

NO. A05-705

State of Minnesota
In Court of Appeals

First National Bank of the North, Prairie National Bank,
and Centennial National Bank, Clare Gallagher, and
Alan R. Sterns, as Trustee of the Alan R. Sterns Trust,
on behalf of themselves and others similarly situated,
Plaintiffs/Appellants,

vs.

State of Minnesota,

Defendant/Respondent.

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(2005) § 103.1615

INTRODUCTION

In its brief, the State seeks to arrogate to the executive branch unfettered discretion to ignore at will statutes passed by the legislature, rules duly promulgated pursuant to those statutes, and the Administrative Procedure Act. Respondent argues that the Minnesota Department of Commerce need not heed its own rules or governing laws in carrying out its duties, including statutorily and regulatorily mandated investor protections, which conduct in this case resulted in the loss by Minnesota investors of almost \$3 million.

In 1997, United Homes, Inc. (“UHI”), a heavily-indebted company that had no operations or employees in Minnesota, came to Minnesota to seek the permission of the Minnesota Department of Commerce (“Department”) to sell its debentures to Minnesota investors so that it could pay off lenders with whom it was in trouble. The Department had a mandatory rule in 1997 that required that a company seeking to sell its fixed income securities to Minnesota investors have a *positive* operating cash flow in order to be able to sell such securities in Minnesota. This rule protects Minnesota investors from investing in companies that cannot demonstrate an ability to service their debt securities. UHI had a *negative* operating cash flow, and the Department rightly concluded that UHI flunked the operating cash flow requirement.

Notwithstanding this requirement and in direct disregard of the rule, the Department, on the basis of unsupported assumptions, some of which were contradicted by the prospectus, allowed UHI to sell its debentures to Minnesota investors. The Department did not seek to determine whether its assumptions were valid by asking UHI for more information. Nor did the Department seek to confirm with UHI’s lenders whether the loans could be used to service junior debt. Almost \$3 million of the \$7 million of UHI’s debentures were sold in Minnesota in 1997 and thereafter. In 1999, two years after selling them, UHI defaulted on the debentures; in early 2000, UHI was bankrupt.

ARGUMENT

The core question framed by the briefs is whether the Commissioner of Commerce

can freely ignore a mandatory rule designed to protect investors from unmeritorious fixed income investments, or can waive such requirements without complying with the law (the Minnesota Securities Act and the Minnesota Administrative Procedure Act). Respondent rightly states that Minnesota is a “merit” state with respect to approving securities for sale in Minnesota—i.e., the Commissioner must affirmatively pass on the *merits* of a proposed offering to Minnesota investors. Resp.’s Brief at 9. Unlike under the federal securities laws, in a “merit” state, disclosure is not deemed sufficient investor protection.

Because the Department’s staff did not follow the applicable requirements in approving UHI’s debentures for sale to Minnesota investors, the staff is not entitled to official immunity. Respondent is vicariously liable for their wrongful conduct. Because reviewing applications for selling fixed income securities to Minnesota investors is not policy-making or planning, statutory discretionary immunity (which is more limited than official immunity) does not shield Respondent from liability in this case.

I. THE STATE IS NOT IMMUNE FROM LIABILITY FOR HAVING WRONGFULLY APPROVED UHI’S DEBENTURES FOR SALE TO MINNESOTA INVESTORS.

A. Approving Securities For Sale In Minnesota Does Not Involve Policy Making and Is Not Discretionary.

Respondent argues that deciding whether to allow a single issuer, like UHI, to sell its fixed income securities to Minnesota investors seeking relatively safe investments involves great financial, political, economic and social effects and, therefore, is planning or policy making. Resp.’s Brief at 7. Deciding whether to allow an issuer that fails the Minn. R. 2875.3500 test to sell its securities in Minnesota does not involve great financial, political, economic and social considerations; it involves, very simply, the application of a mandatory financial measure to an applicant seeking to sell its debt securities to determine whether it has the financial wherewithal to service those securities.

In *Waste Recovery Co-op. of Minnesota v. County of Hennepin*, 517 N.W.2d 329, 332 (Minn. 1994), the court ruled that duties fixed by the requirements of statute or municipal policy are ministerial and, thus, not protected by official immunity. The court

concluded that the decision that phone books were “waste” is not protected by discretionary function immunity. The court held that the employee’s conduct was based on his professional judgment that the phone books were “waste” but that decision did not involve the balancing of social, political, or economic considerations. Just as exercising judgment regarding what constitutes “waste” does not involve a discretionary function, neither does determining whether an applicant has the requisite operating cash flow with which to service the debentures it proposes to sell to Minnesota investors involve discretion.

Respondent argues “the Department must balance the risks for the purchaser associated with a certain type of stock against the benefits of capitalization through issuance of securities, such as economic development, which the issuance might support.” Resp.’s Brief at 10. Minn. R. 2875.3500 does not apply to offerings of stock to Minnesota investors; it applies only to offerings of fixed income securities to Minnesota investors. These securities are sold with the promise that interest will be paid and that the amount invested will be repaid—i.e., a loan. A company selling stock promises neither interest (or dividends) nor that the investment will be repaid. Rule 2875.3500 prevents the sale to Minnesota investors of fixed income securities by companies that are not financially able to promise that interest will be paid on the investment. Whatever the relevance of weighing the merits of a proposed investment against economic development with respect to stock, those considerations are not to be found in Rule 2875.3500. UHI, with no operations or employees in Minnesota, offered no possibility of economic development in Minnesota; it offered only the likelihood that Minnesota investors’ capital would be depleted.

As discussed in Appellants’ opening brief (“Aplts.’ Br.”), the need for some discretion or judgment does not automatically mean a discretionary function. *See Waste Recovery*, 517 N.W.2d at 332 (exercise of professional judgment not protected by discretionary function immunity). The court in *Waste Recovery* ruled it was the employee’s job to enforce the ordinance in conformity with state statutes: “This duty was absolute, certain, and imperative, did not require the exercise of any discretion, and was fixed by the

requirements of the statute.” *Id.* at 333. The same is true of the Department’s employees: they were obliged to enforce Minn. R. 2875.3500; this duty was absolute, certain, and imperative, did not require the exercise of any discretion, and was fixed by the requirements of Minn. Stat. § 80A.25, pursuant to which the rule was promulgated. That the Department’s employees chose to ignore the rule in approving UHI’s debentures for sale in Minnesota did not confer discretion; it merely means that they violated the rule. *See Wiederholt v. City of Minneapolis*, 581 N.W.2d 312, 316 (Minn. 1998) (official cannot convert a ministerial decision into a discretionary one by refusing to comply with the mandate contained in a city ordinance, citing *Waste Recovery*, 517 N.W.2d at 333).

Respondent argues that the statutory invocation of the “public interest” evidences a legislative intent that the Commissioner’s decision be one of planning and not operations. Resp.’s Brief at 9. Aside from the fact that public interest does not necessarily entail planning, Respondent ignores the statutory invocation of investor protection in parallel with the public interest. Minn. Stat. § 80A.25, subd. 2 (rules cannot be rescinded unless the Commissioner “finds that the action is necessary or appropriate in the public interest *or for the protection of investors. . .*”) (emphasis supplied). Here, the Commissioner considered neither the public interest nor investor protection.

If the Department’s approval of UHI’s debentures for sale to Minnesota investors in disregard of Minn. R. 2875.3500 is policy-making, as Respondent says, then it was not done in accordance with law. Ignoring existing rules in individual cases amounts to policy-making on a case-by-case basis, which is what the Administrative Procedure Act, Minn. Stat. § 14.01 *et seq.* was designed to prevent. *See Apls.’ Br.* at 32.

Respondent, as did the district court, relies on the use of “may” in Minn. Stat. § 80A.13, subd. 1, in describing the Commissioner’s function in issuing a stop order, as the basis for concluding approving UHI’s application was discretionary. Resp.’s Brief at 8-9; A-6-7. However, a non-compliant offering can be prevented without a stop order. Several states told UHI that it failed to satisfy their requirements, and UHI voluntarily withdrew

the offering. A-122-32. All it would have taken to stop this offering is for the Department to have informed UHI that it did not comply with Rule 2875.3500.

B. Minn. R. 2875.3500 Could Not Be, and Was Not, Waived.

Respondent's argument that the Commissioner had authority to waive Minn. R. 2875.3500 is not persuasive. Resp.'s Brief at 10-11. The State relies on Minn. Stat. § 80A.12, which provides the Commissioner may "by rule or otherwise permit the omission of any item or information or document from any registration statement." Minn. Stat. § 80A.12, subd. 4 (2002). The State speculates that this is an unfettered grant of discretion to do almost anything the Commissioner pleases, including, improbably, the dispensing of financial statements altogether. Resp.'s Brief at 10-11. Respondent argues that if the Commissioner has discretion to dispense with financial statements, then the Commissioner can certainly ignore a mandatory, non-waivable rule, like 2875.3500. But, of course, the Commissioner is not granted unfettered discretion. Discretion granted by the Minnesota Securities Act is subject to the procedural requirements of the APA, Minn.Stat. § 14.01 *et seq.* Also, Respondent erroneously argues that Minn. R. 2875.0990 is authority for waiving Rule 2875.3500, but by its terms it is clear it is not; that rule allows a waiver only of Rules 2875.0950 - .0980 and does not include Rule 2875.3500. Resp.'s Brief at 11.

The authority in Minn. Stat. § 80A.12 that allows the Commissioner to omit "any item of *information* or *document* from any registration statement" (emphasis supplied) cannot in any way be construed as allowing a mandatory financial standard imposed for the protection of Minnesota investors to be waived. *See* Resp.'s Brief at 11. The financial test imposed by Rule 2875.3500 was not an item of *information* and was not a *document* to be included in the UHI registration statement: information and documents have to do with what is *disclosed* in the registration statement; as noted above, Minnesota is a "merit" state, and Rule 2875.3500 addresses the *merits* of debt securities.

Respondent's other arguments that Minn. R. 2875.3500 could be waived are

equally unavailing. Assuming one can imagine circumstances whereby an issuer's financial statements are omitted from a prospectus used to sell securities to investors, the inclusion or omission of financial statements has nothing to do with the requirement of a positive cash flow. Even if the Commissioner allowed financial statements to be omitted, the financial standard required by Rule 2875.3500 must still be met. Indeed, in the absence of financial information, the requirement is even more crucial to protect investors.

Respondent ignores Appellants' argument that any waiver by the Department was done without proper authority or without following the APA. Neither the Commissioner nor his deputy, the only persons with authority to waive applicable standards, waived the application of Rule 2875.3500 as to the UHI application to register its securities. A-93-96. Nor did the Commissioner have rules or criteria in place for determining whether or when to waive Rule 2875.3500, a strong indication the rule was not waivable. *Id.*

A thread that runs through Respondent's brief is the suggestion that someone with authority actually did weigh arguably relevant competing considerations and concluded, after doing so in compliance with applicable law, that the interests of UHI in selling its debentures to Minnesota investors outweighed the protections of Rule 2875.3500 to which those investors were entitled. *See, e.g.,* Resp.'s Brief at 9 ("the decision to issue a stop order involves numerous decisions with respect to legal and economic standards"), 16 ("the decision whether or not to revoke the registration of a particular securities offering requires the analysis of a myriad of complex factors and the application of discretion"). But, of course, that is not what actually happened here. A-93-96.

The discretionary authority and the ability to waive Rule 2875.3500 that Respondent says, incorrectly, exist were in fact not exercised. Although the Department considered and ignored a required financial standard, the Department did not consider "legal" or "economic" standards. The Department did not consider whether its speculation had any basis in reality. There was no "analysis of a myriad of complex factors." Besides, Rule 2875.3500 neither required nor permitted such analysis; if the applicant did not have an

operating cash flow, it could not sell its fixed income securities, pure and simple. Those who Respondent says had authority to exercise discretion to waive Rule 2875.3500 (the Commissioner and the Deputy Commissioner) never considered whether UHI should be allowed to sell its securities despite failing the Rule 2875.3500 test.

If the unfettered discretion for which Respondent argues is the law, one wonders why there are rules like Rule 2875.3500 and why there is an APA. One is further forced to wonder why an application to sell securities need be reviewed by anyone for compliance with any rules.

C. The Department's Assumptions Were Unfounded.

Respondent recites the assumptions that the Department's staff made in choosing to ignore the requirements of Rule 2875.3500. Resp.'s Brief at 11-12. Respondent ignores the allegations that those assumptions were unfounded. A-97-99. The Department said UHI "appears . . . to be a special situation (industry)" that never had positive operating cash flow. A-96-97. That was simply not true. A-97-99. Besides, Rule 2875.3500 is clear and provides no exceptions: without operating cash flow, a company cannot sell its fixed income securities in Minnesota, regardless of any "special situation." Rule 2875.3500 did not permit the "adjustment" that, in the personal opinion of the Department's analyst, "better portrays what is really happening here." Resp.'s Brief at 12.

The Department's second critical assumption was also baseless. The Department's staff noted: "It does not appear the Company would not have these funds available." Resp.'s Brief at 12. The double negative suggests great uncertainty on the staff's part. Again, the assumption was without basis; the prospectus clearly disclosed limitations on the ability of UHI to use its borrowings from its other lenders to service the debentures. A-98-99. Acting on baseless supposition is inconsistent with the deliberative process contemplated by the discretion Respondent says the Commissioner had in this matter.

Amazingly, the Department's staff recognized that the only way Minnesota investors in UHI's debentures could hope to get interest is if UHI's existing lenders were will-

ing to continue to lend to UHI and were willing to allow their loans to be used to service junior debt, an improbable scenario that, predictably, did not come to pass. Yet, this did not stop the offering, even though UHI was exactly the type of issuer that Rule 2875.3500 sought to prevent from selling fixed income securities to Minnesota investors.

D. Immunity in this Case Is Not in the Public Interest.

Remarkably, the State argues that it is in the public interest for the State to ignore the very statutes and regulations that it is charged with enforcing to protect the investing public. Resp.'s Brief at 12-13. Respondent argues that immunity here would somehow motivate the Commissioner to enforce the Minnesota Securities Act and its rules. *Id.* Immunity in this case is not in the public interest; enforcing this State's securities laws, whose purpose is the protection of investors, is in the public interest. Imposing liability in this case would create an incentive for Respondent to enforce, and not ignore, a rule that protects Minnesota investors in fixed income securities. That is a good thing.

The public interest here certainly includes the protection of Minnesota investors in fixed income securities from fraudulent and shaky investments. Protecting Minnesota public investors in fixed income securities from investments that fail to pass a mandatory standard that determines the issuer's financial ability to service the proposed debt is also protecting the integrity of the market place for legitimate issuers of such securities.

It is difficult to accept at face value Respondent's argument that it needs to be able to ignore a rule that protects investors from investments such as UHI's debentures in order to promote economic development. Surely, Respondent is not arguing that "economic development and other important public policy decisions" (Resp.'s Brief at 13) gives a license to an out-of-state company (or an in-state company, for that matter) to cheat Minnesota investors out of their savings.

Assume, hypothetically, that an administration is elected to office in Minnesota that believes that rules protecting the environment, or rules protecting workers in the workplace, or rules protecting investors are simply impediments to entrepreneurs and the

growth of Minnesota business and, therefore, should be eliminated. Obviously, an administration could not do so simply by fiat. The question posed in this case is whether it can do so by simply ignoring those rules on a case-by-case basis without bothering to comply with the legal process for changing or waiving those rules, either in one case or as a general matter. Such a wholesale rescission of a regulatory scheme could not be accomplished without invoking the legislative and administrative procedural processes. But this is exactly what Respondent argues can be done, so long as it is done case-by-case.

E. Appellants Do Allege Facts Showing Disregard of Minnesota Law.

Inexplicably, Respondent states, “there are no facts alleged showing . . . disregard of Minnesota law.” Resp.’s Brief at 13. These are, in brief, the facts alleged: The Department staff explicitly acknowledged the applicability of Minn. R. 2875.3500, explicitly acknowledged that UHI failed the test of Rule 2875.3500, and explicitly ignored Rule 2875.3500 in allowing UHI’s registration statement (notwithstanding that the Rule is mandatory) by engaging in baseless supposition and speculation that was contradicted by the document they were reviewing; the waiver of the non-waivable Rule 2875.3500 was done by Department staff who had no authority to waive the Rule; and all of this was done without regard to applicable law regarding how waivers may be granted (assuming the requirement was waivable, which Rule 2875.3500 was not). A-90-99. In ignoring Rule 2875.3500’s prohibition of the UHI’s debenture offering in Minnesota, the Department’s staff did not consider whether that rule could be waived, and neither the Commissioner nor his Deputy, the only two persons who could waive a waivable rule, considered either whether to waive it or whether they could waive it.

As discussed at length in Appellants’ opening brief, assuming, arguendo, processing an application to register securities is not a ministerial function, there is no official immunity in the exercise of an operational discretionary function by Department employees in disregard of applicable law.

F. Official Immunity and Statutory Immunity.

The State has no immunity because the actions of the Department's staff are not entitled to common law official immunity as they failed to enforce a mandatory standard. The State also has no statutory discretionary immunity because the function of reviewing applications by issuers of fixed income securities for sale to Minnesota investors does not involve planning or policy-making. The State's vicarious liability for the wrongful conduct of the Department's staff in approving UHI's debentures in disregard of Rule 2875.3500 is not shielded by the statutory immunity found in Minn. Stat. § 3.736, subd. 3(b), for discretionary functions.

Respondent has the burden of showing it is entitled to immunity—i.e., that what it was doing was policy-making. Aplt's. Br. at 13-14. Against the specific allegations in Appellants' Third Amended Complaint, Respondent offers nothing but speculation about what reviewing an application to sell fixed income securities in Minnesota involves. Appellants' allegations must be accepted as true. Aplt's. Br. at 11.

Minn. Stat. § 3.736, subd. 1, provides (emphasis supplied):

The State will pay compensation for injury to or *loss of property* or personal injury or death caused by an *act or omission of an employee* of the State while acting within the scope of office or employment . . . , under circumstances where the State, if a private person, would be liable to the claimant, whether arising out of a governmental or proprietary function. . . .

In this case, the negligence of employees of the State resulted in the loss of Appellants' property and that of other Minnesota investors. Obviously, the State can act only through its employees. Assuming the function of approving a registration statement for the sale of fixed income securities in Minnesota involves some operating discretion, because the Department's staff failed to follow the law in the exercise of this discretion, they are not entitled to cloak their conduct with official immunity. *See Waste Recovery Co-op. of Minnesota v. County of Hennepin*, 517 N.W.2d 329, 332-33 (Minn. 1994). Given that the Department's employees are not immune under the doctrine of official immunity, neither is the State vicariously immune. *See id.* at 333.

In language identical to that found in Minn. Stat. § 3.736, subd. 3(b), Minn. Stat. § 466.03, Subd. 6, provides immunity to municipalities for discretionary acts: “Any claim based upon the performance or the failure to exercise or perform a discretionary function or duty, whether or not the discretion is abused.” In *Waste Recovery*, the Supreme Court held that discretionary function immunity under Minn.Stat. § 466.03 did not immunize Hennepin County from liability for the damages caused by an employee's erroneous conclusion, based on his professional judgment, that phone books collected at depositories for recycling were “waste.” 517 N.W.2d at 331-32. The court also held that the common law doctrine of official immunity did not immunize a Hennepin County employee from liability for the damages he caused through his erroneous interpretation of state statutes and a county ordinance and further held that the county was vicariously liable for its employee’s misjudgment. 517 N.W.2d at 332-33. Applying *Waste Management* here, Respondent is not immunized from liability for the damages caused by the Department’s staff erroneous conclusion, based on their purported professional judgment (negligently exercised), that UHI’s debentures could be registered, which was based on erroneous factual assumptions and on the erroneous interpretation of the securities laws and the erroneous notion that Rule 2875.3500 could be waived.

Although the discretionary function exception to the Tort Claims Act and common law official immunity doctrine both protect discretionary acts, “discretion” has a broader meaning in the context of official immunity. *Rico v. State*, 472 N.W.2d 100, 107 (Minn. 1991). Governmental immunity under the statutory discretionary exception is designed to preserve separation of powers by insulating policy judgments of the other branches of government from review by the courts in tort actions, whereas official immunity primarily is intended to ensure that the threat of potential liability does not unduly inhibit exercising the discretion required of public officers in discharging their duties. *Id.*

In view of the purpose of statutory immunity, the reach of that immunity has been limited to decisions that involve balancing of policy objectives, such as social, political

and economic considerations at the planning or policy level. *Anderson v. Anoka Hennepin Independent School District 11*, 678 N.W.2d 651, 655 (2004), citing *Nusbaum v. Blue Earth County*, 422 N.W.2d 713, 722 (Minn. 1988). In contrast to statutory immunity, common law official immunity applies to discretionary decisions made at the operational level. *Id.* citing *Gleason v. Metropolitan Council Transit Operations*, 582 N.W.2d 216 (Minn. 1998).

Here, no policy or planning was involved in determining whether to permit UHI to sell its debentures to Minnesota investors. A-112 [¶ 229].¹ To call the Department's consideration of UHI's application policy-making would essentially vitiate the judicially imposed limitations on this exemption from government liability for its torts. If it is assumed the Department had discretion, the Department exercised that discretion in a way that exceeded its powers. Applying statutory discretionary immunity here would not preserve the separation of powers; it would sanction an abuse of the executive's power.

Respondent cites *Smith v. Wait*, 350 N.E.2d 431 (Ohio App. 1975), in support of its contention that Respondent cannot be held liable in this case. That case is easily distinguished. First, in that case it was the issuer's trustee who was seeking to hold the state liable for having approved the issuer's registration statement in violation of express statutory provisions. The court held that the trustee had no right to rely upon the registration of the securities by the state, even if fraudulently issued by state employees in violation of their statutory duty, because, as trustee, he had a duty to be aware of the activities of the issuer. *Id.* at 434. Appellants are not the issuer or any affiliate thereof.

Second, the court noted that, like in Minnesota, state officers have no liability under the doctrine of official immunity for the erroneous exercise of discretion resulting from negligence or mistake of judgment where such discretion is exercised in good faith,

¹ The allegations in the Third Amended Complaint with respect to the State are based on discovery obtained from the Minnesota Department of Commerce, including documents and deposition testimony.

but have no such immunity where that good faith was not exercised. *Id.* at 435. Unlike Minnesota, in Ohio the state is not vicariously liable for the exercise of discretion in violation of the law. *Id.* (where the state's employees approved an application to register securities in violation of the law, they not only acted contrary to the express provisions of the law, but breached their duty to the state as officers thereof). In Minnesota, an officer who acts outside of his or her authority—i.e., fails to exercise his or her operating discretion in accordance with applicable law—is not entitled to immunity, and that officer's employer does not escape liability by reason of such unauthorized acts. Thus, *Smith v. Wait* does not help Respondent; indeed, to the extent that Ohio law parallels Minnesota law, the case supports Appellants: officials do not have discretion to act contrary to law and lose their immunity if they do.

G. The Licensing Function Is Subject to the Same Limitations as the Discretionary Function.

Appellants argued below and in their opening brief that, in a matter of first impression, immunity for the licensing function found in Minn. Stat. § 3.736, subd. 3(k), is lost where the licensing function was exercised in contravention of applicable law. Apls.' Br. at 25-28; A-346-48. Just as statutory discretionary immunity has been restricted to planning and policy-making and just as official immunity for operational activity is not available where laws are not followed, immunity for licensing, which is an operational activity, should likewise not be available for an authorization granted in violation of a specifically applicable rule. The district court ignored this argument. A-5-6. Respondent likewise ignores this argument. *See* Resp.'s Brief at 16-18.

Respondent argues that its authorization of the sale of the debentures by UHI to Minnesota investors did not contain any "express representation to Appellants beyond the bare licensing statement that the debentures at issue were registered by coordination" and, therefore, does not come within the reservation made by this Court in *Gertken v. State*, 493 N.W.2d 290 (Minn. App. 1992). Resp.'s Brief 18-19. As Respondent correctly

notes, Minnesota is a “merit” review state, requiring the Commissioner to pass on certain merits of an offering. With respect to fixed income securities like debentures, that means applying a financial test to determine whether the applicant-issuer has the financial ability to service the securities. Because UHI’s debentures could not be registered by coordination if UHI failed the Rule 2875.3500 test, allowing an applicant to sell its securities in this state necessarily means that the securities passed the Commissioner’s merit review by, *inter alia*, being in compliance with that test.

The public has a right to rely on the Commissioner’s merit review and on the implicit representation that an offering of fixed income securities that is approved for sale to Minnesota investors meets the requirements of Minnesota’s statutes and rules. The UHI debentures did not meet those requirements. That implicit representation was false.

II. STATE SECURITIES LAW CLAIMS.

Appellants have not sought appellate review of the district court’s dismissal of their claims under the Minnesota Securities Act. *See* Resp.’s Brief at 19-23.

III. APPELLANTS HAVE NOT WAIVED ANY ISSUES.

The constitutional and statutory construction issues addressed in Appellants’ opening brief are properly before this Court. This appeal is from an order granting a motion to dismiss, so there are no disputed facts. It is “well-established” that an appellate court may base its decision upon a theory not presented to or considered by the trial court where the question raised for the first time on appeal is plainly decisive of the entire controversy on its merits, and where, as in cases involving undisputed facts, there is no possible advantage or disadvantage to either party in not having had a prior ruling by the trial court on the question. *Roth v. Weir*, 690 N.W.2d 410, 413-14 (Minn. App. 2005), citing *Watson v. United Servs. Auto. Ass’n*, 566 N.W.2d 683, 687-88 (Minn.1997) (citations and emphasis omitted); accord *Zip Short, Inc v Comm’r of Revenue*, 567 N.W.2d 34, 42 (Minn. 1997); *Harms v. Independent School Dist. No. 300, LaCrescent.*, 450 N.W.2d 571 (Minn. 1990); see also *Perl v. St. Paul Fire and Marine Ins. Co.*, 345 N.W.2d 209 (Minn.1984) (Su-

preme Court would consider issue of whether liability insurance coverage for forfeiture of attorney fees was contrary to public policy, where insurer raised issue prominently in its brief below, and where issue was not dependent on any new or controverted facts, even though trial court did not discuss public policy in its decision upholding coverage and even though insurer raised public policy in the context of interpreting the insurance policy's language rather than in terms of validity or enforceability of the provision in question); E. J. Magnuson and D. F. Herr, *Minnesota Practice Series, Appellate Rules Annotated* (2005) § 103.16 at 71-72.

An issue of illegality not presented to the trial court, although it involves a mere error of law, may be considered for the first time on appeal if it involves a controlling legal principle or statute which, with respect to undisputed facts, the courts are judicially bound to know; the failure to present to the trial court that of which it is charged with judicial knowledge does not preclude its consideration for the first time upon appeal. *Atwood v. Holmes*, 229 Minn. 37, 42, 38 N.W.2d 62, 66 (Minn. 1949). Also, while the reviewing court may not ordinarily consider issues not considered by the trial court, an exception may be made when failure to review an issue would infringe upon a constitutional right. *Spannaus v. Larkin, Hoffman, Daly, and Lindgren, Ltd.*, 368 N.W.2d 395 (Minn. App. 1985).

Factors favoring review include: the issue is a novel legal issue of first impression; the issue was raised prominently in briefing to the appellate court; the issue was implicit in or closely akin to the arguments below; and the issue is not dependent on any new or controverted facts. *Roth*, 690 N.W.2d at 413-14. Here, the issues raised with respect to the district court's interpretation of Minn. Stat. §§ 3.736, subd. 3(k), and 80A.13 are novel issues of first impression, the issues were prominently addressed in Appellants' opening brief to this Court, the issues are closely akin to the arguments made below, and, this being a motion to dismiss, the issues are not dependent on any new or controverted facts. With respect to the "closely akin" factor, *see* A-328, 330, 341-44, 348-50 (address-

ing the need to interpret Minn. Stat. § 80A.13 in accordance with the APA, Minn. Stat. § 80A.25 and Minn. Stat. § 645.26 and .44).

In support of its motion to dismiss, Respondent argued Minn. Stat. § 80A.13 provides discretion. A-312-13. Appellants met Respondent's argument by arguing that any discretion bestowed upon the Commissioner had to be exercised in accordance with the APA and Minn. Stat. § 80A.25 and arguing further that the Commissioner exercised his discretion improperly by not enforcing Rule 2875.3500. A-340-45. The trial court ignored Appellants' argument, holding only that Minn. Stat. § 80A.13 provides discretion without addressing the issue of whether the discretion was improperly exercised in light of Rule 2875.3500 and § 80A.25. A-6-8. Indeed, the trial court never even mentions Rule 2875.3500. *Id.* Appellants could not have anticipated that the trial court would decide this crucial issue without addressing Appellants' arguments or without even mentioning Minn. R. 2875.3500 and Minn. Stat. § 80A.25, the rule and statute upon which Appellants' claims against Respondent are significantly based.

The issues raised by Appellants in this appeal arise from an interpretation by the trial court of Minn. Stat. § 3.736, subd. 3(k) and 80A.13 that is unconstitutional and contrary to the statutory guidance for interpreting statutes, an interpretation not foreseeable by Appellants in responding to Respondent's motion to dismiss. Thus, these questions of constitutionality and statutory construction first arose as a result of the district court's interpretation of Minn. Stat. §§ 3.736 and 80A.13 to provide unfettered discretion without regard to compliance with law, thereby rendering ineffective Minn. Stat. § 80A.25 and Minn. R. 2875.3500. It is not the constitutionality of Minn. Stat. §§ 3.736 and 80A.13 that Appellants raise on appeal; it is the constitutionality of the construction given to those statutes by the district court that is raised on appeal.

IV. APPELLANTS STATED A CLAIM UNDER THE CONSUMER FRAUD ACT.

Respondent states that "Appellants have failed to identify with specificity any fraudulent practice committed by the Department." Allowing the sale of debentures by an

issuer whose financial condition fails the requisite test for determining whether the issuer can service the debentures, and who therefore should not have been allowed to sell its debentures, is fraudulent and deceptive. *See* Aplt's. Br. at 36-39. The facts supporting the alleged fraudulent practice have been alleged with the necessary specificity. A-90-113.

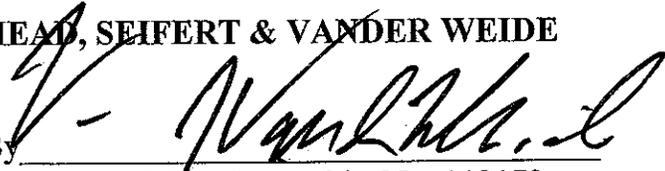
CONCLUSION

Finding for Appellants does not open the State to liability for failed stock investments. This case relates to a rule pertaining to debt securities only, as to which the State can avoid liability by simply enforcing the rule. For the reasons set forth herein, Plaintiffs respectfully request that the district court's order dismissing the complaint be reversed.

Dated: June 16, 2005

Respectfully submitted,

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