

NO. A10-1854

State of Minnesota
In Supreme Court

Hardin County Savings Bank, Walworth State Bank,
Eitzen State Bank, Northern National Bank n/k/a Frandsen Bank
& Trust, Kindred State Bank and First National Bank,

Plaintiffs/ Appellants,

vs.

James H. Bedard, Inc.,

Defendant/ Respondent.

APPELLANTS' BRIEF AND ADDENDUM

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2).

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STATEMENT OF LEGAL ISSUES

1. Whether the Court of Appeals erred in holding the Bondholders' negligent misrepresentation count was not pled with particularity.

The issue was raised in the Bondholders' Memorandum of Law in Opposition to Defendants' Motion to Dismiss (3/1/11 App. 101; 10/25/11 App. 145), and their Request to the Court for Reconsideration of its April 28, 2009 Order. (3/1/11 App. 149-150; 10/25/11 App. 41-42).

The trial court dismissed the Bondholders' claims of negligent misrepresentation against Bedard for failing to plead the circumstances constituting fraud with particularity and later denied the Bondholders' request for reconsideration. (10/25/11 App. 33, 44-45).

The issue was properly preserved for appeal by the Bondholders' Opposition to Defendants' Motion to Dismiss. (3/1/11 App. 101-133; 10/25/11 App. 145-177). The Bondholders timely sought further review of the Court of Appeals' Decision. (Add. 14-19).

Purdy v. Nordquist (In re Estate of Williams), 95 N.W. 2d 91, 99 (Minn. 1959)
Bonhiver v. Graff, 248 N.W. 2d 291, 298-99 (Minn. 1976)
Evangelical Lutheran Church in Am. Bd. of Pensions v. Spherion Pac. Workforce LLC, No. 04-4791, 2005 WL 1041487, at *3 (D. Minn. May 4, 2005)

STATEMENT OF THE CASE

On October 29, 2008, this action was filed in the Minnesota District Court for Crow Wing County by several community banks from Minnesota and surrounding states -- First National Bank of Wadena, State Bank of Eitzen, Northern National Bank of Brainerd, Hardin County Savings Bank, Walworth State Bank and Kindred State Bank (collectively “the Bondholders”).¹ The Bondholders purchased \$3.3 million of municipal bonds that financed the acquisition and development of real estate to be developed as a 96-lot housing project in Brainerd, Minnesota. The principal collateral for the bonds was the real estate, itself.

The Bondholders asserted various claims, including negligent misrepresentation and statutory securities fraud claims, against the appraiser of the real estate, James H. Bedard, Inc. (“Bedard”); the underwriter, Dougherty & Company, LLC (“Dougherty”); and the bond issuer, Housing and Redevelopment Authority for the City of Brainerd (“HRA”).

On November 26, 2008, Bedard filed a motion to dismiss the negligent misrepresentation claim and the state statutory security fraud claims. The district court, the Honorable David J. Ten Eyck, granted Bedard’s motion on April 28, 2009, and

¹ A prior suit was filed on April 18, 2008, in the United States District Court for the Northern District of Iowa alleging violation of the federal securities laws and other related state law claims against Bedard and others. Motions to dismiss were filed, and on September 18, 2008, the court dismissed the federal securities law claims *solely* on the failure to establish “loss causation.” See Hardin County Sav. Bank v. City of Brainerd, 602 F. Supp. 2d 1012, 1020-23 (N.D. Iowa 2008). The court decided not to exercise supplemental jurisdiction and dismissed the remaining claims without prejudice. See id. at 1025. Notably, no challenge was made by Bedard as to the sufficiency of the pleading of the negligent misrepresentation claim in that suit.

dismissed Bedard from the case. The court concluded that the Bondholders had failed to plead the circumstances of the negligent misrepresentation claims with sufficient particularity, despite the fact that the court determined that the Bondholders had pled fraud with particularity against Bedard on the statutory security fraud claims.²

On May 13, 2009, the Bondholders sought leave to file a motion for reconsideration or, in the alternative, leave to file an amended complaint. (3/1/11 App. 149-150; 10/25/11 App. 41-42). The district court denied those requests. (10/25/11 App. 43-46).

The action proceeded against HRA on a claim of negligence and against Dougherty on a claim of common law fraud. HRA and Dougherty eventually settled with the Bondholders, and the Bondholders dismissed these remaining claims with prejudice. A final judgment was entered on October 14, 2010. (3/1/11 App. 151; 10/25/11 App. 193). The Bondholders timely filed a notice of appeal on October 22, 2010. (3/1/11 App. 155; 10/25/11 App. 197).

On September 26, 2011, the Court of Appeals, in a 2-1 decision, affirmed the district court's ruling. (Add. 1-13). The Bondholders timely filed a petition for further review on October 25, 2011 which was granted on December 13, 2011. (Add. 14-19, 20-21).

² The court nevertheless dismissed the Iowa statutory security fraud claim as barred by the doctrine of collateral estoppel (10/25/11 App. 35-39), and the North Dakota statutory security fraud claim because it did not have a sufficient "physical nexus" with the state of North Dakota - a unique pre-requisite under that statute. (10/25/11 App. 21-23).

STATEMENT OF FACTS

I. The Complaint.

The Bondholders' 27-page First Amended Complaint³ alleged the Bondholders relied upon an Appraisal and Feasibility Study prepared by Bedard in deciding to purchase \$3.3 million of municipal bonds that were secured by real estate to be developed as a 96-lot housing project in Brainerd (the "Project"). Despite representations in the Feasibility Study of fourteen lot sales per year, the Bonds thereafter became worthless because virtually no lots were purchased during a three-year period, which was due to the inflated land values set forth in the Appraisal. The Appraisal misrepresented the Project's value by over \$1 million. The principal theory of recovery against Bedard was negligent misrepresentation based on the Appraisal and Feasibility Study which were prepared on October 29, 2003. Those documents were addressed to, among others, the trustee for the Bondholders and were attached to the Private Offering Memorandum ("POM") which was sent to the Bondholders. (3/1/11 App. 271-273, 274-371; 10/25/11 App. 313-315, 316-413).

A. The Project

In 2001, a private developer acquired approximately 40 acres of real estate in Brainerd to develop single-family residential housing. (3/1/11 App. 5 at ¶ 15; 10/25/11 App. 49). Upon the private developer's request, the City of Brainerd created a tax increment financing ("TIF") district for 20 single-family homes. (3/1/11 App. 5 at ¶¶ 17,

³ On January 12, 2009, the Bondholders filed their First Amended Complaint and Jury Demand, which is the operative complaint. (See 10/25/11 App. 21).

18; 10/25/11 App. 49). The private developer did not provide improvements to the real estate, and the City then issued \$1,085,000 of General Obligation Improvement Bonds to add streets, utilities and sidewalks to the Project. (3/1/11 App. 5 at ¶¶ 19, 20; 10/25/11 App. 49). Thereafter, HRA assumed the Project from the private developer and planned to issue taxable revenue bonds to acquire the real estate and make other improvements, including the building of two model homes. (3/1/11 App. 6 at ¶¶ 21, 22; 10/25/11 App. 50).

Taxable revenue bonds are commonly issued by municipal entities, such as the HRA, to the public to finance private projects that serve public needs. (3/1/11 App. 6 at ¶ 23; 10/25/11 App. 50). These bonds are then repaid from funds generated by a dedicated revenue stream from the issuer's project financed with the proceeds of the bond or the issuer's taxing power, and are often secured by the underlying project real estate. (3/1/11 App. 6 at ¶ 23; 10/25/11 App. 50). In this circumstance, the principal revenue stream was expected to be from the sale of lots and not from HRA's taxing power. (3/1/11 App. 6 at ¶ 23; 10/25/11 App. 50).

HRA retained Dougherty as its underwriter to prepare the POM pursuant to which HRA offered to sell \$3.3 million of taxable revenue bonds (the "Bonds") with the proceeds to be used to acquire and improve real estate for the Project. (3/1/11 App. 6 at ¶ 24; 10/25/11 App. 50). The POM contained, among other things, Bedard's Appraisal and Feasibility Study. (3/1/11 App. 7-8 at ¶¶ 27, 29, 40; 10/25/11 App. 51-52).

B. Appraisal and Feasibility Study

The Bedard Appraisal of the residential and commercial lots was made as of October 27, 2003. (3/1/11 App. 158-226, 227-270; 10/25/11 App. 200-268, 269-312). The Bedard Appraisal was specially designed to be relied upon by the Bondholders to induce their purchase of the Bonds. (3/1/11 App. 7, 24 at ¶¶ 31, 158; 10/25/11 App. 51, 68).

The Bedard Appraisal opined the real estate (including 2 model homes, 94 residential lots and 2 commercial lots) was worth \$4,127,670,⁴ which *overstated* the value of the collateral by, at least, \$1 million, and was based on *flawed* absorption and discount rates. (3/1/11 App. 7 at ¶ 32; 10/25/11 App. 51). The Bedard Appraisal, which was used to set residential lot prices, valued each lot at \$43,386 per lot. (3/1/11 App. 7 at ¶ 33; 10/25/11 App. 51). This amount took “*into account the improvements* such as streets, utilities, sidewalks, plantings in addition to the existing approvals, bonding and tax increment financing.” (3/1/11 App. 7 at ¶ 34; 10/25/11 App. 51). These improvements, which were provided by the City at a cost \$1,085,000, translated into a special assessment cost of \$11,302 per lot, which would be paid by the buyer in addition to the lot cost. (3/1/11 App. 8 at ¶¶ 35-36; 10/25/11 App. 52). Thus, a lot buyer would have to pay \$43,386 for the lot plus the \$11,302 special assessment which meant the true cost of the lot was \$54,688. (3/1/11 App. 8 at ¶ 37; 10/25/11 App. 52). Because the Bedard Appraisal was used to determine lot prices, and because of the errors in the

⁴ Total Project Appraised Value of \$4,127,670: 94 Lots -- \$3,282,6702; Commercial Lots -- \$450,000; Patio Home -- \$220,000; Family Home -- \$175,000. (3/1/11 App. 271; 10/25/11 App. 313).

Appraisal, the price of \$54,688 for each lot was too high and resulted in virtually none of the lots being sold, despite a strong real estate market in 2004 and 2005. (3/1/11 App. 8 at ¶ 38; 10/25/11 App. 52).

The Feasibility Study concluded it would take seven years to sell all of the lots in the Development (i.e.--the “absorption rate”) and deemed the sale of approximately 14 lots per year was “a very achievable plan.”⁵ (3/1/11 App. 8 at ¶ 41; 10/25/11 App. 52). The Feasibility Study restated the *erroneous* lot value from the Appraisal and relied upon those *flawed* values and *failed* to properly take into account the special assessment cost on the price of a lot to reach a seven-year absorption rate. (3/1/11 App. 9 at ¶ 42; 10/25/11 App. 53). The Feasibility Study then *contradicted* the seven-year absorption rate and states a four-year absorption rate would be used in the discount process which further overstated the value of the Bondholders’ collateral.

The failure to sell lots resulted from the materialization of the concealed risk caused by the misrepresentations and mistakes in the Appraisal, and this failure was foreseeable. The fact that only three lots were sold during 2004 and 2005, demonstrated the failure to sell the remaining 93 lots was due to the lots being priced too high. The failure of such sales led to insufficient revenue to pay the bonds, which caused a default

⁵ After consideration, Bedard was of the opinion that “this subdivision *would sell out in a* length of time no longer than seven years, which means an average of about 14 home [sic] per year in this 96 lot subdivision.” (3/1/11 App. 272; 10/25/11 App. 314) (emphasis added).

of the bonds and caused Plaintiffs' loss.⁶ (3/1/11 App. 8-9 at ¶¶ 39, 44; 10/25/11 App. 52-53).

The lot price of \$54,688 was an unrealistically high price for moderate-income buyers in Brainerd and materially impacted lot sales. (3/1/11 App. 10 at ¶ 50; 10/25/11 App. 54). Accordingly, the Project was not economically viable when the Bonds were issued because buyers of lots would, in the aggregate, have to repay \$3.3 million in bonds along with \$1,085,000 in special assessments. This amount is in excess of the flawed Bedard Appraisal. (3/1/11 App. 10 at ¶ 51; 10/25/11 App. 54). The Bedard Appraisal and the Feasibility Study were attached as exhibits to the Complaint. (3/1/11 App. 158-226, 271-273; 10/25/11 App. 200-268, 313-315).

In reliance on this information from Bedard, the Bondholders purchased all of the \$3,300,000 of Bonds issued by the HRA. (3/1/11 App. 12 at ¶¶ 60-61; 10/25/11 App. 56). Eventually, HRA defaulted on the bonds, (3/1/11 App. 14-15 at ¶¶ 80-87; 10/25/11 App. 58-59), and the Bondholders filed this action.

C. The Bondholders' Actions

Based upon the facts pled in paragraphs 1 through 61 of the Complaint, the Bondholders asserted three counts against Bedard - Count VIII, a state security fraud

⁶ For example, the Bedard Appraisal and Feasibility Study stated the lots were worth X, failed to subtract the special assessment costs of Y which, had that been done, then the remainder value of Z would have more accurately reflected the value of the lots; yet the Bonds were purchased on the representation that the bondholders' collateral -- the real estate -- was worth X and lot prices were based on X which resulted in lot prices being too high for buyers. Separate from the failure to subtract the special assessment cost of Y, the appraised value of the lots was also too high. (3/1/11 App. 9 at ¶ 45; 10/25/11 App. 53).

claim under Iowa law; Count IX, a state security law claim under North Dakota law; and Count X, a negligent misrepresentation claim. Count VIII specifically stated that Bedard, Inc. made omissions of material fact and representations to Bondholders as follows:

- Omission of material fact with respect to \$1,085,000 in special assessments levied against the lots which resulted in an added cost of \$11,262 per residential lot for buyers.
- Representations that the adjusted average base site value was worth \$43,386 and that amount “*takes into account the improvements*” such as streets, utilities, sidewalks, plantings in addition to the existing approvals, bonding and tax increment financing.” (emphasis added).
- Representations that the real estate was worth \$4,127,670, which overstated the value of the real estate by, at least, \$1,000,000.

(3/1/11 App. 25 at ¶ 160; 10/25/11 App. 69).

Count VIII went on to allege the statements and omissions by Bedard were false and misleading in the following ways:

- Appraisal overvalued the real estate by, at least, \$1,000,000.
- Feasibility Study’s time period for lot sales was a virtual impossibility due to the cost to acquire a lot and pay the related real estate taxes and special assessments.

(3/1/11 App. 25 at ¶ 161; 10/25/11 App. 69).

Count X, the negligent misrepresentation claim stated:

**NEGLIGENT MISREPRESENTATION
BEDARD, INC.**

177. Plaintiffs *reallege* the allegations contained in paragraphs 1 through 176 *as though fully set forth herein*.

178. Bedard, Inc. negligently supplied information to Bondholders which was false.

179. Bedard, Inc. acted in the course of its business and had a financial interest in supplying the information.

180. Bedard, Inc. intended to supply the information for the benefit and guidance of Bondholders in their business transactions.

181. Alternatively, Bedard, Inc. knew Dougherty intended to supply the information for the benefit and guidance of Bondholders in their business transactions.

182. Bedard intended the information to influence the transaction for which the information was supplied.

183. Alternatively, Bedard, Inc. knew that Dougherty intended the information to influence the transaction for which the information was supplied.

184. Bondholders acted in reliance on the truth of the information supplied and were justified in relying on the information.

185. Information supplied by Bedard, Inc. was a proximate cause of the Bondholders' damage, in an amount greater than \$50,000.

(3/1/11 App. 27-28; 10/25/11 App. 71-72) (emphasis added).

II. Bedard's Motion To Dismiss For Failure To Plead Negligent Misrepresentation With Particularity.

Bedard challenged the state statutory securities fraud and the negligent misrepresentation counts for a lack of pleading with particularity.

Bedard's motion regarding Count X acknowledged that the Bondholders claimed:

- Omission of material fact with respect to \$1,085,000 in special assessments levied against the lots which resulted in added costs of \$11,262 per residential lot for buyers.
- Representations that the alleged adjusted site value was worth \$43,386 and that "*takes into account the improvements*" such as streets, utilities, sidewalks, plantings in addition to existing approvals, bonding and tax increment financing.

- Representations that the real estate was worth \$4,127,650, which overstated the value of the real estate by, at least, \$1,000,000.

(3/1/11 App. 67-68; 10/25/11 App. 111-112). But Bedard then stated in conclusory fashion that: “Plaintiffs’ Complaint simply fails to plead the particular details of the alleged ‘representations’ and oral communications.”⁷ (3/1/11 App. 68; 10/25/11 App. 112) (emphasis added).

Bedard’s reply brief asserted that the Complaint still fell far short of the heightened pleadings standard mandated by Rule 9.02 because the negligent misrepresentation claim was “vague” and cannot form the basis for *fraud*. (3/1/11 App. 147; 10/25/11 App. 191). No other grounds or specific objections were asserted by Bedard.

III. The District Court’s Ruling On The Motion To Dismiss.

The district court heard the pending motions to dismiss on January 29, 2009. Bedard did not provide any argument on the negligent misrepresentation claim as pled. (3/1/11 App. 475).

In its Order and Memorandum, the district court reviewed the Amended Complaint and addressed the key provisions:

The heart of Plaintiffs’ claims begins exactly with the October 2003 *Bedard Appraisal and all claims emanate from there*. Essentially what Plaintiffs argue is that the Bedard Appraisal was specially designed to be relied upon by them to induce the purchase of Bonds. *Id.* at ¶ 31. However, according to the Amended Complaint, the Bedard Appraisal was calculated based on “*flawed*” data and incorrectly included the value of improvements in the lots in the lots’ prices. *Id.* at ¶¶ 32, 34. This inclusion of the improvements

⁷No oral communications by Bedard were alleged – only its statements in the Appraisal and Feasibility Study. Accordingly, Bedard’s incorporation of Dougherty’s argument on that point in Bedard’s brief made little sense.

in the lot price resulted in the lots being overpriced by \$11,302 and priced at \$54,688 instead of \$43,386. *Id.* at ¶ 37. As a result of this overpricing, only three lots sold in 2004 and 2005, while 93 remained unsold. *Id.* at ¶ 39. In summary, according to the Plaintiffs' Amended Complaint, the bonds defaulted because there wasn't sufficient revenue to pay them, there was not sufficient revenue because the lots failed to sell, and the lots failed to sell because they were incorrectly priced.

(10/25/11 App. 29) (emphasis added).

That recitation of facts alone demonstrated the detailed facts were pled with particularity as to the misrepresentation claim against Bedard. In addressing the securities fraud claim against Bedard, the court further stated:

Plaintiffs also raise a claim against Bedard for violating the Iowa Securities Act. Specifically, Plaintiffs allege: Bedard omitted a material fact regarding the \$11,262 per lot in special assessments; Bedard made representations that the base site value of \$43,386 already took into account the improvements when they did not; and that *Bedard represented that the real estate was worth \$4.1 million when it was actually worth at least \$1 million less than that.* (P. Am. Compl. ¶¶ 160-161). Plaintiffs also allege that the statements and omissions were material, that they occurred in connection with the sale of bonds, that they were made with scienter, that they were relied on by Plaintiffs, and that they were the proximate cause of the Plaintiffs' losses. Therefore, Plaintiffs have *properly pleaded with particularity a claim against Bedard for violation of the Iowa Securities Act as required by Rule 9.02.*

(10/25/11 App. 30-31) (emphasis added).

In addition to finding a state securities fraud claim against Bedard was pled with particularity, the district court also found that fraud was properly pled with particularity against Dougherty for the written communications in the POM. (See 10/25/11 App. 34 - "Plaintiffs have *properly pleaded fraud* with regard to the claim of the overvalued real property") (emphasis added). Surprisingly, the court then found that the related claim of negligent misrepresentation against Bedard was not sufficiently pled.

The entirety of the court's ruling as to Bedard on the negligent misrepresentation count provided:

Count X raises a charge of negligent misrepresentation against Bedard. The above analysis with regard to Dougherty, McDonald, and Wilder is also applicable to the charge of negligent misrepresentation against Bedard. The count only *vaguely* alleges that Bedard negligently supplied false information to Plaintiffs and *fails to allege any specific details* regarding the alleged negligent misrepresentations. (P. Am. Compl. ¶ 178). Additionally, the count fails to allege that Bedard failed to exercise reasonable care in obtaining *whatever information it is* that Plaintiffs allege was both negligently supplied and false. For these reasons, Count X is not pleaded with particularity.'

(10/25/11 App. 33) (emphasis added).

The district court premised its decision on the allegations contained in the negligent misrepresentation claim itself and seemingly paid no credence to the fact that the first allegation for that count expressly *incorporated* by reference all facts previously set forth in the Complaint. Paragraphs 29, 51, 160 and 161, among others, detailed that the basis for the claim against Bedard was the October Appraisal and Feasibility Study which were attached to the Complaint and by reference incorporated therein.

IV. Court Of Appeals' Decision.

The Court of Appeals, in a 2-1 vote, affirmed the district court's ruling which found that incorporating paragraphs 1-176 was "simply regurgitating a complex complaint against multiple defendants in a catch-all provision would undermine the purpose of requiring a fraud claim be plead with particularity." (Add. 7). The majority failed to properly consider that the preceding security fraud count against Bedard, Count VIII, met the pleading with particularity standard.

Moreover, with no additional facts pled in the negligent misrepresentation claim, it was clear the core fraud facts against Bedard came from preceding allegations.

As the Chief Judge pointed out in the dissent, paragraphs 29-45 and 160-162 provided a detailed description of the misrepresentation in the Appraisal and Feasibility Study. The dissent addressed the “regurgitation” comment and stated that Minn. R. Civ. P 10.03 authorizes statements in a pleading to be adopted by reference in a different part of the same pleading. The dissent concluded that the district court had no difficulty identifying and summarizing the facts underlying the claim that began with the October 2003 *Bedard appraisal and all claims emanate from there* nor did Bedard have difficulty identifying the specific allegations. Further, Bedard could not credibly claim that it did not know the nature of the claims against it nor was it hampered in any way to prepare a defense.

As the Chief Judge aptly stated:

“Appellants have sufficiently alleged the ultimate facts and dismissing their complaint for failure to state a claim *elevates form over substance* and ignores the admonition of Minnesota Rule 8.06 that all pleadings shall be so construed as to do substantial justice.” (Add. 13) (emphasis added).

ARGUMENT

The Bondholders sought further review because the Complaint adequately pleads the circumstances constituting fraud with particularity as required by Rule 9.02 of the Minnesota Rules of Civil Procedure. The Complaint contains detailed fact allegations

which provided adequate opportunity for Bedard to understand the precise negligent misrepresentations made in the Appraisal and Feasibility Study and the harm caused. The Court of Appeals' decision was a significant departure from this Court's rules on pleading with particularity. Instead of elevating form over substance, the Bondholders should be allowed to proceed on the negligent misrepresentation claim. The Bondholders should not be denied the right to pursue a claim due to rulings which failed to apply the proper "pleading with particularity" test to the negligent misrepresentation claim at issue.

I. THE COURT OF APPEALS ERRED IN HOLDING THE BONDHOLDERS' NEGLIGENT MISREPRESENTATION COUNT WAS NOT ADEQUATELY PLED WITH PARTICULARITY.

The sufficiency of pleading in a complaint is a question of law that the Court reviews de novo. See Bodah v. Lakeville Motor Express, Inc., 663 N.W.2d 550, 553 (Minn. 2003); Frost-Benco Elec. Ass'n v. Minn. Pub. Utils. Comm'n, 358 N.W.2d 639, 642 (Minn. 1984) ("[A]n appellate court need not give deference to a trial court's decision on a legal issue"). "The reviewing court must consider only the facts alleged in the complaint, accepting those facts as true and must construe all reasonable inferences in favor of the nonmoving party." Bodah, 663 N.W.2d at 553.

Several general rules of pleading apply to this appeal. A pleading which sets forth a claim for relief "shall contain a short and plain statement of the claim showing that the pleader is entitled to relief and a demand for judgment for the relief sought." Minn. R. Civ. P. 8.01 (emphasis added). "Each averment of a pleading shall be simple, concise, and direct" and "[n]o technical forms of pleading . . . are required." Minn. R. Civ. P. 8.05(a) (emphasis added). "Statements in a pleading may be adopted by reference in a

different part of the same pleading,” and “a copy of any written instrument which is an exhibit to a pleading is a part of the statement of claim or defense set forth in the pleading.” Minn. R. Civ. P. 10.03.

In addition to these rules, “[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity.” Minn. R. Civ. P. 9.02; see also Tuttle v. Lorillard Tobacco Co., 118 F. Supp. 2d 954, 963 (D. Minn. 2000). The pleading standards set forth in Rule 9.02 apply to a claim of negligent misrepresentation. Juster Steel v. Carlson Cos., 366 N.W.2d 616, 618-19 (Minn. App. 1985).

Rule 9.02 requires, but does not define, “particularity,” Stubblefield v. Gruenberg, 426 N.W.2d 912, 914 (Minn. App. 1988), but the Minnesota Supreme Court has explained that the requirements of the rule “are satisfied when the ultimate facts are alleged.” Purdy v. Nordquist (In re Estate of Williams), 95 N.W. 2d 91, 99 (Minn. 1959). Minnesota courts have looked to federal courts’ interpretation of the federal pleading rules for further guidance, because Rules 8.05(a) and 9.02 are virtually identical to Rules 8(d)(i) and 9(b) of the Federal Rules of Civil Procedure. See Signature Bank v. Marshall Bank, Nos. A05-2337, -2556, 2006 WL 2865325, at *3 (Minn. App. Oct. 10, 2006) (describing Rule 9(b) as the “counterpart” to Rule 9.02 and thus looking to the Eighth Circuit’s interpretation of Rule 9(b) to interpret particularity under Rule 9.02) (3/1/11 App. 499-505); see also DLH, Inc. v. Russ, 566 N.W.2d 60, 69 (Minn. 1997) (stating that the federal rules are instructive on interpreting the Minnesota rules, especially when “the relevant language of the state and federal rules is identical”); Gordon v. Microsoft Corp.,

645 N.W.2d 393, 400 (Minn. 2002) (concluding that when the case law in Minnesota regarding a rule is not very helpful and federal jurisprudence in the area is recent and well-developed, Minnesota courts first look to federal law for guidance).

“Particularity” under Federal Rule 9 has been construed to mean the “who, what, when, where, and how: the first paragraph of any newspaper story.” See Parnes v. Gateway 2000, Inc., 122 F.3d 539, 549 (8th Cir. 1997); see also Signature Bank, 2006 WL 2865325, at *3 (looking to interpretations of Rule 9(b) and explaining that the pleading must include “such matters as the time, place, and contents of false representations, as well as the identity of the person making the misrepresentation and what was obtained or given up thereby”) (3/1/11 App. 501). It has been noted that although Federal Rule 9(b) effectively modifies the general notice pleading requirements of Rule 8(a)(2), Rule 8(d)(1) – just as Minnesota Rule 8.05(a) – still dictates that each averment of a pleading of fraud be “simple, concise, and direct.” 2-9 Moore’s Federal Practice - Civil § 9.03. For this reason, courts should harmonize the specificity requirements of Rule 9 with the liberal pleading policies of Rule 8. 2-9 Moore’s Federal Practice - Civil § 9.03[7]; see, e.g., Mobil Oil Corp. v. Dade County Esoil Mgmt. Co., 982 F. Supp. 873, 878 (S.D. Fla. 1997) (complaint provided “reasonable delineation” of acts constituting fraud when plaintiff made specific allegations of defendants’ fraud, including dates and amounts involved, and gave “fair notice” of nature of claim).

When a challenge is made to a complaint failing to allege negligent misrepresentation with particularity, the complaint is analyzed as a whole. Evangelical Lutheran Church in Am. Bd. of Pensions v. Spherion Pac. Workforce LLC, No. 04-4791,

2005 WL 1041487, at *3 (D. Minn. May 4, 2005) (analyzing complaint as a whole to conclude that negligent misrepresentation claim was pled with particularity even where certain allegations taken alone would have failed the particularity test) (3/1/11 App. 476-479). Not every alleged misrepresentation need appear in the pleadings and a claimant is required to set forth only the major misrepresentations or omissions upon which the fraud claims are based. 2-9 Moore's Federal Practice - Civil § 9.03[1][A]; Commercial Prop. Invs., Inc. v. Quality Inns Int'l Inc., 61 F.3d 639, 646 n.6 (8th Cir. 1995) (allegations in pleading unambiguously stated "the core" of claims through examples that were more than adequate to satisfy Fed. R. Civ. P. 9(b)). Above all, "pleadings shall be so construed as to do substantial justice." Minn. R. Civ. P. 8.06. (emphasis added). The Court of Appeals failed to properly apply these standards.

The Court of Appeal's conclusion was based on an overly formalistic reading of the Complaint and an improper limitation of those allegations set forth in Count X.

The decision by the majority made the uncommon criticism that the allegations in the Complaint were *too numerous* for the defendant to figure out what claims were being brought against it. The dissent found that assertion lacking because the district court and Bedard identified the core facts on the Bedard Appraisal and Feasibility Study and the shortcomings therewith. (Add. 11-12).

The Court of Appeals' majority, apparently recognizing the tenuous ground of the first part of its analysis, then grafted new requirements into the pleading with particularity rule. The majority indicated "nowhere in the complaint do [Bondholders] expressly outline what information [Bedard] negligently misrepresented," - yet, the Court never

applied the “who, what, when, where and how” test nor reviewed the ultimate facts pled. (Add. 7).

Had the appropriate standard been applied, it would have demonstrated that in simple, concise and direct allegations, the Bondholders pled the “who, what, when, where and how” of their negligent misrepresentation claim against Bedard. The Complaint stated: who-Bedard (3/1/11 App. 7 at ¶ 29; 10/25/11 App. 51); what-Appraisal and Feasibility Study, (3/1/11 App. 158-273; 10/25/11 App. 200-315); when-October 27, 2003 (3/1/11 App. 7 at ¶ 30; 10/25/11 App. 51); where-Brainerd Oaks Project, Brainerd, Minnesota (3/1/11 App. 5 at ¶ 20; 10/25/11 App. 49); and how-erroneous Appraisal misrepresented collateral value along with a flawed and contradictory Feasibility Study (3/1/11 App. 7-9, 25 at ¶¶ 32-45, 160-161; 10/25/11 App. 51-53, 69).

The majority went on to provide suggestions of what it deemed would have met the pleading with particularity rule. (Add. 7-8). It is troubling that in each instance, the Complaint *did* provide the information the majority found missing:

1) Inflating the base value of the land.

In seemingly contradictory fashion, the majority found an allegation of “inflating the base value of the land” would have met the pleading standard-yet found the allegation that Bedard “overstated value by at least a million dollars” did not meet the standard.

In particular, the Complaint stated:

32. The Bedard Appraisal, among other things, . . . *overstated* the *value* of the collateral by, at least, \$1 million. . . . [a] lot buyer would have to pay \$43,386 for the lot *plus* the \$11,302 special assessment which meant the *true* cost of the lot was \$54,688. (3/1/11 App. 7-8 at ¶¶ 36-37; 10/25/11 App. 51-52). . . .

38. [b]ecause of the *errors in the appraisal*, the price of \$54,688 for each lot was too high . . . (3/1/11 App. 8; 10/25/11 App. 52).

45. [T]he Bedard Appraisal and Feasibility Study . . . *failed to subtract the special assessment costs . . . which, had that been done*, then the remainder value would have more accurately reflected the value of the lots; . . . *Separate from the failure to subtract the special assessment cost of Y, the appraised value of the lots was also too high.* (3/1/11 App. 9; 10/25/11 App. 53).

160. Bedard made . . . *Omission of material fact with respect to \$1,085,000 in special assessments levied against the lots.* . . . [o]verstated the value of the real estate by, at least, \$1,000,000. (3/1/11 App. 25; 10/25/11 App. 69).

161. . . . Feasibility Study's *time period* for lot sales was a *virtual impossibility* due to the cost to acquire a lot and pay the related real estate taxes and special assessments. (3/1/11 App. 25; 10/25/11 App. 69).

2) Outlining why the absorption and discount rates were flawed.

42. The Feasibility Study *restated the erroneous lot value from the Appraisal and relied upon those flawed values and failed to properly take into account the special assessment cost on the price of a lot to reach a seven-year absorption rate.* (3/1/11 App. 9; 10/25/11 App. 53).

43. The Feasibility Study then *contradicts the seven-year absorption rate* and states a four year absorption rate would be used in the discount process which *further overstated the value* of the bondholders' collateral. (3/1/11 App. 9; 10/25/11 App. 53).

3) Ignoring the likelihood of a special assessment fee.

There was no reason to plead the "likelihood" of a special assessment fee for a simple reason—the fee had already been assessed.⁸

⁸ Bedard omi[tte]d material fact[s] with respect to *\$1,085,000 in special assessments levied against the lots.* (3/1/11 App. 10, 14, 25 at ¶¶ 47, 77, 160; 10/25/11 App. 54, 58, 69).

4) Miscalculating the improvement costs.

The improvement costs were \$1,085,000 and there was no reason to claim those costs were “miscalculated.” (3/1/11 App. 8 at ¶ 35; 10/25/11 App. 52).

The Complaint answered each of the questions the majority found insufficiently addressed. The Complaint adequately satisfied the “who, what, when, where and how” test and pled the ultimate facts which put Bedard on notice of the claims against it.

A. Analyzing The Entire Complaint, Simple, Concise And Direct Allegations Of Bedard’s Negligent Misrepresentation Were Pled With Particularity.

This Court has adopted the tort of negligent misrepresentation as defined in the in the Restatement (Second) of Torts § 552:

“One who, in the course of his business, profession or employment, or in a transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.”

Bonhiver v. Graff, 248 N.W.2d 291, 298-99 (Minn. 1976) (quoting Restatement (Second) of Torts § 552); see also Florenzano v. Olson, 387 N.W.2d 168, 174 n.3 (Minn. 1986) (reaffirming this definition of negligent misrepresentation); 4 Minn. Practice, Jury Instruction Guides, Civil, CIVJIG 57.20 (5th Ed. 2008); Yarrington v. Solvay Pharm, Inc., No. A05-2288, 2006 WL 2729463, at *4 (Minn. App. Sept. 26, 2006) (“negligent misrepresentation requires the same proof as fraud, minus scienter”).

The Bondholders pled each of the elements required for a negligent misrepresentation claim under Minnesota law. In particular, the Complaint stated:

1) In the Course of His Business

- The false information was provided in the Appraisal and Feasibility Study, prepared by Bedard, which was hired to conduct the appraisal and did so conduct it as a part of its business. (3/1/11 App. 4, 7, 27 at ¶¶ 12, 29, 179; 158-226, 271-273; 10/25/11 App. 48, 51, 71, 200-268, 313-315).

2) Supplied False Information to Another Person to Guide Them in That Person's Own Business Transactions

- The Appraisal overvalued the real estate by, at least, \$1 million which was false. (3/1/11 App. 7, 25 at ¶¶ 32, 161; 10/25/11 App. 51, 69).
- The Appraisal stated that valued lots at \$43,386 per lot, which was false. (3/1/11 App. 7, 9 at ¶¶ 33, 45; 10/25/11 App. 51, 53).
- The Appraisal omitted the \$11,302 cost per lot that buyers would have to pay. (3/1/11 App. 7-8 at ¶¶ 34-37; 10/25/11 App. 51-52).
- The Feasibility Study indicated 14 lot sales per year were very achievable for lots which cost \$54,688, and that was false. (3/1/11 App. 8-9 at ¶¶ 37, 38, 41, 44; 10/25/11 App. 52-53).
- The Feasibility Study's time period for lots sales was a virtual impossibility due to the cost to acquire a lot and pay the related real estate taxes and special assessments. (3/1/11 App. 25 at ¶ 161; 10/25/11 App. 69).

3) Fails to Use Reasonable Care or Competence in Communicating It

- Bedard was a certified licensed Minnesota appraiser who made errors in the appraisal and used a flawed analysis which over stated the value of the real estate collateral by, at least, \$1 million and ignored the impact the \$1,085,000 special assessment would have on lot sales. (3/1/11 App. 7-8 at ¶¶ 32, 38; 158, 227; 10/25/11 App. 51-52, 200, 269).
- Bedard's Feasibility Study used flawed absorption and discount rates -- at one point he used a 7-year absorption rate for lot sales and then in another portion of the study he used a 4-year absorption rate which was contradictory. (3/1/11 App 8-9 at ¶¶ 41-43; 10/25/11 App. 52-53).
- Bedard indicated that "the subdivision would sell out in a length of time no longer than seven years, which means an average of about 14 home [sic] per year in this 96 lot subdivision." (3/1/11 App. 272; 10/25/11 App. 314).

4) The Other Person Relied on the Information

- The Appraisal and Feasibility Study were attached to the POM which was provided to the Bondholders. The Bonds were purchased based on the representation that the bondholder's collateral (real estate) was worth a certain amount as reflected in the information provided by Bedard and that lots would sell at the rate of 14 lots per year. (3/1/11 App. 7-9, 12 at ¶¶ 30, 31, 40, 41, 45, 60; 10/25/11 App. 51-53, 56).

5) The Other Person Was Justified in Relying on That Information

- Bedard's information in the Appraisal and Feasibility Study was specifically directed to the Bondholders for their use in deciding whether to purchase the bonds. The Appraisal in particular was addressed on the front page to the Bondholder's Trustee. The function of this appraisal is to establish values for bonding purposes. (3/1/11 App. 7 at ¶¶ 30, 31; 158, 160, 227, 229; 10/25/11 App. 51, 200, 202, 269, 271).

6) The Other Person Was Financially Harmed by Relying on That Information

- The Bondholders purchased \$3.3 million of bonds based on the Appraisal and Feasibility Study.
- The lots prices were set too high based upon such information and the lots did not sell because the prices were too high.
- The Bonds went into default because insufficient funds were generated from lot sales to repay the bonds and the bonds defaulted due to the errors in Bedard's information. (3/1/11 App. 8-9, 12, 14-15 at ¶¶ 39, 44, 61, 84-86; 10/25/11 App. 52-53, 56, 58-59).

Thus, the Bondholders properly alleged each of the elements of a negligent misrepresentation claim under Minnesota law.⁹

⁹ Because of the Bondholders' interest in ensuring that the Complaint would state a claim for negligent misrepresentation under Iowa or Minnesota law, depending upon which state's law would ultimately be applied, the Complaint also included allegations that were not necessarily required elements of a negligent misrepresentation claim as articulated by Minnesota courts. See Iowa Uniform Jury Instruction 800.1 (which, like Minnesota law, is based upon Restatement (Second) of Torts § 552). Given that no technical form of pleadings is required, Minn. R. Civ. P. 8.05(a), and facts supporting all necessary elements of negligent misrepresentation are pled with particularity, the

Admittedly, these allegations in paragraphs 178 to 185 of the Complaint set forth few factual specifics of the claim of negligent misrepresentation, but these were not the only factual allegations regarding Bedard's misrepresentations to the Bondholders. When considering whether a complaint pleads fraud with particularity, the court must consider the complaint as a whole. See Evangelical Lutheran Church in Am. Bd. of Pensions, 2005 WL 1041487, at *3. (3/1/11 App. 478). This is particularly so where, as here, the negligent misrepresentation count included a paragraph expressly incorporating the factual allegations previously set forth in the Complaint in paragraphs 1 through 176, as permitted under Rule 10.03 of the Minnesota Rules of Civil Procedure. (See 3/1/11 App. 27 at ¶ 177; 10/25/11 App. 71).

The facts alleged in the Bondholders' Complaint are consistent with, or greater than, the level of particularity found to be sufficient in other state and federal Minnesota courts considering such a challenge to a claim of negligent misrepresentation. See Evangelical Lutheran Church in Am. Bd. of Pensions v. Spherion Pac. Workforce LLC, No. 04-4791, 2005 WL 1041487, at *3 (D. Minn. May 4, 2005) (denying motion to dismiss for lack of particularity, despite some generic and vague allegations where the

presence of any unnecessary allegations or slight variances in the phrasing of the allegations is immaterial.

The district court concluded that the Bondholders failed to allege that "Bedard failed to exercise reasonable care in obtaining" the information negligently supplied (10/25/11 App. 33), but this is not a required element under Bonhiver. Contrary to the district court's description of Bonhiver's holding, (10/25/11 App. 32), one may allege a failure "to exercise reasonable care or competence in obtaining or communicating the information" 248 N.W. 2d at 298 (emphasis added). Accordingly, alleging that Bedard negligently supplied the information to the Bondholders pleads this element and separate pleading regarding obtaining the information is unnecessary.

complaint as a whole put defendant on notice of particular misrepresentations by reference to weekly reports and a specific withheld e-mail) (3/1/11 App. 476-479); Progressive N. Ins. Co. v. Alivio Chiropractic Clinic, Inc., No. 05-0951, 2005 WL 2739304, at *4 (D. Minn. Oct. 24, 2005) (denying motion to dismiss for lack of particularity claims of intentional and negligent misrepresentation) (3/1/11 App. 494-498); Conwed Corp. v. Employers Reinsurance Corp., 816 F. Supp. 1360 (D. Minn. 1993) (denying motion to dismiss for lack of particularity where complaint alleged defendant as an insurance broker made false representations and omissions concerning the coverage afforded by an insurance policy purchased by plaintiffs in reliance on the statements); Yarrington v. Solvay Pharm, Inc., No. A05-2288, 2006 WL 2729463 (Minn. App. Sept. 26, 2006) (concluding that district court erred in concluding that negligent misrepresentation and fraud claims were not pled with particularity – although affirming the claim’s dismissal on other grounds – where complaint, although otherwise lacking allegations of fraudulent statements, did include one specific allegation of misrepresentation and other specific representations that were allegedly deceptive) (3/1/11 App. 506-512); Olson P’ship, L.L.P. v. Scott, No. 69DU-CV-07-1551, 2009 WL 2581763, at Pt. IV (Minn. Dist. Ct. Jan. 4, 2009) (holding that plaintiff had properly pled negligent misrepresentation and fraud with particularity where plaintiff alleged that defendant misrepresented the ownership of certain software by discussing the software at regular weekly meetings with plaintiff and never once challenging the ownership of the software) (3/1/11 App. 485-493). Interestingly, in these cases that involved negligent

misrepresentation and fraud claims, the court analyzed both claims together in a single particularity analysis, further demonstrating the anomalous nature of the prior rulings.

B. The Policy Concerns Underlying The Pleading With Particularity Requirement Are Not Present.

The purposes of the pleading with particularity requirement are to provide detailed notice of a fraud claim to a defending party which facilitates a defendant's ability to respond and to prepare a defense to charges of fraud, protects a defending party's reputation from harm and minimizes strike suits. See Commercial Prop. Invs. v. Quality Inns Int'l, 61 F.3d 639, 644 (8th Cir. 1995); 2 Moore's Federal Practice - Civil § 9.03[1][A] (citing Harrison v. Westinghouse Savannah River Co., 176 F.3d 776, 784 (4th Cir. 1999)) (rule ensures that defendant has sufficient information to formulate defense by putting it on notice of conduct in dispute); Tuchman v. DSC Communications Corp., 14 F.3d 1061, 1067 (5th Cir. 1994) (Fed. R. Civ. P. 9(b)'s "heightened pleading standard" provides fair notice of plaintiff's claims). The requirements of Rule 9 effectively prevent a claimant from searching for a valid claim after a civil action has been commenced. Id.

Because Rule 9.02 is intended to provide a "more specific form" of notice of a claim, the proper focus is on the *core facts* pled. Here, detailed notice was provided to Bedard that the Appraisal and Feasibility Study contained misrepresentations as to the value of the collateral for the Bonds which overvalued the real estate by \$1 million and failed to properly account for the \$1,085,000 of special assessments. Bedard had adequate notice to respond and prepare a defense.

None of the policy concerns regarding abusive pleading practices were present in this case. The claim against Bedard was not a “strike suit” and no undue harm to Bedard’s reputation occurred from being sued for an appraisal and feasibility study which overstated real estate value by over \$1 million and led to the bonds becoming worthless. The claim did not involve a plaintiff “searching for a valid claim after suit was commenced” -- the core facts of the claim were simply and concisely pled.

C. Discovery Has Revealed Additional Evidence To Support The Claim For Misrepresented Collateral Value.

Had the district court and the Court of Appeals’ majority construed the Complaint so as to provide substantial justice as mandated by the rules, the negligent misrepresentation claim would have allowed the suit to proceed against Bedard. See also 2-9 Moore’s Federal Practice - Civil § 9.03[b] (noting that courts allow the plaintiff extra leeway in pleading when the necessary information is under the exclusive control of the defendants because otherwise defrauders might be rewarded for successfully concealing the details of their fraud). The concern expressed in Moore’s regarding the need for extra leeway when information is under the exclusive control of a defrauder directly applies to the claim against Bedard.

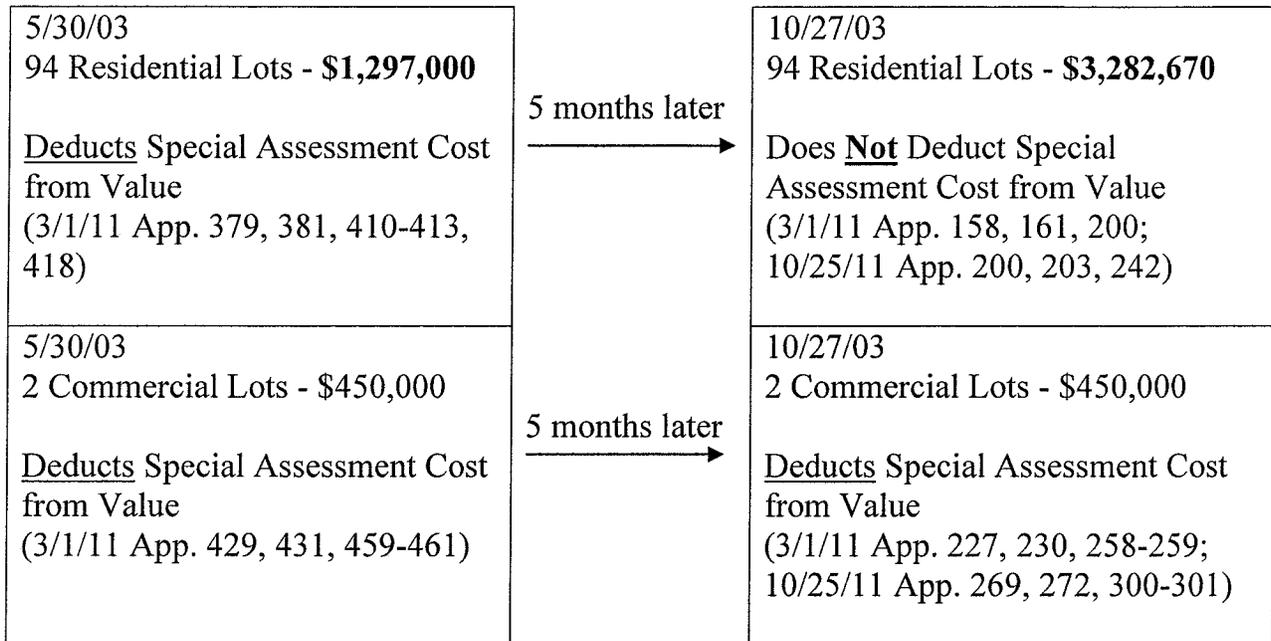
After dismissal of the claims against Bedard at the outset of the case, discovery in the case resulted in production of a prior appraisal by Bedard that was previously unknown and undisclosed to the Bondholders. (3/1/11 App. 379-428). This evidence, uncovered in the files of the Defendants in this action, demonstrates the merits of the

Bondholders' claims against Bedard and would have been uncovered while Bedard was still a party to the action had the district court properly denied the motion to dismiss.

The first appraisal by Bedard was dated May 30, 2003 and valued the property at \$1,297,000, which factored in a deduction of the \$1,085,000 special assessment costs from value -- the very thing the Bondholders claimed in their Complaint that Bedard should have done in the appraisal provided in the POM. (3/1/11 App. 379, 407, 409-412, 418). The May 30 Appraisal and corresponding Commercial Lot Appraisal each correctly reduced the cost of special assessments from the value of the lots. (3/1/11 App. 379-428, 429-471). At that time the amount of the bond issuance was \$2,700,000. (3/1/11 App. 375).

To make the developer's projections work, lot values had to be inflated and an email by Bond Counsel candidly asked whether the Appraisal was being revised to include these improvements (street/sewer/water/etc.) and consequently be more in line with the loan amount. (3/1/11 App. 372-374). Four days after that email and only five months after the first Bedard appraisal valued the 94 residential lots at \$1,270,000, Bedard submitted a different appraisal dated October 27, 2003 which showed the 94 residential lots jumped to a value of \$3,282,670. (3/1/11 App. 158, 161, 200; 10/25/11 App. 200, 203, 242). As instructed, the new Bedard appraisal did not deduct the \$1,085,000 special-assessment cost, even though each of the other appraisals by Bedard did so. By failing to deduct the special assessment cost in this lone appraisal, the project "value" increased by \$1,085,000.

The history of the Bedard Appraisals is summarized as follows:



Interestingly, the May Appraisal valuing the residential lots at \$1,270,000 was not mentioned by Bedard in the October Appraisal he submitted to the Trustee for Bondholders or that was provided in the POM to Bondholders.

In addition to the evidence regarding the “omitted” May Appraisal which appeared during discovery, the Bondholders retained a well-respected and knowledgeable valuation expert: Al Leirness of Cassidy Turley, a certified public accountant, who opined that:

- 1) The project was not viable from its inception, as the lots were worth between \$25,000-\$30,000 -- not the \$43,386 contrived appraisal value Bedard was asked to come up with after the projections demonstrated that amount was needed to pay off bondholders and special assessment (instead of the proper method of valuing first and then allocating to make payments).
- 2) The failure to sell lots was solely due to the prices being too high.
- 3) The failure to sell lots caused the loss because:

- a) lot prices were too high and resulted in virtually no sales in three years (42 sales were predicted to occur by the end of 2006 and, in fact, one model home and one lot were sold);
 - b) there was no revenue to repay bondholders (in fact, the payments to Bondholders primarily came from their own money--\$495,000 of "capitalized" interest) and a default occurred; and
 - c) the collateral was not worth \$4,127,000 as represented and had no value after forfeiture for failure to pay special assessments, the bondholders lost their investment.
- 4) The appraisal reports prepared by Bedard contained many errors that resulted in erroneous and unreliable conclusions, including:
- a) failing to subtract the special assessments from the final lot appraisal;
 - b) contradicting the 7 year absorption rate established in his own feasibility study;
 - c) failing to establish an absorption period and apply and appropriate time value discount in the valuation conclusion on the commercial lot appraisal; and
 - d) failing to establish an absorption period and apply and appropriate time value discount in the valuation conclusion on the model home appraisal.

(3/1/11 App. 472-473). Although the Bondholders acknowledge that the ruling must be judged based upon the allegations in the Complaint, this evidence further highlights why the negligent misrepresentation claim should not have been dismissed at the outset of the case and why substantial justice will be served by allowing this action to proceed.

CONCLUSION

For these reasons, the ruling by the Court of Appeals which affirmed the dismissal of the negligent misrepresentation claim against Bedard was in error and that claim should be remanded to the district court for trial.

Respectfully submitted,

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