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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA

In re:

CLINICA REAL, LLC,

and

KEITH MICHAEL STONE,

Debtors.

Chapter 11 proceedings

Case No. 2:12-bk-20451-EPB

Jointly Administered With:

Case No. 2:12-bk-20452-EPB

**RESPONSE TO DEBTORS' MOTION
FOR SUMMARY JUDGMENT ON THE
AMOUNT OF STATE FARMS' CLAIMS
(Res Judicata)**

Hearing Date: May 21, 2015

Hearing Time: 10:00 a.m.

Hearing Place: Courtroom 703

This filing applies to:

All Debtors

Specified Debtor

State Farm Mutual Automobile Insurance Company and State Farm Fire & Casualty Company (collectively "SFIC"), creditors and parties in interest in the jointly administered Chapter 11 cases (the "Cases") of Clinica Real, LLC ("Clinica Real") and Keith Michael Stone (with Clinica Real, the "Debtors"), hereby file their Response to "Debtors' Motion for Summary Judgment on the Amount of State Farms' Claim (Res Judicata)" (the "Motion") [Docket No. 432].¹

¹ The Debtors titled their pleading "Motion for Summary Judgment"; however, the Motion is part of a claim estimation process pursuant to 11 U.S.C. § 502(c). Consequently, as the Court reiterated during the pretrial hearing on March 31, 2015 [Adv. Pro. 2-14-00297, Docket No. 15], the Motion will not result in a binding judgment for purposes other than estimating the value of SFIC's claim for plan voting purposes. Accordingly, Sections A through C in the Debtors' Discussion Section (Motion, pp. 7-9) are not properly before the Court.

1 In the Motion, the Debtors argue that *res judicata* bars “relitigation” of the underlying
2 non-core claims giving rise to the timely filed SFIC proofs of claim (collectively, the “SFIC
3 Claim”) [Case No. 12-20451, Claim No. 4; Case No. 12-20452, Claim No. 5]. The Debtors
4 argue that the judgment entered by the State Court (the “Judgment”) ruling that SFIC, the
5 Debtors, and non-debtor Patricia Rascon (“Rascon”) entered into a valid and binding settlement
6 agreement (the “Settlement”) extinguishes the SFIC Claim because this Court, while
7 recognizing the Judgment, did not approve the Settlement pursuant to Fed. R. Bankr. P. 9019.

8 None of the non-core claims have been litigated to final judgment; therefore, the
9 Debtors’ *res judicata* argument is wholly without merit. In addition, the Debtors entered into
10 the Settlement, and the Debtors requested the State Court to enter the Judgment so that they
11 could appeal it. That appeal is ongoing. Their argument that the Judgment extinguishes the
12 SFIC Claim must fail. SFIC respectfully requests that the Court deny the Motion in its entirety.
13 SFIC’s response is supported by the record in these Cases, the following Memorandum of
14 Points and Authorities, and the “Declaration of William L. Moran in Support of Response to
15 Debtors’ Motion for Summary Judgment on the Amount of State Farms’ Claims (Res Judicata)”
16 (“Moran Dec.”), filed contemporaneously herewith.

17 **MEMORANDUM OF POINTS AND AUTHORITIES**

18 **I. STATEMENT OF FACTS**

19 1. On September 13, 2012 (the “Petition Date”), the Debtors commenced the Cases
20 by filing their voluntary petitions for relief under Chapter 11 of Title 11 the United States
21 Bankruptcy Code (the “Code”).²

22 2. The Debtors are debtors-in-possession pursuant to Code §§ 1107(a) and 1108,
23 and the Cases are being jointly administered pursuant to that Stipulated Order entered by the
24 Court on October 18, 2012 [Docket No. 36].

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28 ² Unless otherwise indicated, all chapter and section references are to the Code, 11 U.S.C.
§§ 101-1532. “Rule” references are to the Federal Rules of Bankruptcy Procedure.

1 **The State Court Litigation**

2 3. The Debtors filed the Cases to prevent the state court case styled *State Farm*
3 *Mutual Automobile Ins. Co. and State Farm Fire & Casualty Co. v. Keith Michael Stone;*
4 *American Bank Institute, Inc. dba Clinica Real; Clinica Real, LLC, Victoria Patricia Rascon,*
5 Case No. CV 2007-003838 (the “State Court Litigation”) from proceeding to a jury trial before
6 the Maricopa County Superior Court in the State of Arizona (Hon. Katherine Cooper) (the
7 “State Court”).

8 4. As set forth in the Joint Pretrial Statement [Docket No. 403], the State Court
9 Litigation alleges claims against the Debtors and Rascon³ for common law fraud, statutory
10 fraud, and Arizona RICO claims in connection with Clinica Real's fraudulent billing practices
11 (the “Non-Core Claims”).

12 5. After notice and a hearing, this Court (Hon. Redfield T. Baum) entered a stay relief
13 order (the “Stay Relief Order”) [Docket Nos. 70 and 82] allowing the State Court Litigation to
14 proceed to jury trial on the Non-Core Claims. In the Stay Relief Order, the Court noted that for
15 various reasons, including the applicability of Stern v. Marshall, 564 U.S. 2, 131 S.Ct. 2594,
16 2611, 180 L.Ed.2d 475 (2011), the stay would be lifted after sufficient time to allow the Debtors
17 to build their “war chest” to litigate the State Court Litigation.

18 6. After Stay Relief Order was entered, SFIC filed the SFIC Claim.⁴

19 7. Subsequently, after Court-ordered mediation, the Debtors, Rascon, and SFIC
20 entered into the Settlement, which globally resolved *all* disputes between the parties. However,
21 the Debtors later balked and backpedaled and refused to sign the Settlement.

22 8. On December 23, 2013, the State Court entered a nine-page Under Advisement
23 Ruling (“UAR”) finding (after a three-day evidentiary hearing) that a valid and binding
24 settlement exists between and among SFIC and the Debtors and Rascon. A true and correct
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³ SFIC continues to reserve its rights against Rascon.

28 ⁴ By doing so, SFIC did not expressly or impliedly consent to the jurisdiction of this Court
for purposes of adjudication of the SFIC Claim.

1 copy of the UAR is attached to the Moran Dec. as **Exhibit A**.⁵

2 9. On January 16, 2014, the Debtors filed a Petition for Special Action with the
3 Arizona Court of Appeals, to which SFIC responded. Contemporaneously with the Petition for
4 Special Action, the Debtors filed "Defendants' Motion for Stay Pending Outcome of Special
5 Action" ("Motion for Stay") in the State Court. A true and correct copy of the Motion to Stay is
6 attached to the Moran Dec. as **Exhibit B**.

7 10. In the Motion for Stay, Debtors and non-debtor Rascon specifically set forth the
8 relief sought in the Petition for Special Action:

9 Based on the forgoing this Court should accept Special Action jurisdiction and reverse
10 the finding of the Respondent Judge that there was a binding settlement agreement, and
11 remand this case to the trial court for a trial. Alternatively, this Court should accept
12 Special Action jurisdiction and reverse the ruling of the Respondent Judge which
13 requires Petitioners to affix their signatures to the July 12, 2013 State Farm iteration of
14 the settlement documents, and instead order that the July 12, 2013 State Farm iteration
15 of the settlement documents is deemed signed by the Petitioners as of a date certain, and
16 enter judgment accordingly (as was done by the trial court in *Castle*). By doing this,
17 there will be a final judgment of the Respondent Judge which may be appealed, through
18 the normal course, by Petitioners. As it stands now, Petitioners have no plain, speedy or
19 adequate remedy by appeal, save and except relief by this Special Action.

20 *Id.* at p. 3 (emphasis added).

21 11. On January 23, 2014, the State Court considered the Motion to Stay and agreed
22 with the Debtors' Special Counsel (Mr. Mahaffy) that the UAR needed to be reduced to
23 judgment to allow for an appeal to proceed and ordered SFIC to lodge a form of judgment and
24 allowed the Debtors and Rascon adequate time to object to the form of judgment lodged. A true
25 and correct copy of the Status Conference Minute Entry dated January 23, 2014 is attached to
26 the Moran Dec. as **Exhibit C**.

27 12. On January 28, 2014, SFIC filed a proposed form of judgment that, when
28 entered, would trigger the Debtors' and Rascon's appeal rights, to which the Debtors and
Rascon objected.

⁵ Pursuant to FRE 201, SFIC respectfully requests the Court to take judicial notice of the State Court's UAR, and all other Minute Entry Rulings and Orders referred to herein.

1 13. On January 30, 2014, the Arizona Court of Appeals denied the Petition for
2 Special Action.

3 14. On March 10, 2014, the State Court entered a Minute Entry Ruling dated March
4 6, 2014 addressing the Debtors' objection to SFIC's proposed form of judgment, among other
5 things. A true and correct copy of the March 6, 2014 Minute Entry Ruling is attached to the
6 Moran Dec. as **Exhibit D**. In short, the State Court did not appreciate the Debtors' objections to
7 the proposed form of judgment, specifically because the Debtors had requested entry of a
8 judgment so they could appeal.

9 15. On March 10, 2014, the State Court also declined to enter SFIC's proposed form
10 of judgment and entered the Judgment, under seal. A true and correct copy of the Judgment is
11 attached to the Moran Dec. as **Exhibit E**.

12 16. After the Judgment was entered, the Debtors and Rascon appealed to the Arizona
13 Court of Appeals, seeking among other things a determination that the State Court was wrong in
14 finding the Settlement to be valid and binding. The fully briefed appeal is still pending before
15 the Court of Appeals.

16 17. At the Debtors' urging, this Court denied approval of the Settlement pursuant to
17 Rule 9019 ("9019 Order") [Docket No. 261] and SFIC motion for reconsideration of the 9019
18 Order [Docket No. 300].

19 18. SFIC then moved the United States District Court for the District of Arizona for
20 leave to appeal the 9019 Order because the 9019 Order is interlocutory.

21 19. On February 10, 2015, the District Court denied SFIC's motion for leave to
22 appeal [Docket No. 405, Ex. 1]. The District Court's denial is not appealable.

23 20. The State Court continues to hold the State Court Litigation on its dismissal
24 calendar pending bankruptcy court and appellate proceedings. A true and correct copy of the
25 State Court's Minute Entry Order dated February 23, 2015 is attached to the Moran Dec. as
26 **Exhibit F**.

27 21. The 9019 Order is not yet a final order.

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1 **II. LEGAL ARGUMENT**

2 **A. Res Judicata Does Not Apply To Extinguish The SFIC Claim.**

3 “Res judicata applies when [an] earlier suit: (1) reached a final judgment on the merits;
4 (2) involved the same cause of action or claim; and (3) involved identical parties or privies.”
5 *Leon v. IDX Sys. Corp.*, 464 F.3d 951, 962 (9th Cir. 2006). Here, the three required elements are
6 not met; therefore, *res judicata* does not apply.

7 First, in the Judgment, the State Court ruled that SFIC, the Debtors, and Rascon entered
8 into the Settlement that set forth monetary and non-monetary terms resolving numerous disputes
9 between the parties. However, the Judgment does *not* contain findings on the merits of the
10 Non-Core Claims at the heart of the SFIC Claim or decide liability on the Non-Core Claims.
11 No court has considered or adjudicated the Non-Core Claims.⁶

12 At the time of agreement, the parties deemed it more advantageous and less costly to
13 settle the numerous disputes between them, including the State Court Litigation. Later, after
14 entry of the Judgment (at their request), the Debtors and Rascon appealed the Judgment and,
15 among other things, asked the Arizona Court of Appeals to overturn the Judgment. If the
16 Judgment is overturned, the merits of Non-Core Claims will be adjudicated by a jury in the
17 State Court. If the Judgment is upheld, then the merits of the Non-Core Claims must be
18 adjudicated by a court of competent jurisdiction. However, final judgment has *not* been entered
19 on the merits of the Non-Core Claims. Therefore, *res judicata* cannot apply.

20 Second, while the State Court Litigation involves the same Non-Core Claims at the heart
21 of the SFIC Claim, as noted above, the Judgment entered by the State Court found solely that
22 the Debtors and Rascon entered into the Settlement with SFIC, and that the Settlement was
23 valid and binding. The Non-Core Claims were not at issue, except to the extent that the parties
24 agreed to settle them rather than litigate them. The State Court heard evidence only in
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27 ⁶ The Settlement required the Debtors to sign a Stipulation for Entry of Judgment
28 admitting the truth of the Non-Core Claims; however, the 9019 Order precludes any entry of the
Stipulation for Entry of Judgment against the Debtors. As always, SFIC reserves its rights
against Rascon.

1 connection with the agreement between the parties and whether the Debtors' special counsel
2 (who also represents Rascon) had authority as their agent to bind them to the Settlement. It was
3 this evidence that led to the entry of the Judgment against the Debtors and Rascon that a valid
4 and binding Settlement exists. Further, the State Court continues to hold the State Court
5 Litigation on its dismissal calendar, pending further proceedings before this Court and the
6 Arizona Court of Appeals. Consequently, the second required element of *res judicata* is not
7 met.

8 Third, the Judgment found that there was a Settlement by and between SFIC, the
9 Debtors, and Rascon. The SFIC Claim was filed in the Debtors' Cases and does not have any
10 bearing on Rascon, who is not a debtor. Therefore, the third requirement for application of *res*
11 *judicata* is not met. Accordingly, the Court should deny the Debtors' Motion as a matter of law.

12 **B. The Debtors' Rooker-Feldman Argument Cannot Prevail.**

13 The Debtors argue, pursuant to the *Rooker-Feldman* doctrine, that this Court should give
14 the Judgment full faith and credit and *res judicata* effect. As set forth above, their *res judicata*
15 argument fails. However, the Debtors' current position should be excluded under principles of
16 judicial estoppel given that they argued the exact opposite position in connection with the
17 proceedings that resulted in the 9019 Order. Nonetheless, SFIC notes that the Court already
18 ruled in the 9019 Order that a) it did give the Judgment full faith and credit, but b)
19 notwithstanding the Judgment, the Settlement was not in the best interest of the Debtors'
20 creditors and could not be approved pursuant to Rule 9019. SFIC disagrees with the 9019
21 Order (believing the Settlement *is* in the best interest of creditors), but the 9019 Order cannot be
22 appealed at this time.

23 The 9019 Order did not dispose of the Judgment; it rendered the terms of the Settlement
24 ineffective against Debtors notwithstanding the Judgment. The Judgment did not extinguish the
25 Non-Core Claims at the heart of the SFIC Claim, which have never been adjudicated. The
26 Debtors' own litigation tactics have prevented that from occurring. The Debtors' strategy to use
27 the Judgment they are appealing as both a sword and a shield to extinguish the SFIC Claim
28 should not yield relief from this Court.

1 **III. CONCLUSION**

2 Based on the foregoing reasons, SFIC respectfully requests the Court deny the Motion in
3 its entirety, and for such other relief as is just and appropriate under the circumstances.

4 DATED: April 13, 2015.

5 **ALLEN, MAGUIRE & BARNES, PLC**

6 /s/ Hilary L. Barnes #019669

7 Hilary L. Barnes

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15 **E-FILED** on April 13, 2015 with the
16 U.S. Bankruptcy Court and copies served
17 via ECF notice on all parties that have
18 appeared in the case.

19 **COPY** mailed the same date via U.S. Mail to:

20 GE Capital Retail Bank
21 c/o Recovery Management Systems Corp.
22 25 SE 2nd Avenue, Suite 1120
23 Miami, FL 33131-1605
24 Attn: Ramesh Singh

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/s/ Misty Vasquez