STATE OF MINNESOTA
IN COURT OF APPEALS
A07-1149

Gulfstream Medical Arts, Inc., et al.,
Respondents,

vs.

Frank Heller, individually
and
Frank Heller d/b/a Oak Grove Chiropractic Clinic, P. A.,
Appellants.

Filed May 13, 2008
Reversed and remanded
Stoneburner, Judge

Hennepin County District Court
File No. 27CV0613447

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Considered and decided by Lansing, Presiding Judge; Stoneburner, Judge; and Worke, Judge.

U N P U B L I S H E D O P I N I O N

STONEBURNER, Judge

Appellants challenge the district court's order striking their answer and counterclaims and entering default judgment against them on both liability and damages

as a discovery sanction in respondents' action for conversion, fraud, embezzlement, unjust enrichment, and breach of a partnership/joint venture agreement. Because the district court did not consider whether and to what extent respondents were prejudiced by the discovery violation, and whether less restrictive sanctions would have prevented prejudice, we reverse and remand.

FACTS

In October 2005, appellant Frank Heller, a chiropractor who was operating appellant Oak Grove Chiropractic Clinic, P.A. (the clinic) entered into an oral agreement with respondent Alex Prasievi, a Florida resident. The agreement apparently provided that respondent Gulfstream Medical Arts Inc. and Prasievi would fully manage the "operation side" of the clinic business, bring in new professionals, and loan money to the business to pay salaries during the initial months of startup. Prasievi characterizes the agreement as a joint venture or partnership agreement. Heller and Prasievi opened a business account at Wells Fargo Bank for the purpose of paying salaries, rent, and utilities. The account listed Heller as "owner" and Prasievi as an "authorized person."

The parties' relationship deteriorated, and in February 2006, Heller obtained a restraining order against Prasievi, alleging that Prasievi had threatened to physically harm him. In April 2006, respondents Prasievi, Gulfstream, and Oleg Vinetsky (identified as a Gulfstream shareholder) sued Heller and the clinic, alleging, among other claims, conversion, fraud, embezzlement, unjust enrichment, and breach of contract. Heller answered and counterclaimed for fraud, defamation, and assault.

Respondents sought a temporary restraining order (TRO) prohibiting Heller and the clinic from dissipating assets, requiring a complete accounting of all funds, prohibiting Heller from spending partnership funds without posting a bond, and prohibiting the sale, transfer, or encumbrance of assets. The district court denied the TRO. After a telephone conference, the district court issued a scheduling order and set trial for the spring of 2007.

In August 2006, respondents served Heller with an extensive request for production, seeking patient billing records and other banking and financial records generated after the parties' business relationship deteriorated in January 2006. Respondents asked for copies of all client accounts, all checks issued or received by the clinic and Heller, all bills to insurance providers, all payments received by the clinic and Heller from insurance providers, all documents relating to services performed at the clinic, and tax returns for 2004 and 2005. In October 2006, the parties stipulated to entry of a protective order regarding the requested documents, but it was not approved by the district court until January 2007.

In December 2006, respondents moved for an order to compel discovery. Heller opposed the motion, asserting that the discovery request was overbroad and onerous. Heller stated that he had been attempting to compile the requested information but that numerous documents in storage were damaged due to a pipe leak at his former office building. Heller stated that he had produced copies of patient billing records for the past two years and was in the process of producing bank records.

At the hearing on the motion to compel, respondents stated that they had received documents from one of three bank accounts "for the year 2006, from January to the present; and also roughly three inches worth of documents" all relating to "what was billed on behalf of a particular patient and what was collected for the year 2006." Heller's attorney explained that the bank records came directly from the bank and that the patient-account statements were retrieved from Heller's computer. Respondents raised their earlier proposal that in order to satisfy some of the document requests, Heller produce a copy of the hard drive of his computer. But Heller declined to produce such a copy.

The district court granted respondents' motion to compel, noting that the court had previously, in an unreported telephone conference call, ordered Heller to produce the documents. The district court discredited Heller's explanations for having not produced the documents, finding that they "give every appearance of intentionally delaying the litigation." The district court found that Heller had not made a good-faith effort to comply and ordered compliance by January 8, 2007. The district court warned that it "shall consider sanctions, including striking [Heller's] Answer and Counterclaims" if he did not satisfy the order.

By January 8, 2007, Heller had produced only tax returns for 2004 and bank statements from three separate accounts for 2005 and part of 2006. Respondents served Heller with notice of a motion for an order dismissing his answer and counterclaims as a sanction for failing to fully comply with the discovery order, but told him that they would withdraw the motion if he produced the remaining discovery. Heller did not produce

additional discovery, and respondents filed the motion for sanctions. Respondents' memorandum supporting the motion acknowledged that the moving party must show prejudice to justify the harsh sanction of dismissing pleadings. Respondents asserted that their prejudice "centers on an inability to properly proceed to trial in terms of presentation of evidence and witnesses" and an absence of "records . . . which would demonstrate the damages sustained, . . . [and] that [Heller's] Counterclaims are without merit." Respondents also asserted that Heller's lack of compliance forced them to miss several court-imposed scheduling deadlines.

Heller opposed the motion in an affidavit, stating that he had produced all of the documents that he was able to produce, that "[m]ost of the requested documentation simply does not exist," and that respondents had failed to identify what documents they think he can produce but has not. At the motion hearing, Heller explained that the information he had produced included a "superbill" that identifies all of the patient names, all the related financial transactions, what has been billed, and what has been paid. Heller argued that nothing in patient files would add to "the financial perspective of the business." Heller asserted that he had taken complete bank records for all of 2005 and 2006 to his attorney's office, and could further explain the documents he had provided in a deposition. Heller's attorney told the court that Heller was willing to promptly sign authorizations for each of the banks, and willing to allow opposing counsel to come to the office to look at and copy his records.

Based in part on Heller's testimony that his computer software was capable of generating some of the documents respondents requested, the district court granted

respondents' motion. The district court struck Heller's answer and counterclaims and entered default judgment in favor of respondents. The district court concluded that Heller "repeatedly, knowingly, and intentionally failed to comply with" respondents' discovery requests and the district court's orders. The district court found that a default judgment was a "just" sanction, and ordered respondents to "file affidavits verifying the amount of damages incurred and sought," including expenses and attorney fees.

Prasievi filed an affidavit supporting respondents' request for $82,000 in damages plus $15,843 in attorney fees and $1,880 in costs. The district court denied Heller's request to respond to Prasievi's affidavit because Heller was in default. The district court granted the damages requested by respondents, and entered judgment against Heller and the clinic in the amount of $99,928.50. This appeal followed.

D E C I S I O N

Heller and the clinic (Heller) argue that the district court's order striking their answer and counterclaims should be vacated and the matter remanded for a determination on the merits because the district court failed to find that respondents were prejudiced by the discovery violations. In the alternative, Heller seeks vacation of the judgment and remand for an opportunity to contest the amount of damages claimed by respondent, arguing (1) that the district court violated his right to due process by refusing to allow a challenge to damages claimed and (2) that the record does not support the amount of the judgment.

Respondents argue that Heller has waived all of these claims by failing to assert them in the district court. *See Thiele v. Stich*, 425 N.W.2d 580, 582 (Minn. 1988) (stating

that an appellate court will generally not consider matters not argued in the district court). Based on the record, we conclude that Heller sufficiently raised the claims to preclude waiver on appeal. Heller argued to the district court that respondents had not specified what necessary documents were missing, that the information produced contained all of the financial information sought by respondents, and that additional information sought was not relevant to the issues in dispute. Although Heller did not specifically argue due-process violations to the district court, he requested an opportunity to be heard on damages and asserted that the record did not support the damages claimed. *See Thorp Loan & Thrift Co. v. Morse*, 451 N.W.2d 361, 363 (Minn. App. 1990) (recognizing that "there are a limited number of issues which may be raised for the first time on appeal from a default judgment," including "that the relief granted was not justified by the complaint"), *review denied* (Minn. Apr. 13, 1990).

I.

Heller first argues that the district court applied an incorrect standard in determining that striking his pleadings was the appropriate sanction for discovery violations; a standard that does not address prejudice to the moving party. Permissible discovery sanctions include striking pleadings, dismissing actions or parts of an action, and rendering default judgment against a party who disobeys discovery orders. Minn. R. Civ. P. 37.02(b)(3). We review a discovery sanction for abuse of discretion, keeping in mind that a sanction "must be no more severe . . . than is necessary to prevent prejudice to the movant." *Chicago Greatwestern Office Condo. Ass'n v. Brooks*, 427 N.W.2d 728, 731 (Minn. App. 1988) (quotation omitted). Because default judgment infringes on a

party's right to trial by jury and runs counter to the policy of deciding cases on the merits, our review of discovery sanctions involving default judgment requires greater scrutiny than our review of lesser sanctions. *Id.*

Here, the district court, citing *Breza v. Schmitz*, 311 Minn. 236, 237, 248 N.W.2d 921, 922 (1976), stated: "[t]he sanctions of default and dismissal are traditionally reserved for a party who willfully, without justification or excuse, and with the intent to delay trial fails to comply with discovery orders or refuses to cooperate with the court and counsel to resolve the case promptly and expeditiously." The district court found that Heller's conduct was willful and without justification or excuse, therefore warranting the sanction imposed. But the district court did not address whether respondents were prejudiced by Heller's conduct.

Breza was a per curiam decision involving the second dismissal of a plaintiff's personal-injury action arising out of an automobile accident. 311 Minn. at 236, 248 N.W.2d at 922. The district court initially dismissed the lawsuit for failure to prosecute, but because trial had not been scheduled, the supreme court found involuntary dismissal was improper and remanded. *Id.* On remand, Breza was ordered to answer interrogatories and submit to a deposition. *Id.* Breza did not comply, and the supreme court affirmed the district court's dismissal of the case with prejudice as a discovery sanction. *Id.*

The rationale for dismissal articulated in *Breza* was applied by this court in *State by Humphrey v. Ri-Mel, Inc.*, 417 N.W.2d 102, 108-09 (Minn. App. 1987), *review denied* (Minn. Feb.17, 1988), to affirm a default judgment entered against defendants in an

action brought through the attorney general. There, defendants failed to comply with three discovery orders and twice failed to appear in response to orders requiring personal appearance to show cause why they should not be held in contempt of court. 417 N.W.2d at 104-05. "[T]he last straw prompting the default judgment was appellants' decision not to appear before the [district] court as ordered." *Id.* at 109.

Here, the district court made clear to Heller that it found his excuses to be without merit and felt Heller had engaged in deliberate delay. Plainly, Heller's conduct warranted sanctions. Nonetheless, Heller's conduct in this case does not rise to the level of the conduct that justified dismissal without specific consideration of prejudice in *Breza* and *Ri-Mel*. Heller appeared at scheduled hearings, responded to motions, and produced documents and information that he asserted contained the relevant facts sought through respondents' production request. We conclude that, to the extent *Breza* asserts a standard that does not require a specific inquiry into prejudice, its application in this case was an abuse of discretion. The district court should have applied the standard that requires a specific inquiry into prejudice to the moving party, including whether the prejudice asserted could have been remedied with a lesser sanction than entry of default judgment.

This court has previously stated that "[t]he primary factor to be considered in a dismissal . . . is the prejudice to the parties." *Hous. & Redevelopment Auth. of St. Paul v. Kotlar*, 352 N.W.2d 497, 499 (Minn. App. 1984). Likewise, in *Chicago Greatwestern* we stated that, despite a lack of caselaw specifically addressing when a default sanction is appropriate, "several cases indicated that prejudice to the moving party is a prime consideration in determining the severity of the sanction to be imposed." 427 N.W.2d at

730-31. Looking to judicial interpretation of default sanctions under the Federal Rules of Civil Procedure 37(b)(2), we quoted *Wilson v. Volkswagen of America, Inc.*, 561 F.2d 494, 505 (4th Cir. 1977):

> [I]n determining whether to impose [the default] sanction, the needs of the discovery party must be evaluated as well as the nature of the non-compliance and the [district court] must consider how the absence of such evidence not produced would impair the other party's ability to establish their case and whether the non-complying party's conduct in not producing documents would deprive the other party of a fair trial.

Chicago Greatwestern, 427 N.W.2d at 730-31.

In *Chicago Greatwestern*, the district court failed to state its reasons for granting a default sanction, making review on appeal "very difficult." *Id.* at 731-32. In this case, the district court made specific findings and listed the 30-plus items respondents had requested. But the district court did not address how respondents were prejudiced by Heller's failure to produce any of the specified documents and did not address Heller's assertions that some of the documents requested do not exist and that the documents produced are sufficient for respondents to determine damages in this case. The district court also did not address whether Heller's offer to provide bank authorizations and to open his records to inspection, perhaps coupled with an extension of the deadline for dispositive motions, would have eliminated the prejudice that respondents claimed. "The [moving party] must show particular prejudice overcoming the court's reluctance to procedurally dismiss without a decision on the merits before a dismissal will be proper." *Kotlar*, 352 N.W.2d at 499.

Although respondents asserted that they needed the documents to fully understand the clinic's business operations, respondents did not explain their theory of damages or how their discovery requests related to determination of damages. In the end, they appear to have been awarded rescission damages, although they did not plead rescission. We therefore vacate the default judgment and reverse and remand for the district court's reconsideration of the discovery sanction. If, on remand, the district court concludes that default remains the appropriate sanction, it must make findings on the prejudice to respondents that support such a determination.

II.

Because the district court may find, after analyzing the issue of prejudice, that dismissing Heller's claims and granting default judgment remains the appropriate sanction, we will address Heller's arguments concerning damages.

Heller argues that even if default judgment on liability is an appropriate sanction, he was denied due process when the district court failed to allow him to be heard on the issue of damages. We disagree. Heller's argument is primarily that the case relied on by the district court to exclude his participation is "from another era." The case, though old, remains good law and stands for the proposition that "[a] defendant against whom a default judgment is entered is out of court and, in the absence of statute, is not entitled to notice of further proceedings in the case." *Anderson v. Graue*, 183 Minn. 336, 337, 236 N.W. 483, 484 (1931).

Nonetheless, on appeal, Heller is still entitled to challenge the amount of the damages award as unsupported by the record. *Thorp Loan & Thrift*, 451 N.W.2d at 363

(stating that "[i]n a default judgment the relief awarded to the plaintiff must be limited in kind and degree to what is specifically demanded in the complaint even if the proof would justify greater relief"). The party seeking default damages must prove damages by a fair preponderance of the evidence. *Hill v. Tischer*, 385 N.W.2d 329, 332 (Minn. App. 1986).

The district court based the damage award on Prasievi's affidavit, which states that he "*agreed* to loan [Heller] $75,000 during the first three months of operation[,] . . . *agreed* to pay rent of $1,296.00 per month, plus utilities of approximately $600 per month . . . [, and] *contributed* new equipment into [the clinic] such as a hydro bed, new computers, new printers, a traction bed, heat outputs, and new forms and documents." (Emphasis added.) Prasievi refers to "certain checks" attached as an exhibit to the complaint, but the checks do not add up to $75,000. Additionally, not all of the attached checks were paid out by Prasievi, Vinetsky, or Gulfstream, and not all were payable to Heller or the clinic. Respondents did not provide any evidence identifying these payors and payees or explaining how these checks relate to their damages claim.

Prasievi's affidavit further contends, without documentation, that respondents invested $82,000 into the joint venture, and that as of the date of the affidavit, "none of the $82,000 that [respondents] personally invested into the joint venture has been repaid by [Heller]." At oral argument on appeal, respondents' counsel suggested that a portion of the claimed $82,000 investment came from clinic profits that should have been distributed to respondents, rather than from actual cash advances, but nothing in the

record identifies how respondents arrived at the amount of $82,000 or the source or disposition of such an amount.

Prasievi's affidavit and the referenced checks do not support the district court's award of damages. Even if we had sustained the default sanction, we would have reversed the judgment entered. If the sanction of default is reimposed on remand, the damages awarded must be supported by evidence in the record.

Reversed and remanded.