.467 may be reversed only upon a showing that the trial court judge abused his or her discretion. Bolander v. Bolander, 703 N.W.2d 529, 548 (Minn. Ct. App. 2005); see Foy v. Klapmeier, 992 F.2d 774, 780 (8th Cir. (Minn.) 1993) (upholding award of attorneys' fees under §302A.467 and noting that equitable relief under the statute is reviewed under an abuse-of-discretion standard); Advanced Communication Design, Inc. v. Follet, 601 N.W.2d 707, 711 (Minn. Ct. App. 2000), (upholding award of attorneys' fees under §302A.467); aff'd in part, rev'd in part 615 N.W.2d 285 (Minn. 2000).

The jury determined that Respondent was entitled to mandatory indemnification under §302A.521. Appellants, therefore, violated Respondent's right to indemnification. As a result, it was within the trial Court's discretion to award Respondent attorneys' fees under §302A.467.

B. Section 302A.467 Requires Only that the Claim be Brought by a Shareholder for Violation of Chapter 302A.

Appellants argue that Section 302A.467 applies only to a claim brought by a shareholder in his or her capacity as a shareholder. The courts in Minnesota have not

¹⁰ A copy of this unpublished decision is located at RA 312.

addressed this issue. However, in his dissent in PJ Acquisition Corp. v. Skoglund, 453 N.W.2d 1 (Minn. 1990), Justice Yetka opined that §302A.467 simply requires (a) a violation of Chapter 302A, and (b) a suit by a shareholder:

The ability to bring a claim under this chapter does not depend on the type of injury suffered and whether it is direct or derivative, but, rather, stems from the occurrence of the misconduct by the corporation, officer or director. All that section 302A.467 requires is that a provision of the chapter be violated and the suit be brought by a shareholder.

Id. at 16 (Yetka, J., dissenting). In other words, §302A.467 focuses on the violation of Chapter 302A, not on the nature of the injury.

Justice Yetka's analysis is supported by the plain language of the statute, which grants the trial court broad discretion to award attorneys' fees in any suit for a violation of Chapter 302A brought by a shareholder. Because Respondent was a shareholder, and because the Company violated a provision of Chapter 302A, the trial Court did not abuse its discretion when it awarded Respondent his fees.

V. THE JURY'S VERDICT REGARDING THE VALUE OF THE STOCK SHOULD BE AFFIRMED.

A. Applicable Law.

Under Minnesota law, when parties agree that an appraisal will be conducted, the appraisal is conclusive only if the parties "expressly stipulated" that the appraisal is conclusive, or if the intention to be conclusive is "fairly inferable from the language which they have used." Sanitary Farm Dairies, Inc. v. Gammel, 195 F.2d 106, 113 (8th Cir. 1952) (applying Minnesota law); Nelson v. Charles Betcher Lumber Co., 88 Minn. 517, 521, 93 N.W. 661, 662 (1903) ("the authorities do not seem to sustain the position

that the decision of the person agreed upon to make measurements or calculations is final and conclusive, in the absence of an express stipulation to that effect, or unless an intention to be bound is fairly inferable from the terms of the agreement”).

Moreover, even if the parties agree to be bound by the appraisal, under Minnesota law, a party may challenge the appraisal if (a) it is not conducted by an independent appraiser, (b) if the appraiser does not use proper applicable appraisal process or (c) the appraisal was fraudulent or contains gross errors. Sanitary Farm Dairies, 195 F.2d at 114-115.

B. The Appellants Moved for Summary Judgment, and the Court Held that the Provision is Ambiguous.

Appellants moved for summary judgment on the ground that the Separation Agreement provides that the appraisal is conclusive. As support for its argument, Appellants cited PVI, Inc. v. Ratiopharm, 253 F.3d 320 (8th Cir. 2001).¹¹ In PVI (which interpreted the law of Delaware, not Minnesota), the parties selected an appraiser to determine which of the parties’ proposed purchase prices best approximated the fair market value of the stock. Applying Delaware law, the Court held the parties were bound by the appraiser’s selection because the agreement stated that the expert’s determination “shall be final, binding and conclusive.” Id. at 324.

Unlike the agreement in PVI, Respondent’s Separation Agreement does not provide that the appraisal obtained by the Company is final, binding, or conclusive. The

¹¹ Appellants have cited PVI in their appellate Brief. Appellants’ Brief p. 38.

Separation Agreement does not use any language that implies that the appraisal obtained by the Company is final, binding, or conclusive.

The trial court denied Appellants' Motion for Summary Judgment. It held that whether the parties agreed that the Company's appraisal would be conclusive was a genuine issue of material fact for the jury:

Genuine issues of material fact exist as to whether the Separation and Release Agreement signed between Plaintiff Augustine and Defendants Augustine and Arizant regarding Plaintiff Augustine's "Phantom Stock" valuation expressly stipulated that the appraisal was to be conclusive. Harvet v. Independent School District, 428 N.W. 2d 574 (Minn. App. 1988).

A 320.

After the jury returned its verdict, Appellants moved for judgment as a matter of law and for a new trial. In its Order denying the motion, the Court again ruled that the issue was for the jury:

Defendants Arizant claim the Court committed a reversible error by refusing to construe and apply the alleged unambiguous language of the 2002 Separation Agreement regarding the selection of an appraiser and by submitting a claim to the jury that is not allowed under Minnesota law.

The Court determined on Summary Judgment that the language of the Separation Agreement specific to the selection of an appraiser was ambiguous, thus the construction of the language of the Separation Agreement became a question of fact for the jury. See Court Order dated Dec. 13, 2005 ("Genuine issues of material fact exist as to whether the Separation and Release Agreement ... expressly stipulated that appraisal was to be conclusive."); Hickman v. Safeco, Inc. Co., 695 N.W.2d 365, 369 (Minn. 2005).

A. 426-7. Appellant's did not address the Court's Order in their appellate Brief.

C. At Trial, the Parties Submitted Evidence on Whether they had Agreed that the Appraisal would be Binding.

1. Respondent Testified that he did not Agree to be Bound by the Company's Appraisal.

At trial, Respondent testified that he participated in negotiating the terms of the Separation Agreement. T. 887, 2-4 (RA 140). He testified that he did not agree that the appraisal obtained by the Company would be binding. To the contrary, he testified that the parties were free to challenge the appraisal. T. 923, 24-924, 7 (RA 152-153).

2. The Appellants were not Precluded from Presenting Parol Evidence on whether the Parties Intended to be Bound by the Company's Appraisal.

Appellants argue that they were precluded from presenting parol evidence regarding whether the parties had agreed that the appraisal obtained by the Company would be binding. Appellants' Brief p. 39. Appellants cite several portions of the record in support of their argument. Appellants' Brief p. 15. As set forth below, Appellants were not precluded from submitting such evidence, and the record does not support Appellants' argument.

- Appellants argue that Marie Humbert was not allowed to testify regarding whether the parties had agreed that the Company's appraisal was binding. See Appellants' Brief p. 15 [citing A549 (T. 325)]. Appellants' argument fails for three reasons. First, the cited testimony does not relate to whether the Company's appraisal was binding. Second, Marie Humbert was in the Company's finance department. Ms. Humbert admitted during her testimony that she did not have any knowledge regarding the negotiation or

drafting of the Separation Agreement. T. 332, 19–333, 16 (RA 36-37). Respondent objected to Humbert’s testimony based on foundation. That objection was sustained. Third, Appellants’ counsel rephrased his question and the witness answered the question. T. 325, 19–326, 11 (RA 34-35).

- Appellants argue that they were not allowed to question Respondent regarding whether he had agreed that the appraisal was binding. See Appellants’ Brief p. 15 [citing A698-99 (T. 969, 21–970, 3)]. However, while the transcript reflects an objection based on parol evidence, the record also shows that the objection was withdrawn. T. 971, 14-23 (RA 157). In addition, the question was re-asked and then answered by the witness. T. 972, 16–973, 17 (RA 158-159).
- Appellants argue that Respondent objected to the documents at A434-35 and A436-38 (Tr. Exs. 1024 and 1025A). However, as set forth above, the record reflects that Respondent’s objection to the documents was withdrawn. T. 971, 14–973, 16 (RA 157-159). In addition, the record reflects that Appellants’ counsel questioned the witness about the documents.
- Appellants argue that they were not allowed to introduce the document at A474-86 (Tr. Ex. 1099). However, Appellants attempted to introduce that document regarding an issue completely unrelated to whether the parties had agreed that the Company’s appraisal was binding. Rather, Appellants attempted to introduce the document regarding the nature of Respondent’s

employment with the Company. T. 1056, 9–1058, 4 (RA 166-168). Therefore, the document was properly excluded as parol evidence.¹²

- Appellants argue that they were not allowed to introduce the document at A543-48. However, such document is a draft Shareholder Agreement, which is completely unrelated to the Separation Agreement, and completely unrelated to whether the parties had agreed that the Company’s appraisal was binding. T. 1046, 12–1048, 7 (RA 163-165).

Because Appellants were not precluded from submitting parol evidence regarding whether the parties agreed that the appraisal would be binding, Appellants’ claim of error must be rejected.

D. The Court Properly Instructed the Jury Regarding Respondent’s Breach of Contract Claim.

A party is entitled to jury instructions based upon its theory of the case. Weiby v. Wente, 264 N.W.2d 624, 628 (Minn. 1978). In addition, “general charges are preferred to more specific instructions” and “requested instructions should be refused if they are argumentative, or tend, by repetitiveness, to unduly emphasize one side of the issue.” Id. Where proposed jury instructions require major changes to cure their argumentative nature, such changes are best left to counsel submitting the instructions. Wank v. Richman and Garrett, 165 Cal. App. 3d 1103, 1114 (Cal. Dist. Ct. App. 1985). “It would not serve the impartial role of the trial judge to [make] such major changes, particularly where the [standard jury instructions] adequately, if not ideally state[] the principles of

¹² Appellants have not asserted error regarding exclusion of evidence of the nature of Respondent’s employment.

law applicable to the key factual issue presented.” Id. (internal quotation omitted). Finally, jury instructions should avoid quoting appellate court decisions. See 6 AmJur Trials 923, §15, Common faults –Quoting opinion language (“Appellate courts have, on a number of occasions, commented upon the practice of converting sentences in a court opinion into jury instructions, and have held that it is a practice that can lead to serious error.”)

Respondent asserted that Appellants breached the Separation Agreement by failing to obtain an accurate appraisal from an independent appraiser. Therefore, the Court gave a breach of contract instruction based on Civ. Jig. 20.45:

BREACH OF CONTRACT

The Separation Agreement between Dr. Augustine and Arizant dated December 31, 2002 is a contract. A contract is breached when there is a failure to perform a substantial part of the contract. Dr. Augustine’s claim relating to phantom stock payments is based upon the claim that Arizant breached the Separation Agreement.

A. 387-8; T. 1349, 11-18.

1. Appellants Requested a Jury Instruction that was Argumentative and Improper.

Appellants did not want the Court to submit the breach of contract instruction.

Instead, Appellants submitted the following proposed jury instruction:

FRAUDULENT APPRAISALS

If it was fairly inferable from the 2002 Separation Agreement that the parties intended to set the Fair Market Value of one share of Arizant stock through an annual valuation by an independent appraiser, then you must decide whether the appraisal itself was a fraud. If the appraisal was not a fraud, then you must deny Augustine’s request to second-guess the appraisal.

You are instructed that in this context, the appraisal is fraudulent ONLY if you find that any of the following are true:

- a) The appraisal was fraudulent; that is, the appraiser intentionally gives the shares a value that he knew was wrong and untrue.
- b) The appraisal is so obviously wrong that it implies that the appraiser acted with bad faith or dishonesty.
- c) The appraiser did not exercise honest judgment.
- d) The appraisal contains errors so gross as to evidence or establish fraud or corruption or partiality or malfeasance or misfeasance on the part of the appraisers.

Augustine has the burden to prove by a preponderance of the evidence that the appraisal was a fraud. In deciding this issue, you are not to consider whether you believe Harris Nesbitt's valuation was accurate or not or whether reasonable appraisers could disagree on the value. That is, you are not to "second guess" the adequacy or inadequacy of Harris Nesbitt's valuation. You need only determine whether the appraisal was a fraud according to the law I have given you above.

A. 361. Respondent objected to Appellants' proposed "Fraudulent Appraisals" instruction on the grounds it was argumentative, repetitive, and inaccurately summarized the decision of the Eighth Circuit in the Sanitary Farms case. The Court sustained the objection and declined to give the proposed instruction. Appellants did not propose an alternative instruction.

2. The Court Explained its Decision Regarding the Jury Instruction in its Order Denying Defendants' Motion for Judgment as a Matter of Law and for New Trial.

After the jury returned its verdict, Appellants moved for judgment as a matter of law and for new trial. Appellants asserted that the Court should have given the

“Fraudulent Appraisals” instruction they proposed. In its Order denying the motion, the

Court ruled:

Defendants Arizant claim that the Court committed a reversible error by failing to properly instruct the jury with regard to the law applicable to contractual appraisal clauses and by failing to include necessary questions on the special verdict form related to the 2004 appraisal.

Plaintiff Augustine’s phantom stock claim was plead under a breach of contract theory. See Am. Cmpt., dated October 26, 2005. The Court instructed the jury on breach of contract following Minn. CivJig 20.45, which adequately instructed the jury on the phantom stock claim. The Court properly rejected Defendants Arizant’s proposed jury instructions and verdict form questions regarding Plaintiff Augustine’s phantom stock claim as argumentative and as an improper attempt to synthesize appellate court decisions. See Weiby v. Wente, 264 N.W.2d 624 628 (Minn. 1978); Sanitary Farm Dairies, Inc., v. Gammel, 195 F.2d 106 (8th Cir. 1952).

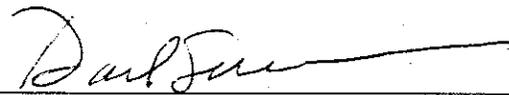
A 427.

Appellants did not even address the Court’s Order in its Brief. Appellants should not be allowed to address the Order for the first time in its Reply Brief. See McLaughlin v. Heikkila, 697 N.W.2d 231, 233, note 1 (Minn. Ct. App. 2005).

CONCLUSION

For the reasons set forth above, Respondent respectfully requests that the Court affirm the judgment entered in the District Court.

Dated: October 27, 2006



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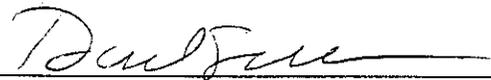
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WORD COUNT COMPLIANCE CERTIFICATE

The undersigned hereby certifies that this Appellant's Reply Brief conforms to the requirements of Minn. R. Civ. App. P. 132.01, subd. 1 and subd. 3(a)(1), for a brief produced with a proportional font. The font used in this brief is Times New Roman 13-point. The length of this brief is 12,934 words, including the cover page, table of Contents and Table of Authority. This brief was prepared using Microsoft Word 2003.

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