Case No. 10-51125

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

ROY E. ERWIN; RUTH ILENE ERWIN ROBERTS; TED BOOHER; ELIZABETH ANN MCKINNEY, as attorney-in-fact for MARY M. LUNSFORD; TODD REYNOLDS; CLIFTON MUZYKA; CAROL FITZPATRICK; PHILLIP KRUMNOW, JR., as representative of the Estate of Phillip Krumnow, Sr., Krumnow Family Trust, and Phil Krumnow, Inc. Employee Pension Trust; RAYMOND F. MARTINE; TIMOTHY R. STONE; LUCINDA R. WARNSTAFF; BRIAN MOORE; MADELINE MOORE; CINDY NICHOLS, individually and as next friend of J.H.; CASSANDRA BUTLER; ALAN EPPERS; CHERYL MAXWELL; WAYNE MAXWELL; JIMMY CZAJKOWSKI; ESTELLA SCOTT; NANCY ERICKSON; and JANNA GOSSEN,

Plaintiffs - Appellants,

vs.

BRYAN F. RUSS, JR.; JAMES H. MCCULLOUGH; NESTOR LEAMON; PALMOS, RUSS, MCCULLOUGH & RUSS, L.L.P.; L K & P, L.L.C; OAKS & DIAMONDS, L.L.C.; VELNON, L.L.C.; DEMINIMUS MANAGEMENT, L.L.C.; FLARE ROYALTIES GENERAL PARTNER; FLARE ROYALTIES, L.P.; LEOR ENERGY, L.P.; ENCANA OIL & GAS (USA), INC.; HEARNE BUSINESS PARK, L.L.C.; RODRICK JACKSON; SHIRLEY BIELAMOWICZ; BLUE WATER SYSTEMS, L.P.; KAREN BOX; STEPHEN BOYKIN; MARC CATALINA; JOE DAVIS; FIRST STAR BANK OF BREMOND; GUARANTY TITLE OF ROBERTSON COUNTY, INC.; DONA E. HARRIS; MACRU, LLC; BETTIE MENDENHALL; DICK MILSTEAD; MARK MILSTEAD; TIM MOORE; TRACEY MOORE; CATHERINE MOTLEY; MICHAEL MUZYKA; JERRY WAYNE NICHOLS; BRYAN F. RUSS, III; KENNETH SWICK; MICHAEL WERLINGER; HEATHER WHEELER; NORA CORA WITHEM; GERALD YEZAK; AMY ZACHMEYER; JERRY BAXTER; MOLLY HEDRICK; and HOLLIE ELLIOTT,

Defendants – Appellees,

Appeal from the United States District Court for the Western District of Texas
Honorable Walter S. Smith, United States District Judge
Case No. W:09-CA-127 *consolidated with* Case No. W:10-CA-005

BRIEF OF PLAINTIFFS / APPELLANTS

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UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

ROY E. ERWIN, et al.

Plaintiffs / Appellants,

vs.

BRYAN F. RUSS, et al.

Defendants / Appellees.

CERTIFICATE OF INTERESTED PARTIES

The undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of this court may evaluate possible disqualification or recusal.

(1) The Plaintiffs / Appellants

(2) The Defendants / Appellees

(3) Ty Clevenger

(4) Frederick D. Bostwick, III
James David Dickson
Mark Christopher Hobbs
Melissa Waden Wray
Beard, Kultgen, Brophy, Bostwick, Dickson, & Squires, LLP

(5) Clyde Vance Dunnam

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(17) Christopher A. Beck
Baker Beck, PC

(18) Derrel J. Luce

/s/ Ty Clevenger
Ty Clevenger
ATTORNEY FOR PLAINTIFFS / APPELLANTS

RULE 35(b)(1) STATEMENT

The panel decision conflicts with *Marlin v. Moody Nat'l Bank, N.A.*, 553 F.3d 374 (2008), which held that Fed.R.Civ.P. 11 sanctions require notice and an opportunity to respond, as well as *Procter & Gamble v. Amway Corp.*, 280 F.3d 519 (5th Cir. 2002), which held that 28 U.S.C §1927 cannot serve as a basis for sanctions against parties. This case is one of exceptional importance because it contradicts the near-universal holding in other courts that all sanctions, including those under 42 U.S.C. §1988, require notice and an opportunity to respond. *See, e.g., Braley v. Campbell*, 832 F.2d 1504 (10th Cir. 1987)(*en banc*). This case is further of exceptional importance because it affirms a district court opinion that dismissed all claims of all plaintiffs because it deemed *some* claims frivolous.

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JURISDICTIONAL STATEMENT

The Plaintiffs brought claims against the Defendants under 42 U.S.C. § 1983 and 18 U.S.C. § 1964, *see* First Amended Complaint ("FAC") 11-14, Record Excerpt Tab 4 (hereinafter "Tab 4," and so forth), therefore the district court had subject-matter jurisdiction under 28 U.S.C. §§ 1331 and 1343. This appeal is brought from the U.S. District Court for the Western District of Texas, therefore jurisdiction and venue are properly before the U.S. Court of Appeals for the Fifth Circuit.

TABLE OF AUTHORITIES

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STATEMENT OF THE CASE

The Plaintiffs sued the various Defendants for fraud, breaches of fiduciary duty, racketeering, civil rights violation, civil conspiracy, statutory theft, and conversion. *See* First Amended Complaint ("FAC") at ¶¶197-217, Record Excerpts Tab 4. A majority of the Defendants answered, and discovery proceeded. Based on those pleadings, and as set forth below, Defendant Mark Milstead immediately entered into settlement negotiations. The district court, however, suddenly and arbitrarily started dismissing all claims. In a series of opinions that flatly contradicted the pleadings and were rife with errors, the district court dismissed the entire lawsuit on the pleadings. Acting *sua sponte*, and without any notice to the Plaintiffs or any opportunity to respond, the district court then sanctioned all the Plaintiffs and their attorney $25,000.

Naturally, the settlement negotiations with Defendant Milstead came to a crashing halt. Plaintiffs Erickson and Gossen then sued him in state court on overlapping claims, and he quickly settled, but the claims against his co-defendants were all dismissed in the federal court. In a *per curiam* opinion, a panel of this Court appears to have applied a deferential standard of review to all of the district court's legal conclusions.

STATEMENT OF FACTS

In a 47-page complaint, the Plaintiffs alleged that Defendant Bryan F. Russ and James McCullough, two law partners in Hearne, Texas, and Judge Robert M. Stem, the state district judge in Robertson County, Texas, ran a white-collar criminal enterprise that affected just about anything that could pass through a small-town law office. *See* FAC.[1] The FAC generally alleges that Defendants Russ and McCullough used their law firm and various shell companies to carry out fraudulent business and real estate transactions. Defendant Palmos, Russ, McCullough & Russ, LLP ("The Firm"), L K & P, LLC, Oaks & Diamonds, LLC, Velnon, LLC, Deminimus Management, LLC, Flare Royalties, LLC, Flare Royalties, LP, and MACRU, LLC are business entities owned or controlled by Russ and McCullough. FAC at ¶¶29-35 and 72. They, together with Defendants Trey Russ, *id*. at ¶26, and Molly Hedrick, *id*. at 41, are referred to collectively as the Russ and McCullough Defendants. The Russ and McCullough Defendants periodically joined forces with other Defendants to steal surface and mineral estates, steal livestock, and corruptly influence almost any kind of court proceeding before Judge Stem. FAC at ¶¶78, 80, and 191-192.

[1] Since this case was decided on the pleadings, the Plaintiffs will incorporate the FAC by reference rather than restate it all here.

ARGUMENT AND AUTHORITIES

Standard of Review

Motions to dismiss and motions for judgment on the pleadings are reviewed *de novo*. *See Association of American Physicians & Surgeons, Inc. v. Texas Association of American Physicians & Surgeons, Inc. v. Texas Medical Bd.*, 627 F.3d 547 (5th Cir. 2010). A grant of summary judgment is reviewed *de novo*, *Bolton v. City of Dallas*, 472 F.3d 261, 263 (5th Cir.2006), while sanctions generally are reviewed for an abuse of discretion. *Fleming & Associates v. Newby & Tittle*, 529 F.3d 631, 641 (5th Cir. 2008). Here, however, the Plaintiffs contend that the trial court erred as a matter of law by failing to comply with the express requirements of the relevant rules and statutes concerning sanctions.

Summary of Argument

The district court awarded $25,000 in sanctions to the Defendants *sua sponte* and without notice or an opportunity to respond, haphazardly referring to 28 U.S.C. §1927, 42 U.S.C. §1988, and Fed. R. Civ. Pro. 11. *See* March 11, 2011 Sanctions Order ("Sanctions Order"), Record Excerpts Tab 18. The district court made no attempt to explain who was being sanctioned on what basis, and in any event the court failed to follow the basic requirements of *all* of the rules / statutes it cited. The district court implicitly conceded that at least some of the Plaintiffs' claims had merit, yet dismissed *all* claims on the pleadings in an opinion with findings that repeatedly *contradicted* the pleadings.

Argument

(1) The trial court had no legal basis for awarding sanctions or attorney fees.

In their brief, the Plaintiffs / Appellants carefully explained that the district court did not follow the procedural requirements of any of the statutes / rules that he cited as a basis for sanctions. Appellants' Brief at 45-49. The panel seems to have concluded that this was harmless error. An unlawful sanction of $25,000 is not harmless error. On the contrary, it is a denial of due process.

"Due process requires notice and an opportunity to respond before the sanctions of costs, expenses, or attorneys' fees are imposed." 10 A Fed. Prac., L. Ed. §26:771; *see also In re Ames Dept. Stores, Inc.,* 76 F.3d 66, 70 (2nd Cir. 1996) ("[D]ue process

requires that courts provide notice and opportunity to be heard before imposing *any* kind of sanctions") and *Braley v. Campbell*, 832 F.2d 1504, 1514 (10th Cir. 1987)(*en banc*).

(a) The sanctions cannot be upheld under 28 U.S.C. § 1927.

Aside from the fundamental due process problem, *i.e.*, the lack of notice and opportunity to respond, the award of sanctions under 28 U.S.C. § 1927 fails to comply with the plain terms of the statute. The statute only allows sanctions against attorneys of record – not parties. *See* 28 U.S.C. §1927. This restriction applies even if the client is jointly and severally responsible for the improper conduct. *See Procter & Gamble Co. v. Amway Corp*., 280 F.3d 519, 525 (5th Cir. 2002). The sanctions against the Plaintiffs therefore fail according to the plain terms of the statute. The panel wrote that the Plaintiffs and Plaintiffs' Counsel "argue the sanctions and fees imposed on attorneys under §1927 may only be imposed with prior notice to the attorney." This much was true, as the Plaintiffs did indeed make that argument. Strangely, though, the panel then completely ignored that argument. Other circuits have explicitly held that §1927 requires notice and an opportunity to respond. *See, e.g., Johnson v. Cherry*, 422 F.3d 540, 551-552 (7th Cir. 2005). If this Court disagrees, that is probably something it should state clearly in a published opinion.

(b) The sanctions cannot be upheld under Rule 11.

Citing Rule 11, the district court created an arbitrary number and awarded sanctions to 19 Defendants *sua sponte*, and without giving the Plaintiffs any opportunity to respond. *See* Sanctions Order, Tab 18 at 7 ("Having considered the Johnson factors and the requirements of Rule 11, the Court determines that the Plaintiffs and their attorney should reimburse the Defendants in the total amount of $25,000"). In its *per curiam* opinion, the panel wrote that the Plaintiffs "contend, citing to out-of-circuit authority, that the court may not grant Rule 11 *sua sponte*." Opinion at 5. That statement is simply false. Here is what the Plaintiffs actually wrote:

> [A] court may only impose Rule 11 sanctions *sua sponte* after (1) entering an order describing the specific conduct that allegedly violates Rule 11; and (2) directing the offending party to show cause why it has not violated the rule. *See* Fed.R.Civ.Proc. 11(c)(3); *see also Johnson v. Waddell & Reed, Inc*., 74 F.3d 147, 151 (7th Cir. 1996)(not sufficient to give attorney after-the-fact opportunity to convince court to set aside sanctions it already determined.). Here no such order issued beforehand, nor an order to show cause thereafter.

Appellants' Brief at 46. Never mind any out-of-circuit authority, the "safe harbor" provision is part of the plain text of the rule, *see* Fed.R.Civ.P. 11(c)(3). The district court gave no "safe harbor" order, therefore it violated the rule *per se*. And a *sua sponte* sanction under Rule 11 can only result in monetary payments to the court, *i.e.*, not to opposing parties, *see Marlin v. Moody Nat'l Bank, N.A.*, 533 F.3d 374, 379 (5th Cir. 2008), citing Fed.R.Civ.P. 11(c)(4), therefore the award of sanctions

to the 19 defendants was unlawful.

This Court has expressly held that Rule 11 sanctions require the due process protections of notice and an opportunity to respond. *See Marlin,* 553 F.3d at 379 and *Merriman v. Security Ins. Co. of Hartford*, 100 F.3d 1187 (1996). And the lack of due process is not merely a theoretical concern in this case. The Plaintiffs are *crime victims,* and most of them have limited financial resources. Because they were denied due process, they were denied an opportunity to present evidence regarding their inability to pay sanctions.

Defendant Boykin and his company, Defendant Guaranty Title, were the only Defendants who requested Rule 11 sanctions, and they only sought sanctions against Plaintiffs' Counsel, not the Plaintiffs themselves. *See* Motion for Sanctions, Docket No. 157, ROA 2641. Thus it was a denial of due process to sanction the Plaintiffs when they had no notice or opportunity to respond. Moreover, sanctions may be awarded against a party *only* when "a court determines *factual contentions* lacked evidentiary support." *Marlin*, 533 F.3d at 380, citing Fed. R. Civ. P. 11(c)(5)(A). Since this case never moved past the pleadings stage, evidence (or the lack thereof) never came into consideration.

Plaintiffs' Counsel does not appeal the *amount* of sanctions that <u>he</u> was directed to pay Defendants Boykin and Guaranty Title, as the district court seems to have recognized that the amount requested by these Defendants was grossly

inflated. *See* Response in Opposition to Motion for Sanctions, Docket No. 164, ROA 2699, *et seq*. But the *merits* of the sanction is a different story. The Plaintiffs would direct the Court's attention to a few of the paragraphs from the Complaint:

> 172. In April of 2003, Judge Stem removed Plaintiff Krumnow as executor without notice or a hearing and appointed Defendant Boykin to replace him. According to correspondence obtained by the undersigned, Defendant Rusty Russ was simultaneously serving as Judge Stem's personal attorney in a real estate dispute – an egregious conflict of interest that neither of them disclosed to Mr. Krumnow nor anyone else. On May 25, 2004, Judge Stem appointed Defendant Harris as receiver to sell the property of the estate. On June 17, 2005, Defendant Boykin and Defendant Harris conspired with Defendant Aiken, who represented DDC, to sell 824.57 acres of estate property at a below-market price. Specifically, these defendants conspired to sell the Krumnow property to DDC for an amount lower than what had already been offered by another buyer. On June 22, 2005, Defendant Harris filed a report with the court attempting to sell the property to DDC at the below-market price, and he mailed copies of the report and fraudulent contract to at least seven people on that day.
>
> 173. In *Krumnow v. Krumnow*, the appeals court reversed Judge Stem, holding that he had no authority to appoint Defendant Boykin as a successor representative to Mr. Krumnow; the court further held that Judge Stem abused his discretion in appointing Defendant Harris as receiver on his own motion. 174 S.W.3d 820 (Tex.App.-Waco 2005).
>
> 174. Since 2002, Judge Stem has abused the power of his office egregiously, trying to force Plaintiff Krumnow to "back off" so he and his co-conspirators could parcel up the Krumnow estate. Further discovery will likely reveal that Defendants Boykin, Harris, The Firm, Russ, Hedrick, Aikens, and DDC – and possibly Judge Stem – attempted to profit from the estate and the trusts by selling estate and trust property to DDC for less than what it was worth.

FAC at ¶¶172-174. Defendants Boykin and Guaranty Title are mentioned elsewhere in the complaint, so there are plenty more details beyond this, but what

exactly is "conclusory" about those three paragraphs? Those paragraphs plainly identify who, what, when, where and how. And the Plaintiffs' claims for fraud, breach of fiduciary duty, and RICO clearly were timely under the four-year statute of limitations. So why were these claims cast aside, much less derided as "conclusory" and sanctionable?

(c) The sanctions cannot be upheld under 42 U.S.C. 1988.

The panel wrote that the "Plaintiffs claim that the sanctions and fees could not have been proper under §1988, which permits winning parties under §1983 to collect attorney's fees, because §1983 only purports to provide attorney's fees to successful plaintiffs." But the Plaintiffs never said any such thing. In fact, the Plaintiffs cited *U.S. v. State of Miss.*, 921 F.2d 604, 609 (5th Cir. 1991) and even included the following quote from that case: "While plaintiffs prevailing under 42 U.S.C. § 1988 are entitled to attorneys' fees unless special circumstances would render an award unjust, prevailing defendants are entitled to attorney fees *only* when a plaintiff's underlying claim is frivolous, unreasonable, or groundless." Appellant's Brief at 49.

The Plaintiffs instead argued that the trial court erred by awarding attorney fees to parties who did not request them. *See* Appellants' Brief at 49. An award of attorney fees under 42 U.S.C. § 1988 must comply with Fed. R. Civ. Pro. 54(d)(2). *See, e.g., Slader v. Pearle Vision Inc.*, 199 F.R.D. 125, 126 (S.D.N.Y. 2001). The

First Circuit has held that failure to comply with Rule 54(d)(2) constitutes waiver. *See Logue v. Dore*, 103 F.3d 1040, 1047 (1st Cir. 1997).[2] Either way, the Plaintiffs were denied due process. If fees are going to be assessed against the Plaintiff's under §1988 because the pleadings supposedly are "frivolous, unreasonable, or groundless," *i.e.*, if §1988 is going to be applied punitively, then due process requires notice and an opportunity to respond.

Only Defendant Blue Water Systems properly sought attorney's fees pursuant to Rule 54(d)(2), and that result is instructive. Blue Water sought more than $34,000 in sanctions, *see* Motion for Attorney's Fees and Costs, Docket No. 186, ROA 2935, but the Plaintiffs had an opportunity to respond and pointed out that the requested amount was grossly inflated and perhaps fraudulent because one of the billing entries pertained to another case. *See* Response in Opposition, Docket No. 187, ROA 2968, *et seq*. Blue Water was awarded only $1,388.88. *See* Sanctions Order at 8. However, Blue Water only requested sanctions against the Plaintiffs, but not Plaintiffs' Counsel, therefore the $694.44 assessed against Plaintiffs' Counsel fails for lack of due process as explained above. That said, Plaintiffs' Counsel will gladly pay the remaining $694.44 assessed against the Plaintiffs

[2] The panel seems to have taken a dismissive view of out-of-circuit authorities. *See* Opinion at 5. Insofar as there are no Fifth Circuit opinions on some of these issues, and particularly since the Plaintiffs have found no conflicting opinions, the Plaintiffs urge the Court either to follow the undisputed case law or issue a *published* opinion explaining why it rejects the established rule from other jurisdictions.

simply to put an end to this matter. Finally, the plain terms of §1988 do not allow attorney's fees to be assessed against opposing counsel:

> Interpretation of § 1988 must begin with its language, which provides in pertinent part:
>
> > In any action or proceeding to enforce a provision of section [ ] ... 1983 ... of this title ... the court, in its discretion, may allow the prevailing party, other than the United States, a reasonable attorney's fee as part of the costs.
>
> The Supreme Court has commented on the fact that § 1988 makes no "mention of attorney liability for costs and fees." *Roadway Express, Inc. v. Piper*, 447 U.S. 752, 761, 100 S.Ct. 2455, 2461, 65 L.Ed.2d 488 (1980). In *Roadway*, the Court found convincing support in the legislative history for the view that the statute permits recovery only from a party, not from his counsel. 447 U.S. at 761 n. 9, 100 S.Ct. at 2461 n. 9.

Brown v. Borough of Chambersburg, 903 F.2d 274, 276 (3rd Cir. 1990); *see also Spears v. Meeks*, 2011 WL 3703966, *4 (M.D.Ala. August 24, 2011) (summarizing cases from various circuits).

(2) <u>The trial court applied the wrong standard of review and the wrong pleading standards.</u>

The panel correctly identified a *de novo* standard of review for dismissed claims but, in practice, it appears that the panel's review was deferential. The panel quoted the district court's conclusory statements that "[a]ll Plaintiffs' §1983 and state conspiracy claims were frivolous..." and "the majority of the claims asserted by Plaintiffs are barred by limitations." Opinion at 6. These statements are objectively false, as demonstrated herein, and the Plaintiffs submit that genuine *de*

novo review would require the Court to independently examine the *entire* 47-page complaint, rather than rely on an interpretation from the district court.

The Plaintiffs previously excerpted Paragraphs 172-174 from the First Amended Complaint. The Plaintiffs further ask the Court to consider Paragraphs 183-189 (attached to this petition as Exhibit A). The Plaintiffs described in *great detail* how the Defendants fraudulently obtained title to 30 acres in Robertson County. *See* FAC at ¶¶183-189. The who, what, when, where and how were all covered. *Id*. All of the wrongdoing occurred within the four-year limitations period for racketeering, fraud and breach of fiduciary duty claims.[3] *Id*. at ¶188. And since the claims were not discovered until August of 2007, *id*. at ¶189, all of the civil rights and state-law claims were timely. Faced with this, Defendant Mark Milstead entered settlement negotiations, and that was made known to the trial court when the parties sought more time to work out the settlement terms. *See* Docket No. 62, ROA 1010 and Docket No. 71, ROA 1071.

Naturally, those settlement negotiations fell apart when the trial court decided to dismiss all the claims on the pleadings. Docket No. 95, ROA 1289. So Plaintiffs Erickson and Gossen quickly filed an overlapping suit in state court.[4] Defendant

[3] Defendant Harris clearly breached his fiduciary duties to his clients.

[4] The Plaintiffs ask the Court to take judicial notice of *Nancy Erickson and Janna Gossen v. Mark Milstead*, Cause No. 10-11-18,704-CV, 82nd District Court of Robertson County. As witnessed by his signature below, the undersigned declares under penalty of perjury under the laws of the United States that Exhibit B is a true and correct copy of the original petition in that

Milstead then returned to the table and settled, although his co-defendants got off scot-free (at least thus far) because the federal court dismissed the overlapping federal lawsuit on the pleadings. Shouldn't those facts alone give this Court great pause about dismissing the *entire* lawsuit on the pleadings? Can there be any doubt that Defendant Milstead had sufficient notice of the claims against him? And if Defendant Milstead thought the pleadings were plausible (*i.e.*, plausible enough to enter settlement negotiations), how can the district court say the claims are implausible?

The panel faulted the undersigned for "the expansion of the suit to parties well outside the main conspiracy" and for including a "multitude of superfluous defendants." Opinion at 6. The panel, like the trial court, implicitly acknowledges that at least some of the claims, like those against Defendant Milstead, were not "superfluous." Yet the trial court effectively imposed death-penalty sanctions against innocent parties like Plaintiffs Erickson and Gossen because their attorney mixed their claims with those of other plaintiffs whose claims the judge deemed implausible. The Plaintiffs would direct the Court's attention to *Fox v. Vice*, 131 S.Ct. 2205 (2011), a case cited by the panel. Opinion at 6. The Supreme Court upheld sanctions related *only* to those portions of the complaint that were frivolous. *Id*. at 2213. It did not sanction dismissal of all claims against all defendants. *Id*.

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lawsuit.

Regardless of the differences between notice pleading and "plausibility pleading," *nothing* in existing case law authorizes a court to dismiss the legitimate claims of some plaintiffs merely because it concludes that their co-plaintiffs have failed to state a claim.

CONCLUSION

The trial court failed to afford due process to the Plaintiffs, therefore the sanctions order must be reversed. If the Court concludes that some claims lack merit, it should identify those claims rather than punitively dismissing all claims across the board.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on June 15, 2012, a true and correct copy of the above and foregoing brief was filed with the Court's electronic filing system, which should result in notice to the individuals below.

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