

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' REPLY BRIEF**

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**TABLE OF CONTENTS**

TABLE OF AUTHORITIES .....ii

STATEMENT OF LEGAL ISSUES ..... 1

STATEMENT OF CASE.....2

STATEMENT OF FACTS.....3

ARGUMENT .....3

    I.    THE BONDHOLDERS PROPERLY PLED THEIR NEGLIGENT  
          MISREPRESENTATION CLAIM WITH PARTICULARITY ..... 3

        A.    The Complaint Properly Incorporated Prior  
              Allegations Into The Negligent Misrepresentation Count  
              And Bedard Was Able To Determine The Claim  
              Made Against Him .....4

        B.    The Complaint Properly Pled That The Bedard Appraisal and  
              Feasibility Study Supplied False Information ..... 10

        C.    The Complaint Properly Pled That The Bondholders  
              Justifiably Relied On Information Provided By Bedard That  
              Caused Financial Harm To The Bondholders..... 15

CONCLUSION ..... 18

## TABLE OF AUTHORITIES

	<b>Page(s)</b>
<b>CASES</b>	
<u>Adams Respiratory Therapeutics, Inc. v. Perrigo Co.</u> , 255 F.R.D. 443, 446 (W.D. Mich. 2009) .....	7
<u>Bodah v. Lakeville Motor Express, Inc.</u> , 663 N.W.2d 550 (Minn. 2003) .....	5
<u>Bonhiver v. Graff</u> , 248 N.W.2d 291 (Minn. 1976) .....	14
<u>Commercial Prop. Invs. v. Quality Inns Int’l</u> , 61 F.3d 639 (8th Cir. 1995).....	3
<u>Parnes v. Gateway 2000, Inc.</u> , 122 F.3d 539 (8th Cir. 1997).....	3
<u>Schwartz v. Celestial Seasonings, Inc.</u> , 124 F.3d 1246 (10 <sup>th</sup> Cir. 1007).....	5
<u>United States ex rel. Costner v. United States</u> , 317 F.3d 883 (8 <sup>th</sup> Cir. 2003) .....	8
<u>Vanderweyst v. Langford</u> , 303 Minn. 575, 228 N.W.2d 271 (1975).....	12
<b>STATUTES</b>	
Fed. Rules of Civil Procedure 9(b).....	5
Fed. Rules of Civil Procedure 10(c).....	6
Minn. R. Civ. P. 8.05(a) .....	6
Minn. R. Civ. P. 10.03.....	6
Minn. CIVJIG 57.20.....	10
<b>OTHER AUTHORITIES</b>	
5A A. Wright, A. Miller, M. Kane, <u>Fed. Prac. &amp; Proc. Civ.</u> § 1298 (3d ed. 2011).....	5

## STATEMENT OF LEGAL ISSUES

### I. THE BONDHOLDERS PROPERLY PLED THEIR NEGLIGENT MISREPRESENTATION CLAIM WITH PARTICULARITY.

#### CASES

Bodah v. Lakeville Motor Express, Inc., 663 N.W.2d 550, 553 (Minn. 2003)

Commercial Prop. Invs. v. Quality Inns Int'l, 61 F.3d 639, 644 (8th Cir. 1995)

Parnes v. Gateway 2000, Inc., 122 F.3d 539, 549 (8th Cir. 1997)

Vanderweyst v. Langford, 303 Minn. 575, 576, 228 N.W.2d 271, 272 (1975)

#### OTHER AUTHORITIES

Minn. CIVJIG 57.20

## Statement of Case

The lone exception the Bondholders take to the statement of the case of James H. Bedard, Inc. (“Bedard”) is that Bedard implies that its motion to dismiss put the Bondholders on notice of its specific arguments regarding the negligent misrepresentation claim in Count X and the Bondholders failed to use their right to amend to address those concerns. That is not so. Interestingly, 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.” [sic]
- Representations that the real estate was worth \$4,127,650, which overstated the value of the real estate by, at least, \$1,000,000.

(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.” (App. 112) (emphasis added). Bedard then simply piggy-backed on another party’s motion to dismiss and stated: “the arguments presented in Dougherty’s Memorandum of Law in Support of Dismissal Pursuant to Rule 9.02 are adopted herein and incorporated by reference.” (App. 104-105) Tellingly, the arguments by Dougherty focused on a perceived lack of specificity regarding *oral* communications by two of its agents. (App. 112). *No* oral communications by Bedard were alleged – the claim against Bedard was based solely on written 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 and added no relevant argument for the Bondholders to address in their amended complaint.

Additionally, Bedard's motion demonstrated it knew that the specific facts pled in paragraphs 160 and 161 applied to the negligent misrepresentation claim in Count X, a point observed by Chief Judge Hudson. (App. 13). Had Bedard pointed out it wanted the facts pled in the fraud to be put into Count X, a simple "copy and paste" of paragraphs 160 and 161 into Count X would have sufficed.

### **Statement of Facts**

The Bondholders make no further comment on the facts section of Bedard's brief.

### **ARGUMENT**

#### **I. THE BONDHOLDERS PROPERLY PLED THEIR NEGLIGENT MISREPRESENTATION CLAIM WITH SUFFICIENT PARTICULARITY.**

The narrow issue is whether the Complaint at issue, which the district court ruled did properly plead statutory securities fraud claims against Bedard failed to properly plead a negligent misrepresentation claim against Bedard based on the *same* operative facts. The Bondholders submit that the Complaint did properly plead such a claim and they should be allowed their day in court.

The Complaint specifically pled that Bedard made the following omissions of material fact and representations to Bondholders in its Appraisal and Feasibility Study:

- 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.

(App. 138 at ¶ 160).

And these statements were false and misleading because:

- Appraisal overvalued the real estate by, at least, \$1,000,000 and was based on *flawed* absorption and discount rates.
- 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.

(App. 138-39 at ¶¶ 161).

Bedard does not seriously argue that those allegations were “vague” or that they lacked specific detail. And for good reason -- those allegations are specific and detailed. The district court even found those allegations were sufficient to support a security fraud claim against Bedard. (Add. 30-31, 34).

**A. The Complaint Properly Incorporated Prior Allegations Into The Negligent Misrepresentation Count And Bedard Was Able To Determine The Claim Made Against Him.**

Bedard now suggests that the Complaint actually had too many facts and it could not discern what the claims were against Bedard. As Chief Judge Hudson noted, Bedard's brief demonstrates its counsel was more than capable of understanding the claim and put forth detailed arguments to refute the allegations. (App. 13).

This issue really boils down to application of Minnesota Rules of Civil Procedure 8.05--simple, concise pleadings—and 10.03—the ability to incorporate allegations by reference—being read in conjunction with the pleading with particularity requirement in Rule 9.02. In construing these rules, Minnesota courts look to similar federal rules. A leading commentator on the federal rules has noted that it is of primary importance in understanding the pleading with particularity requirement that the circumstances of an alleged fraud is the recognition that it does not render the general principles of simplicity set forth in Rule 8 entirely inapplicable to such pleadings; rather, the two rules must be read in conjunction with each other. 5A A. Wright, A. Miller, M. Kane, Fed. Prac. & Proc. Civ. §1298 (3d ed. 2011) It is inappropriate to focus exclusively on the fact that Rule 9(b) requires particularity in pleading the circumstances of fraud which is too narrow of an approach and fails to take account of the general simplicity and flexibility

contemplated by the federal rules. Id. The rule regarding the pleading of fraud does not require absolute particularity or a recital of the evidence. Id.<sup>1</sup>

Courts have recognized that the requirements of Federal Rule 9(b) must be read in conjunction with the principles of Rule 8, which calls for pleadings to be simple, concise, and direct and to be construed as to do substantial justice. See Schwartz v. Celestial Seasonings, Inc., 124 F.3d 1246, 1252 (10<sup>th</sup> Cir. 1997). In that case, the fraud count incorporated by reference all of the statement-identifying paragraphs and the defendant moved to dismiss by claiming incorporating facts by reference into the fraud count failed to meet the pleading with particularity requirement. The district court granted the motion by reasoning that the Complaint failed under Federal Rule 9(b) because the fraud count did not “enumerat[e] which paragraphs in the Complaint” contained the statements which gave rise to the fraud claim. Id. at 1253. The appellate court judged the sufficiency of the Complaint by reviewing the Complaint in its entirety, rather than in a piecemeal fashion, and found the lower court’s reasoning effectively deprived plaintiff of its Federal Rule 10(c) right to incorporate by reference and that a fair reading of the Complaint indicated that by cross-referencing as allowed by Rule 10(c), it sufficiently particularized the circumstances constituting fraud to comply with Rule 9(b). Id.

In addition to harmonizing these two rules, a challenged fraud count is bolstered when documentary exhibits are attached to a pleading because such exhibits become a part of the pleading *for all purposes under* Federal Rule 10(c) and “all purposes”

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<sup>1</sup> It has been recommended that stringent pleading practices could be justified in only a very limited number of cases such as where greater detail would reveal a fatal defect in the plaintiff’s case and lead to dismissal of the action. Id.

includes the satisfaction of Rule 9(b)'s particularity requirement. Adams Respiratory Therapeutics, Inc. v. Perrigo Co., 255 F.R.D. 443, 446 (W.D. Mich. 2009). The Bondholders attached the disputed Appraisal and Feasibility Study as exhibits and incorporated them into the Complaint which is expressly permitted by Minn. R. Civ. P. 10.03. (App. 120-121). It is equally important to recall that the rules provide “[n]o technical forms of pleading . . . are required.” Minn. R. Civ. P. 8.05(a).

With these rules in mind, the entirety of the entire Complaint should be judged. Bedard claims it had to engage in piece-meal hunting to respond to the claim and makes it sound as if there were 176 paragraphs that randomly had facts scattered through-out that may or may not apply to Bedard and created confusion. Not so. A cursory examination of the Complaint dispels that notion.

Paragraphs 1 to 12 identified the parties--no difficulty for Bedard there. Paragraphs 14-88 set forth in detail the chronological facts. To further aid Bedard's understanding of the claims against it, the “Fact” section had specific subheadings titled “Appraisal” (paragraphs 29-39) and “Feasibility Study” (paragraphs 40 to 45). (App. 120-121). His appraisal and feasibility study were attached as exhibits as permitted by Rule 10.03. (App. 120-121). No difficulty for Bedard there.

Counts I-III (paragraphs 89 to 111) were against HRA. Bedard could have easily understood those paragraphs did not apply to it. (App. 128-132). Similarly, Counts IV-VII (paragraphs 112 to 156) were against Dougherty so Bedard knew those paragraphs did not apply to it. (App. 132-137). Counts VIII-X were denominated as claims against Bedard. (App. 138-141). The fraud claim had the specific facts in paragraphs 160-161

(and repeated in 170-171). (App. 138-140). Those facts were incorporated by reference into Count X, the negligent misrepresentation claim, as permitted by Rule 10.03. (App. 141).

Additionally, the district court found the fraud counts were pled with particularity and specifically alleged what Bedard did wrong. The negligent misrepresentation claim then incorporated those counts against Bedard as expressly authorized by Rule 10.03. The logical inference, given that negligent misrepresentation is part of a fraud claim under Minnesota law, would be that the same facts pled in the fraud counts were incorporated into the negligent misrepresentation. To suggest that the negligent misrepresentation claim could have been founded on unpled facts, with a design to prevent Bedard from knowing what he was being sued for, is implausible.

Bedard was able to read the complaint and prepare a response that identified disputed areas in the claims against it. It is peculiar to cry foul for having *too much* information when trying to dismiss a complaint for failing to plead with particularity.

Bedard relies upon a newly found case, United States ex rel. Costner v. United States, 317 F.3d 883 (8<sup>th</sup> Cir. 2003), to claim the pleading with particularities’ “who, what, where, when and how” test was not met. Costner is inapposite to this situation because the defendant in that case was not able to respond specifically and quickly to the allegations where the plaintiffs did not provide any information regarding the identity of those who allegedly tampered with the certain industrial monitors or when such tampering occurred. Costner, 317 F.3d at 888. That court found the complaint was “not specific enough to give defendants notice of the particular misconduct which is alleged to

constitute the fraud charged so that they can defend against the charge and not just deny that they have done anything wrong.” Id.

Bedard makes no such argument here—Bedard prepared the Appraisal and Feasibility Study at issue and that work product was attached to the complaint which referenced specific portions which were challenged as containing flaws and errors. Bedard had the ability to respond specifically and quickly—as it has done in the appellee briefs without the benefit of partaking any discovery.

Next Bedard claims it was somehow “unable to determine from the Complaint what it’s he misrepresented” and “how the Appraisal and Feasibility Study were in any way erroneous.” (Appellee’s Brief p. 12-13). Paragraph 160 of the Complaint stated that Bedard “represent[ed] that the real estate was worth \$4,127,670, which overstated the value of the real estate by, at least, \$1,000,000 and omitted material facts 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. (App. 138-39 at ¶ 160-161).

Similarly, as to the Feasibility Study, the Complaint stated that 14 sales per year and sale of all lots in a 7 year time period was a virtual impossibility due to the cost to acquire a lot and pay the related real estate taxes and special assessments. (App. 94-95 at ¶¶161).

The allegations regarding the Appraisal and the Feasibility Study addressed specific areas-special assessments, added lot costs, overall real estate value, lot sales per year—and specific amounts--\$1,085,000, \$11,262,an actual value of no more than

\$3,127,670 and inability to sell 14 lots per year. Bedard was most certainly informed as to how the Appraisal and Feasibility Study were erroneous.

Moreover, at this stage, all of the allegations that Bedard wants to dispute are deemed true. See Bodah v. Lakeville Motor Express, Inc., 663 N.W.2d 550, 553 (Minn. 2003) (“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”). The Complaint was more than adequate to put Bedard on notice of the claims against him.

**B. Complaint Properly Pled That The Bedard Appraisal and Feasibility Study Supplied False Information.**

As mentioned, the pleading with particularity rule has a five part test. Parnes, 122 F.3d at 549. Bedard contends the Complaint failed to meet one of those requirements- “what” was negligently misrepresented.

Beyond the basic core facts which gave notice to Bedard of the particular circumstances of the negligent misrepresentation, the Bondholders pled detailed facts supporting the false information provided by Bedard as follows:

- The Appraisal overvalued the real estate by, at least, \$1 million which was false. (App. 120, 138-39 at ¶¶ 32, 161).
- The Appraisal stated that valued lots at \$43,386 per lot, which was false. (App. 120, 122 at ¶¶ 33, 45).
- The Appraisal omitted the \$11,302 cost per lot that buyers would have to pay. (App. 120-21 at ¶¶ 34-37).

- The Feasibility Study indicated 14 sales per year were very achievable for lots which, in effect, cost \$54,688, and that was false. (App. 121-22 at ¶¶ 37, 38, 41, 44).
- The Feasibility Study's time period for sales was a virtual impossibility due to the cost to acquire a lot and pay the related real estate taxes and special assessments. (App. 139 at ¶ 161).

The decision by the Bondholders to invest was made at the time the Bedard information was provided to them, they justifiably relied on that information and bought the bonds and later lost their investment because the collateral did not have the value that Bedard represented in the Appraisal and Feasibility Study. Bedard goes to great lengths to argue the *merits* of those allegations. As mentioned, a motion to dismiss is not the proper vehicle to make such an argument. In reviewing a motion to dismiss, the facts pled are accepted as true and, after construing all reasonable inferences in favor of the nonmoving party, the inquiry is whether a claim was stated. See Bodah, 663 N.W. 2d at 553.

The Bedard Appraisal stated that it took into account the special assessment, but that does not change the allegation that it falsely failed to provide information that any buyer of a lot (whether the homeowner or the builder) would have to pay the special assessment. (App. 120 at ¶ 34).

In like fashion, the Feasibility Study specifically pled that Bedard supplied false information by using the false property value from the Appraisal and used those *flawed* values. It went on to state that Bedard *failed* to properly take into account the special assessment cost on the price of a lot to reach a seven-year absorption rate. The Complaint

clearly alleged that Bedard erroneously concluded a seven-year period would be sufficient to sell out the Development (i.e.--the “absorption rate”) even though the *seven-year* absorption rate *contradicted* the *four-year* absorption rate he used in the Appraisal and further overstated the value of the Bondholders’ collateral. (App. 121-22 at ¶ 41-43, App. 233, 314).

The Complaint even went so far in its detailed pleading to state that 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. (App 122 at ¶ 45).

Bedard then addresses the assumptions it made. That is a red-herring. Regardless of the assumptions, the Bedard Appraisal and Feasibility Study still contained false information.

Next, Bedard claims that the “Complaint contains absolutely no statement that would indicate Bedard was in any way responsible for setting the prices of the lots that were marketed to the potential buyers or responsible for any marketing decisions related to the Project.” (Appellee’s Brief, p. 16). That assertion is not well-founded.

First, the elements to establish a claim of negligent misrepresentation against Bedard do not require any allegation that it was responsible for actual sales in the Project or that Bedard controlled prices -- the false information he provided to Bondholders,

alone, is sufficient. Bedard communicated erroneous assumptions and values to prospective buyers of bonds who relied upon what he communicated to be the value of the underlying collateral.

Secondly, Bedard contends it did not contemplate lot sales and “expressly only considered home sales.” (Appellee’s Brief, p. 17). Bedard appears to simply ignore the allegations in the Complaint. Paragraph 33 plainly states: The Bedard Appraisal, which was used to set *lot* prices, valued each lot at \$43,386 per lot. (App. 120) (emphasis added). Similarly, paragraph 38 states: Because the Bedard Appraisal was used to determine *lot* prices, and because of errors in the appraisal, the price of \$43,688 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. (App. 122) (emphasis added). The Appraisal valued 94 vacant lots; nowhere did it refer to *home* values in determining those lot values. (App. 231-233). In fact, Bedard looked at the time it took to “sell out” the lots in two other Brainerd developments. (App. 190). The Feasibility Study acknowledges the \$3,282,670 property value was based on “the current value of gross *lot sales* of 94 residential *lots*. (App. 313). And concludes the development will “sell out” in seven years. (App. 315). The information supplied by Bedard to Bondholders clearly vouches for the value of lots and time to sell those lots.

Moreover, Bedard’s argument overlooks the fact that *someone* had to buy a lot from the HRA before a home could be built (whether the builder or a homeowner) and that lot owner had to pay the special assessment. Thus, the cost of the lot factors directly into the price of a home regardless of whether a builder buys a lot and constructs a home

which a home buyer purchases later or a person buys a lot and has their home built on the lot. The point is the lot had to be acquired before a home could be built. Failing to disclose that \$11,262 in special assessment would have to be paid, in addition to the lot price, which directly and materially impacted the ability to sell lots and was a critical failure in the Bedard Appraisal.

The observation that the Bondholders simply “disagree with the value stated in the Bedard appraisal” and that somehow is of no consequence to Bedard is puzzling. (Appellee’s Brief, p. 17). The tort of negligent misrepresentation involves a party who supplies false information for the guidance of others 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). The Bondholders allege Bedard supplied false information which contained errors and flaws in the Appraisal and Feasibility Study. Errors in computing the land value is the type of wrong that this tort is meant to encompass and those errors were specifically identified in the Complaint.

Additionally, the Complaint stated that the Ludenia Appraisal was significant because it “reflect[ed] the *material impact* from the Bedard Appraisal’s failure to properly account for the impact on the ability to sell lots based on the special assessment and taxes.” (App. 79, 97, 127) (emphasis added). The Ludenia Appraisal demonstrated the economic fact that if a *value* does not take in account a *cost* that must be paid, the value is inflated. Simply put, the Bedard information falsely told Bondholders the collateral was worth \$4.1 million and they were investing \$3.3 million — so they were informed by Bedard that there was more than adequate security to cover a potential loss

of revenue from lot sales. The truth was that \$1,085,000 of special assessment costs had to be paid regardless of whether the lots sold or not and that cost decreased the value of the lots correspondingly.

Bedard then misstates the issue by suggesting there is no connection between its work product (Appraisal and Feasibility Study) and ultimate pricing and marketing. The issue raised by the Complaint is that Bedard's work product coupled with the Bondholders' reliance on Bedard's misrepresentation of the collateral value and time to sell the lots misled them when they made their decision to purchase the bonds.

Bedard now contests that policy concerns supporting the pleading with particularity rule by relying on the "undue harm" prong. Bedard has failed to identify any *undue* harm from the allegations in the Complaint. Those allegations are based on written statements from the Appraisal and Feasibility Study. The May Appraisal and expert opinion provide additional support that the allegations in the Complaint did not cause the type of undue harm which the pleading with particularity is designed to prevent.

**C. The Complaint Properly Pled That The Bondholders Justifiably Relied On Information Provided By Bedard That Caused Financial Harm To The Bondholders.**

Bedard's final assertion is that the Complaint did not properly plead that the Bondholders justifiably relied upon the Bedard information which caused them financial harm. That argument is misplaced for several reasons.

The Bondholders will address the fifth element — that the Bondholders were financially harmed by relying on the information.<sup>2</sup> The Complaint stated:

- 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 and expressly stated that the function of the appraisal was to establish values for bonding purposes. (App. 120 at ¶¶ 30, 31; App. 200, 202).
- In reliance on this information from Bedard that the Bondholders received through the POM, the Bondholders purchased all of the \$3,300,000 of Bonds issued by the HRA. (App. 125 at ¶¶ 60-61).

The Complaint pled specific facts demonstrating the Bondholders’ justifiable reliance on the Bedard Appraisal and Feasibility Study which were intended by Bedard to be relied upon by Bondholders in making their purchasing decision. The Complaint alleges that the Bondholders invested money based on the information supplied by Bedard in the Appraisal and Feasibility Study. The lack of lots sales led to insufficient revenue to pay the bonds which caused a default in 2007 and resulted in damage to the Bondholders. (App. 123, 125, 128 ¶¶53, 61, 84, 88). Unquestionable financial harm resulted to the Bondholders from relying on Bedard’s information.

Even if “cause” is required as part of the fifth element, the Complaint pled the causal chain in detail. In particular, the Complaint stated:

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<sup>2</sup> As a threshold matter, the fifth element of a claim for negligent misrepresentation under Minnesota law is: “The other person was financially harmed by relying on the information.” (*citing* Minn. CIVJIG 57.20). Bedard then grafts a “causation” element into the fifth element and creates the following brief heading: “There Was No Justifiable Reliance On Any Information Provided By Bedard That *Caused* Any Financial Harm To The Bondholders.” (Appellee’s Brief, p. 21).

- 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. (App. 120-122, 125 at ¶¶ 30, 31, 40, 41, 45, 60).
- The Bondholders purchased \$3.3 million of bonds based on the Appraisal and Feasibility Study and the lots prices were set too high based upon such information, and the lots did not sell because the prices were too high and 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. (App. 84, 120-122, 128 at ¶¶ 39, 61, 84-86).
- 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 sold, especially during 2004 and 2005, demonstrates the failure to sell the remaining 93 lots from the time of issuance to the present was due to the lots being prices too high because, even during two strong years in the real estate market, these lots did not sell. The failure of such sales led to insufficient revenue to pay the bonds, which caused a default of the bonds and resulted in Plaintiffs being damaged. (App. 122 at ¶ 44).

In spite of those allegations, Bedard remarkably states its information "caused no loss to the Bondholders." (Appellee's Brief, p. 22). The investments by the Bondholders were based on the false information that Bedard provided and the inability to sell out the development in seven years, as Bedard represented, was due to Bedard's error in not addressing the fact that whoever owned any given lot had to pay \$11,262 in special assessments.

Bedard suggests a "myriad of other activities and circumstances" caused the loss besides its information. (Appellee's Brief, p. 22). One of the fallacies with that argument is that allegations of the Complaint are deemed true at this stage and any other reason Bedard may want to advocate simply should not carry any weight, particularly

when the question of causation is normally for the jury to decide. Vanderweyst v. Langford, 303 Minn. 575, 576, 228 N.W.2d 271, 272 (1975).

The Complaint properly provided detailed notice to Bedard of their reliance on the information he provided and the financial harm he caused to the Bondholders. The Bondholders should have their day in court.

### CONCLUSION

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

Respectfully submitted,

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