

Nos. A04-2088 and A04-2054

State of Minnesota
In Supreme Court

Christopher P. Schermer, John V. Smith, Marjorie B. Smith,
 Reverend Albert Gallmon, on behalf of themselves
 and all others similarly situated,

Petitioners,

vs.

State Farm Fire and Casualty Company,
 State Farm General Insurance Company,

Respondents.

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INTRODUCTION

The briefs of the parties and *amicus curiae* frame this important question: Should Minnesota courts exercise their jurisdiction over claims involving an illegal contract term?¹ State Farm does not address the fundamental unfairness of letting State Farm retain the money it collected on an illegal payment term or explain why this Court should depart from its long-standing precedent that equitable remedies are available when a contract term violates the law. *Shank v. Fidelity Mut. Life Ins. Co.*, 221 Minn. 124, 21 N.W.2d 235 (1945).

Nor does State Farm identify any compelling reason why this Court should adopt the filed rate doctrine to limit policyholders' rights under *Shank*. The application of a filed rate doctrine here would not advance any of the doctrine's purposes. Not once does State Farm indicate how resolution of this case on the merits could disrupt the activities of the Department of Commerce ("DOC") or the Minnesota Attorney General. Indeed, the Governor, Attorney General and the various DOC employees support having the Minnesota courts determine whether State Farm's Utilities Rating Plan ("URP") surcharge violates the anti-redlining provisions of Minn. Stat. § 72A.20, subd. 13. This Court should decline to create a filed rate doctrine and allow the Class' rescission claim to be heard.

¹ This case presents an appeal from summary judgment in State Farm's favor. The court presumes the facts as the Class alleges – that the URP surcharge is illegal.

ARGUMENT

I. **Contract Provisions That Violate the Law or Public Policy² are Invalid and Subject to Rescission and Reformation.**

A. **A contract term that violates Minnesota law is void *ab initio*.**

State Farm does not even comment on *Shank*, the seminal case in a long line that has held that an illegal insurance contract term is void and subject to equitable remedies, including the return of premiums. Using the proper analysis, a contract provision that violates a Minnesota statute was never valid. Any payment made in consideration for that invalid provision should be returned to the policyholder. To argue otherwise offends common sense and public policy.

“It is well established that contract provisions which conflict with statutory law ‘or the well clarified and clearly expounded rules set forth by judicial decision’ will not be enforced.” *AMCO Ins. Co. v. Lang*, 420 N.W.2d 895, 900 (Minn.1988) (quoting *Wm. Lindeke Land Co. v. Kalman*, 190 Minn. 601, 606, 252 N.W. 650, 652 (1934)). Such a contract is invalid when issued. *Id.* This Court has long recognized the common law doctrine of illegality of contract:

Illegality vitiates contracts of every description, and the courts decline to enforce them. **Illegality, within the rule, includes agreements in violation of some prohibitive statute, in violation of the express rules of the common law, or contrary to public policy...** The term “public policy,” as applied to this subject, is comprehensive, and covers a wide range, whether evidenced by the trend of legislation, judicial decisions, or the principles of the common law. It embraces all acts or contracts which .

² Contrary to State Farm’s assertion, the Class’ reliance on public policy as a ground for contract rescission is not a “new” issue. From the inception of this case, the Class has sought the equitable remedy of rescission. Violations of both the law and public policy support a rescission claim.

. . . undermine that sense of security for individual rights, whether of personal liberty or private property, which every citizen has the right to feel.

Holland v. Sheehan, 108 Minn. 362, 364, 122 N.W. 1, 2 (1909) (emphasis added).

This Court has often applied this legal principle to invalidate insurance policy terms that violate a statute. *Illinois Farmers Ins. Co. v. Glass Serv. Co.*, 683 N.W.2d 792, 802 (Minn. 2004) (“If a term in an insurance contract conflicts with Minnesota statutes, the contract term becomes unenforceable.”); *Kwong v. Depositors Ins. Co.*, 627 N.W.2d 52, 55 (Minn. 2001); *Roering v. Grinnell Mut. Reins. Co.*, 444 N.W.2d 829, 833 (Minn. 1989) (“[C]ontract provisions which conflict with statutory law will not be enforced.”); *Streich v. Am. Family Mut. Ins. Co.*, 358 N.W.2d 396, 399 (Minn. 1984); *Coughlin v. Reliance Life Ins. Co.*, 161 Minn. 446, 453, 201 N.W. 920, 923 (1925).³

Because illegal contract terms are void from the start, this Court has ordered the return of contract payments following a determination that a contract contained illegal terms. *Nutting v. McCutcheon*, 5 Minn. 382, 1861 WL 1818, *6 (1861) (“There is no doubt that where contracts are made in violation of statutory provisions, or in contravention of public policy, they are as a general rule void, and money paid under them may be recovered back . . .”). The Court of Appeals erred in failing to apply this long-standing law and its own precedent. *Casablanca Concerts, Inc. v. American National General Agencies, Inc.*, 407 N.W.2d 440 (Minn. Ct. App. 1987) (if rain

³ In these and many other Minnesota cases, insurance contract provisions that had been approved by the DOC were invalidated as violating various Minnesota statutes. This case law establishes the role the courts, rather than the DOC, have in ensuring that contracts conform to Minnesota law.

insurance policy is found to be an illegal wagering contract, insured who valued his property interest in good faith is entitled to recover his premium).

The DOC's approval of State Farm's URP does not make the surcharge provisions legal. If an insurance contract violates the requirements of Minnesota statutes the DOC has no power to ratify the illegality. *Watson v. United Services Automobile Assoc.*, 566 N.W.2d 683, 692 (Minn. 1997) ("The commissioner is an administrative official **with no power** to alter the meaning and intention of the language of the legislature." (emphasis added)). Like State Farm, the insurer in *Watson* claimed that its policy language complied with the statutes because the DOC had approved the policy. The *Watson* court quickly dispatched with such an argument. *Id.* at 692.

The surcharge payment terms were never valid under Minnesota law. The surcharge must be returned to the 177,000 policyholders who made these payments.

B. The absence of an explicit statutory right to sue does not preclude a rescission or reformation claim based on contract illegality.

Minnesota courts routinely allow policyholders to challenge insurance provisions based on the law without a statutory directive creating a private cause of action. In *Watson*, the insured sued to obtain fire insurance coverage required by Minn. Stat. § 65A.01. *Id.* at 684. Section 65A.01 - like § 72A.20, subd. 13 - does not create an express right for a policyholder to bring a private cause of action. Yet, this Court concluded the fire policy must be reformed. *Id.* at 692.

Likewise, in *Am. Fam. Mut. Ins. Co. v. Ryan*, 330 N.W.2d 113 (Minn. 1983), this Court considered a policyholder's claim that a household exclusion in a homeowner's

insurance policy violated Minn. Stat. §§ 65A.27-.29. Again, the Court permitted the policyholder's suit even though the statutes in question did not expressly allow a private cause of action. *Id.* at 115-16.

Relying on *Shank*, the Minnesota Court of Appeals considered whether an exclusion in an aircraft liability policy violated Minn. Stat. § 60A.081 and § 360.92. *RLI Ins. Co. v. Pike*, 556 N.W.2d 1, 2 (Minn. Ct. App. 1996), *rev. denied* (Minn. Jan. 29, 1997). Neither of those statutes created an express right for a policyholder to bring a private cause of action. The appellate court nonetheless resolved the policyholder's illegality claim. *Id.* The appellate court should have followed this authority here.

The foreign cases State Farm cites are not persuasive. None of them involved the question of a specific contract term that violated a statute. *Broder v. Cablevision Sys. Corp.*, 418 F.3d 187, 203 (2d Cir. 2005) is inapposite because the parties in that case agreed that the underlying federal statute did not provide a private cause of action. The statute at issue in *McGowan v. Progressive Preferred Ins. Co.*, 618 S.E.2d 139, 148 (Ga. Ct. App. 2005) specifically stated that there was no private cause of action for violations of the claims handling guidelines set out in the statute. In *Goldberg v. Enterprise Rent-A-Car Co.*, 14 A.D.3d 417, 417 (N.Y. App. Div. 2005) the court simply reiterated the already settled proposition that a certain New York statute did not provide a private cause of action.

II. *Morris v. American Family* Does Not Bar the Class' Rescission Claim.

First and foremost, *Morris v. Am. Family Mut. Ins. Co.*, 386 N.W.2d 233 (Minn. 1986) does not preclude the Class' rescission claims because the Class is not asserting a private cause of action under the Unfair Claims Practices Act ("UCPA"). Under the common law, an insurance policy may not contain terms that violate a statute. The illegality of State Farm's surcharge contract term itself, not any failure by State Farm to comply with statutory claims handling requirements, provides the basis for the Class' claims. The Court need go no further in dispensing with the *Morris* argument.

A. *Morris* only precludes private litigants from asserting claims related to the claims handling sections of §72A.20.

As noted above, State Farm does not attempt to distinguish or even cite *Shank*. State Farm implicitly argues that *Morris* overrules *Shank*. This argument fails under even a cursory analysis. *Morris* did not involve an illegal insurance contract term. Rather, *Morris* challenged the way her insurer investigated and responded to her no-fault claim. The *Morris* court analyzed only the claims handling provisions of § 72A.20, subd. 12⁴ and did not consider whether policyholders are permitted to seek relief based on the unrelated, non-claims handling statutes. *Morris* did not restrict a policyholder's right to seek rescission of illegal insurance provisions.

⁴ The *Morris* court noted the empowering and enforcement provisions of § 72A but focused its analysis on the claims handling provisions of Subdivision 12.

Minnesota adopted the Unfair Claims Practices Act (“UCPA”) in 1947 and the Model UCPA⁵ is now contained entirely within Subdivision 12 of § 72A.20. *Morris*, 386 N.W.2d at 234. The UCPA deals exclusively with claims handling standards. As the National Association of Insurance Commissioners stated, the very purpose of the UCPA “is to set forth standards for **the investigation and disposition of claims** arising under policies or certificates of insurance.” (PA 257) (emphasis added).⁶ The UCPA does not address what insurance terms are or are not permitted.

Although § 72A.20 and all of its subdivisions have been collectively referred to as the UCPA by some courts, only a few of the provisions actually relate to claims handling. Many of the subdivisions relate to false advertising, discrimination, bookkeeping, cancellations and renewals, underwriting, premiums, rebates and other non-claim related requirements. *See generally* § 72A.20. The Court of Appeals incorrectly interpreted *Morris* to bar **any** claim premised on other subdivisions of § 72A.20.

The 1979 anti-redlining legislation at issue prohibits an insurance policy from containing certain payment terms. The statute was never part of the Model UCPA or Model Regulations to the UCPA. (PA 254). Subdivision 13 does not address claims handling practices and instead prohibits certain insurance contract payment terms.

⁵ The Model Act was followed by the Model Regulations adopted by the State in 1984 and are now contained in Minn. Stat. § 72A.201. Similar to the Model Act, the Model Regulations set forth standards for claims handling and settlement and do not deal with the permitted terms of an insurance policy. *Morris*, 386 N.W.2d at 234, n.2.

⁶ References to “PA” are to the Appendix to Petitioners’ Opening Brief. References to “PCA” are to Petitioners’ Confidential Appendix.

State Farm's argument overlooks the limited scope of the *Morris* court's inquiry. The *Morris* court did not, as State Farm suggests, without any analysis forever preclude any cause of action predicated on the fact that a policy term may violate one of § 72A.20's many other subdivisions.⁷ Here, unlike *Morris*, the Class is not using any part of Subdivision 12 to establish a duty or claims handling standard that State Farm did not already owe under Minnesota law. Rather, the Class' claim is premised on State Farm's common law duty to ensure that its policy terms comply with the law and public policy. The Class has not, as in *Morris*, tried to use § 72A.20 to create extra-contractual or tort-based remedies. The *Morris* issues and concerns are simply not present here.

B. Public policy does not support the broad reading of *Morris* that State Farm proposes.

Since *Morris* was decided, there has been an increasing propensity by insurance companies to stretch its holding. The draconian interpretation of *Morris* that State Farm champions is a perfect example. The former Commissioner of Commerce, DOC employees and the current Attorney General concluded the contract surcharge term violated Minnesota's anti-redlining statute. (PA 70-73, 79 at ¶ 11, 147, 84 at ¶ 4). The Governor directed the DOC to suspend subsequent approval of the URP until the courts resolve the legal issue. (PA 285). Yet, State Farm contends *Morris* prevents this Court

⁷ Not surprisingly, cases citing *Morris* deal with claims handling standards, not the validity of insurance contract provisions. See e.g., *Glass Service Co., Inc. v. State Farm Mut. Auto. Ins. Co.*, 530 N.W.2d 867, 872 (Minn. Ct. App. 1995) (non-policyholder sued in tort alleging insurer violated claims handling standard in § 72A.201, subd. 6); *Elder v. Allstate Ins. Co.*, 341 F.Supp.2d 1095, 1098 (D. Minn. 2004) (suit in tort alleging insurer committed negligence *per se* in violating § 72A.201, subd. 8 dealing with automobile claims).

from considering the illegality of the surcharge and permits State Farm to keep millions of dollars it collected even if the surcharge is illegal. Such a result does not square with the law or public policy.

Review of other subdivisions of § 72A.20 demonstrates *Morris* should not be construed so broadly. Subdivision 18 prohibits an insurer from misappropriating a policyholder's money. Subdivision 17 requires insurers to return unearned premiums. The *Morris* court could not have intended to deny insureds' common law conversion and other claims and permit insurers to retain money it did not legally obtain or have a right to keep.

If this Court adopts the expansive reading of *Morris* State Farm advocates, there would be no opportunity for the 177,000 members of the Class to get their money back, even if the surcharge payment term violated the law. Ironically, if the DOC had commenced a hearing against State Farm the Class would have been able to intervene into the action. Minn. Stat. §§ 72A.22; 72A.26. According to State Farm, the DOC's decision to permit entry of a consent decree precluded a contested hearing and foreclosed the Class members' opportunity to obtain an administrative remedy. This result is unfair.

C. The *Morris* court's concerns about allowing private attorney general suits to enforce § 72A.20 are not implicated in this case.

Minn. Stat. § 8.31, subd. 3a allows private parties to assert claims that the Attorney General is authorized to bring under § 8.31, subd. 1. This Court's reluctance to use what is often called the "private attorney general statute" in *Morris* to permit a private cause of action was based in significant part on Subdivision 12's requirement that

claims handling violations happen “with such frequency to indicate a general business practice” of the insurer. *Morris*, 386 N.W.2d at 237; § 72A.20, subd.12. If, as in *Morris*, a single plaintiff needed to prove that the insurer’s misconduct was so widespread as to be a “general business practice” the scope of the litigation of that single claim would have been significantly enlarged.

These practical concerns about wasteful litigation under § 8.31 are not present here. First, application of Subdivision 13 does not require any evidence regarding an insurer’s conduct or general business practices because the legality of the contract term itself is at issue. Second, this is not a single plaintiff case but is instead a certified class action with an estimated 177,000 members – making the scope of the litigation concern inapplicable.

Since *Morris*, this Court has set limitations on a litigant’s use of the private attorney general statute that addresses some of the *Morris* concerns. Parties seeking to pursue a claim under § 8.31, subd. 3a must show their action will advance state interests or provide public benefit. *See e.g., Ly v. Nystrom*, 615 N.W.2d 302, 313-14 (Minn. 2000). The Legislature enacted § 72A.201 in 1984, which further outlines prohibited claims handling procedures. That section empowers the DOC to seek and impose administrative remedies for violations of §§ 72A.201 and 72A.20, subd. 12 but does not include any reference to Subdivision 13. In addition, § 72A.201, subd. 1 excludes individual violations from being an “unfair, discriminatory, or unlawful business practice” for purposes of § 8.31; thereby precluding private attorney general actions for violations of § 72A.201.

Had the Legislature intended to preclude the use of § 8.31 attorney general or private attorney general actions for violations of § 72A.20, subd. 13 it could have referenced Subdivision 13 in § 72A.201, subd. 1. It did not. This Court should not “read into the statute” a bar to private attorney general claims under § 8.31 where the Legislature has not included such a provision. *Metro. Sports Facilities Comm’n v. County of Hennepin*, 561 N.W.2d 513, 516-17 (Minn. 1997).

III. This Court Should Not Adopt or Apply the Federal Filed Rate Doctrine in This Case.

A. Courts should not defer questions of legality of rates to the DOC.

Long ago, this Court determined that the courts, not administrators within the DOC, have the final say concerning the legality of insurance contract terms. *Shank*, 221 Minn. at 130, 21 N.W.2d at 238; *Kersten v. Minnesota Mut. Life Ins. Co.*, 608 N.W.2d 869, 874 (Minn. 2000) (courts have the duty to interpret statutes). State Farm could not dispute the holding of these cases, so it chose not to address this authority. Obviously, this line of cases is in direct conflict with the breadth of the filed rate doctrine proposed by State Farm.

State Farm’s countervailing arguments about agency deference are belied by the cases it cites. For example, State Farm refers to a concurring opinion by Judge Kenneth Starr in *AT&T Co. v. FCC*, 836 F.2d 1386, 1394 (D.C. Cir. 1988) to suggest that Minnesota would become an “Orwellian world” if State Farm were forced to return any monies – even if the contract surcharge payments were found to violate state law. (Resp.

Br., p. 34). Review of the *AT&T* decision calls State Farm's analysis and argument into serious question.

In truth, the reference to "Orwellian world" in *AT&T* reflects Judge Starr's fear that the judiciary would provide **too much deference** to a rate-making agency when the agency refused to follow the laws passed by Congress. In *AT&T*, the D.C. Circuit enjoined a rate-making federal agency from acting in conflict with the Communications Act of 1934, 47 U.S.C. § 201-205. *AT&T*, 836 F.2d at 1392-93. Judge Starr expressed concern about deferring to a rate-making agency on questions of law, especially when the rate-making agency's "innovations of law [sic] are without statutory foundation." *Id.* at 1393. Referring to a situation where an agency does not follow the law as an "Orwellian world," Judge Starr warned against providing any deference to an agency:

In this age of deference to largely unaccountable organs of government, we [the courts] must not permit these quasiautonomous creatures of political branches to tear asunder that which the representatives of the people seen fit to ordain and maintain for a quarter of the Nation's history. To do so is a misguided affront to the basic principles of republicanism.

Id. at 1394, 1396 (emphasis added).

AT&T does not stand alone in supporting the notion that courts should not defer to agencies on questions of law. See *Daleure v. Kentucky*, 119 F.Supp.2d 683, 687 n.10 (W.D. Ky. 2000) ("In some areas the PSC, at least, is without power. In cannot, for instance, determine the legality of certain contractual relationships at issue.").

Not only do the authorities State Farm relies on support the Class' position, but the un rebutted authorities previously cited by the Class demonstrate that federal courts will

not hesitate to determine that a rate filing violates a statute. *See e.g., Telco Communications Group, Inc. v. Race Rock of Orlando, LLC*, 57 F. Supp. 3d 340, 344-45 (E.D. Va. 1999). State Farm attempts to challenge this authority by citing two trial court decisions as “black letter law.” (Resp’t. Br. p. 41). These cases do not even address a filing that violates a statute. State Farm also cites *Wegoland Ltd. v. NYNEX*, 806 F. Supp. 1112 (S.D.N.Y. 1992), *aff’d.*, 27 F.3d 17 (2d. Cir. 1994), but the *Telco* decision expressly distinguished *Wegoland* on point. *Telco*, 57 F. Supp. 3d at 344.

Other authorities provide further support. In *City of Cleveland v. Federal Power Commission*, 525 F.2d 845 (D.C. Cir. 1976), the court was confronted with a utility rate schedule that allegedly violated a city ordinance. In refusing to apply the filed rate doctrine, the court held:

The considerations underlying the [filed rate] doctrine, however, are preservation of the agency’s primary jurisdiction over reasonableness of rates and the need to insure that regulated companies charge only those rates of which the agency has been made cognizant. **We perceive no reason why the doctrine should be employed to render unmodifiable a rate which has been filed in breach of either authority or contract. Surely the agency loses no control over the rate-setting process by allowing a party to show the rate on file is a mistake.**

Id. at 853 (emphasis added); *see also Phillips v. Federal Energy Regulatory Commission*, 586 F.2d 465, 468 (5th Cir. 1978) (“Indeed, if the Commission fails to reject an improperly filed rate, **it may be required to do so by a court.**”).

In short, the Court should not hand-over its authority to determine the legality of insurance filings to the DOC. This Court has rejected such efforts, and the foreign authorities State Farm cites do not support its position.

B. The Class' claims do not conflict with Minnesota's regulatory scheme.

Even if this Court considers limiting the *Shank* line of cases, which the Class strongly opposes, the Court should still not adopt the federal filed rate doctrine. Courts analyzing the propriety of adopting a filed rate doctrine look to: (1) the disruption to the agency that would result from the judicial involvement;⁸ (2) the absence of uniformity that would result from the proffered remedy;⁹ (3) whether the administrative agency scrutinizes all insurance filings for legality;¹⁰ and (4) the availability of another remedy for consumers.¹¹ Consideration of these factors does not support application of the filed rate doctrine.

1. Administrative efficiency is enhanced, not disrupted, by judicial resolution of the illegality claim.

There is no record evidence to suggest that allowing this case to go forward will disrupt the DOC's activities. As the Class noted in its opening brief, the Court should consider the continued disruption caused by the repeated reinterpretations of the anti-redlining statute. (Pet. Br. pp. 12-13, 42-43). State Farm acknowledges the dispute between current employees of the DOC, between current and former Commerce Commissioners and between the DOC and the Attorney General's office regarding the legality of the URP (Resp't. Br. pp. 10-14). Far from disrupting the agencies, the record

⁸ See *H.J. Inc. v. N.W. Bell Tel. Co.*, 954 F.2d 485, 489 (8th Cir. 1992).

⁹ See *Marcus v. AT&T Corp.*, 138 F.3d 46, 60 (2d Cir. 1998).

¹⁰ See *Brown v. Ticor Title Ins. Co.*, 982 F.2d 386, 393-94 (9th Cir. 1992).

¹¹ See *H.J. Inc.*, 954 F.2d at 493; *Hanson v. Acceleration Life Ins. Co.*, No. Civ. A3-97-152, 1999 WL 33283345, *4 (D.N.D. Mar. 16, 1999) (PA 287).

evidence shows that the government officials affirmatively desire judicial resolution of the legality question and that resolution by the courts would actually ease and enhance agency functioning.

Beyond the existing conflicts amongst government officials and near universal¹² desire for judicial interpretation of the law, the Court should note that the DOC believed private remedies would co-exist with administrative remedies at the time it entered into the Consent Decree with State Farm. Commissioner Bernstein attested to his belief that policyholders could seek redress from the courts for the illegal surcharges.¹³ The record evidence further established that Commissioner Bernstein purposely structured the DOC settlement agreement so as not to preclude any policyholder's day in court.¹⁴

Respectfully, it is unfair for a court to adopt a filed rate doctrine when the regulators in question believed that no such doctrine existed and acted in accordance with this belief. Previously, neither the Legislature nor any Minnesota court had ever adopted the federal filed rate doctrine, and as noted by Amicus Curiae MTLA, several Minnesota

¹² In addition to the former Commissioner of Commerce, the Governor and Attorney General seek judicial resolution of the legal issue presented in this case. *See supra* at p. 8.

¹³ "The Department of Commerce did not resolve the claims of the individuals harmed by State Farm's discriminatory, illegal rates. Nothing prohibits Minnesotans from bringing claims against an insurer for discriminatory, illegal rates." (PA 79).

¹⁴ "At no time during the URP negotiations did anyone appear on behalf of the policyholders... [T]he consent Order was structured so that the policyholder claims at issue were not released. No part of the DOC's actions regarding the State Farm entities' URP plan foreclosed the private remedies sought in this case." (PA 82) (emphasis added).

trial courts rejected the doctrine. Clearly, the DOC contemplated private actions arising from the illegal contract term at the time of the informal administrative settlement.

Both the Class and State Farm believe the legal challenge to the URP surcharge can be expeditiously determined by the Court of Appeals.¹⁵ If this happens, insurers, policyholders and the DOC will forever know whether surcharges similar to the ones State Farm imposed are legal. Such a simple action could help tens of thousands of Minnesotans living in older communities. (R. Amundson Dep., Vol. 2, 385-387, Ex. QQ to Aff. of Shawn M. Raiter in Supp. of Class' Mem. of Law in Opp'n to Defs.' Mot. Summ. J.).

The Attorney General, a former Commerce Commissioner, shares Commissioner Bernstein's belief that the insurance regulatory scheme does not preclude this lawsuit. (PA 86). The Attorney General urges this Court to reject the federal filed rate doctrine as conflicting with *Shank*: "It is my opinion that application of any version of the so-called 'filed rate doctrine' to limit policyholders' ability to obtain monetary relief for amounts which were illegally charged in violation of Minn. Stat. § 72A.20, subd. 13 would be inconsistent with Minnesota law and unfair to those policyholders." (PA 85).

Finally, there is no record evidence that the DOC desires to impose a filed rate doctrine in this case. No one from the DOC has ever claimed that the Court should adopt

¹⁵ If this Court reverses the decision of the Court of Appeals, State Farm has urged the Court to remand this case to the Court of Appeals to decide whether the URP surcharge was illegal. (Resp't. Br. p. 46, fn. 23). The Class agrees with State Farm and urges the Supreme Court to remand the parties' cross-appeals on the issue of illegality of contract to the Court of Appeals in the event of reversal.

a filed rate doctrine. The unrebutted record evidence from the Governor, Attorney General, Commissioner Bernstein and the DOC employees demonstrates the opposite.

2. Regulatory uniformity will be lacking if the Court declines to exercise its jurisdiction to resolve the legal issue in this case.

Courts adopting the filed rate doctrine often consider the negative impact a private lawsuit has on rate uniformity. Here, the Class' lawsuit will have the opposite effect. After the DOC determined the URP was illegal and State Farm entered into the Consent Decree, a surcharged policyholder made a complaint against State Farm through the consumer division of the Attorney General's office. On April 2, 2003, after this class action lawsuit was commenced but before the case was certified, State Farm returned the URP surcharges that were the subject of the Attorney General's complaint. (PA 24-25). If a remedy is not provided to other policyholders, who did not complain through the Attorney General's office, the goal of uniformity is defeated.

Once Commissioner Bernstein stated that the surcharges were illegal, the very underpinning of the filed rate doctrine -- agency approval¹⁶ -- was lost. State Farm recognized this and returned premiums after the Attorney General commenced a formal inquiry on behalf of a surcharged policyholder. Such an action destroys any argument by State Farm that uniformity will be achieved through the filed rate doctrine in this case.

¹⁶ In fact, State Farm did not respond to the Class' argument, set out on pages 34 to 35 of its opening brief, that no case law would support the application of the filed rate doctrine to a filing that was set aside by a regulator. State Farm found not a single case in which a court applied the filed rate doctrine to a rate that an agency set aside as illegal.

3. The absence of agency review weighs against adoption of the federal filed rate doctrine.

State Farm's lengthy recitation of its communications with the DOC regarding the URP filing does not change that fact that State Farm used age of dwelling as a surrogate for age of the electrical utility when setting the surcharge payment term. State Farm has admitted this in connection with this lawsuit and admitted to the DOC in June 2001 that it had no electrical system cause of loss data to support the URP surcharge. (PA 66). The record evidence also shows that no one from the DOC looked at the offending portion of the filing (PCA 46).¹⁷ Any purported "review" by the DOC did not and could not have revealed the illegality of the surcharge.

Even if the DOC's communications with State Farm are deemed to constitute substantive review of the URP, it is undisputed that such review by the DOC is the exception, not the rule. In truth, the DOC never reviews most insurance filings. The "file and use" statutory procedures combined with the DOC's budget and staffing limitations result in an insurance rate-making scheme in which effective review is largely absent. (Amicus State of Minnesota Br. pp. 5-7). As the Attorney General plainly stated, "it has been the general historical practice at the Minnesota Department of Commerce not to submit homeowner's insurance rate filings to actuarial review." (PA 85 at ¶8). The lack of meaningful agency review weighs against adoption of a filed rate doctrine.

¹⁷ According to one DOC witness:

Q: Would you say that a thorough review of [the mislabeled filing] was done on an actuarial basis back in 1997?

A: I think it is safe to say it wasn't. (PCA 46).

4. The absence of a remedy for affected consumers in this case mandates against adoption of the federal filed rate doctrine.

To determine whether the filed rate doctrine may act as a bar against claims, courts routinely examine whether the administrative scheme provides an adequate remedy for aggrieved consumers. *See H.J. Inc.*, 954 F.2d at 493 (“[H]ere, another forum exists for telephone consumers to recover the alleged overcharges”); *Hanson*, 1999 WL 33283345 at *4 (citing *Taffet v. Southern Co.*, 967 F.2d 1483, 1490 (11th Cir. 1992)). As discussed more thoroughly in Appellants’ opening brief, no administrative remedy was available to the policyholders harmed by State Farm’s discriminatory and illegal surcharge. (Pet. Br. pp.39-40); *see also supra* notes 12-13.

The DOC never filed a contested case concerning State Farm’s URP. As a result, there was no opportunity for the public to intervene or be heard about the classification in any administrative proceeding. Moreover, affected policyholders had no opportunity to appeal under the contested case hearing procedures set out in Minn. Stat. §§ 14.57-14.69. Finally, no public report or public notice was ever issued concerning the DOC’s investigation and subsequent disapproval of the use of the surcharge rate, other than through the consent order and press release dated December 4, 2002. (PA 74).

In short, there are no administrative procedures available for aggrieved policyholders under Minnesota law.¹⁸ Adopting the filed rate doctrine to bar a common law rescission claim based on illegality of contract would shield State Farm from any real

¹⁸ *See Amicus MTLA Br.* at 13 (“The entire administrative proceeding involved only the agency and the insurer; the injured parties had no voice, no participation, and no remedy.”).

consequences. The absence of an administrative remedy for aggrieved policyholders weighs heavily against adoption of the filed rate doctrine.

C. The undisputed record evidence demonstrates this is not a case about the “reasonableness” of insurance rates.

Just as the DOC ordered State Farm to stop surcharging policyholders without a single change to any policyholder’s base rate, and just as State Farm returned surcharges to particular policyholders after the Attorney General commenced a formal inquiry, neither the Class nor State Farm contends that any homeowners’ insurance rate must be recalculated if the Court interprets the law as the Class advances. While the Class recognizes the foreign authorities cited by State Farm stand for the proposition that courts should not second-guess an agency’s determination of the “reasonableness” of a rate, this is simply not a case where a different rate must be calculated.

Unlike the cases cited by State Farm, the legality of the surcharge at issue is not based upon a finding that the DOC approved a rate that was “unreasonable.” In contrast to other Minnesota statutes in Chapter 70A, there is nothing within the anti-redlining statute that is based upon a subjective determination of what is “unjust,” “reasonable,” “fair” or “excessive.” In the anti-redlining statute, there is simply a flat prohibition against using of age of dwelling as a basis for charging different amounts.

Actuaries would not interpret the language of Minnesota’s anti-redlining statute any differently than the average layperson. (PA 116-17 at ¶3). Even the DOC agrees that, if the Court were to interpret the statute as advised by the Class and the Attorney General, there simply would never be any surcharges in this case. (N. Myers Dep., Vol. 1

at 135-136, Ex. K to Aff. of T. Joseph Snodgrass in Supp. of Mot. for Partial Summ. J.). (“[I]f we say that the age of utility is only connected to the ... losses actually caused by faulty wiring, then there would not be any discounts or surcharges. There’s simply not enough claims to base a discount or surcharge on. So that just doesn’t exist. That won’t happen.”).

D. Courts that have adopted the filed rate doctrine do not apply the doctrine to preclude contract illegality claims.

Contrary to State Farm’s assertion that there are no “exceptions” to the filed rate doctrine, courts in other jurisdictions have, in fact, held that the doctrine is inapplicable in a variety of circumstances. For example, the Mississippi Supreme Court held that its newly-created filed rate doctrine would not extend to claims involving surcharges under a classification that did not have appropriate actuarial support:

At the same time, the complaints do contain some allegations which arguably fall outside the scope of the filed rate doctrine, including the claims that Fidelity and American Bankers should be liable for: ... **adding a forty-five percent surcharge to premiums when their own actuary state that this charge was not based upon any objective underwriting criteria.**

American Bankers’ Ins. Co. of Fla. v. Wells, 819 So.2d 1196, 1204 (Miss. 2001) (remanding case with directions to allow recovery for claims “arguably outside of the scope of the filed rate doctrine” and acknowledging that other jurisdictions have also recognized exceptions to the doctrine) (emphasis added).

Similarly, in *Litton Sys., Inc. v. Am. Tel. & Tel. Co.*, 700 F.2d 785 (2d Cir. 1983), the Second Circuit held the filed rate doctrine did not apply where the issue was the fact of the charge itself, not merely the amount:

This case can be distinguished from *Keogh* and decisions holding the filed rate doctrine applicable, * * * because the issue here is not the reasonableness of the interface tariff rate as compared to some other rate that might have been charged, but instead whether the PCA requirement itself was reasonable, *i.e.*, **whether there should have been any charge at all.**

Id. at 820-21 (emphasis added).¹⁹ Simply put, analysis of the case law shows that courts readily except claims from the scope of the filed rate doctrine. Moreover, courts that have adopted some form of the doctrine sharply limit its scope. *See e.g., Pink Dot, Inc. v. Teleport Communications Group*, 107 Cal. Rptr. 2d 392, 398 (Cal. Ct. App. 2001) (“There is no parallel state filed rate doctrine that would operate to bar **all** state statutory and common law claims.”) (emphasis in original).

E. Public policy does not support creation of a filed rate doctrine.

State Farm claims it would be against public policy to force it to disgorge any money if it is determined that the URP surcharges were illegal contract terms. The only case State Farm cites for this proposition is Judge Starr’s concurring opinion in *AT&T*. However, in his opinion, Judge Starr specifically noted that consumers had a statutory

¹⁹ *See also Gulf States Utils. Co. v. Alabama Power Co.*, 824 F.2d 1465, 1472 (5th Cir. 1987) (contracts to purchase electricity could be set aside if the plaintiff could demonstrate fraudulent inducement, as such a remedy “would not interfere with the federal agency’s rate-making powers”); *City of Kirkwood v. Union Elec. Co.*, 671 F.2d 1173, 1179 (8th Cir. 1982) (award of antitrust damages for alleged creation and maintenance of anti-competitive prize squeeze did not conflict with regulatory agencies’ authority to oversee rates because plaintiffs did not challenge the agencies’ findings that the rates were reasonable); *Destec Energy, Inc. v. S. California Gas Co.*, 5 F. Supp. 2d 433, 459-60 (S.D. Tex. 1998) (filed rate doctrine did not preclude plaintiffs from challenging the fact of the transport-or-pay requirement itself as opposed to the amount that results from its inclusion in the contracts at issue); *Gelb v. AT&T Co.*, 813 F. Supp. 1022, 1031 (S.D.N.Y. 1993) (nothing in the policy behind the filed rate doctrine would cause it to protect a defendant who unlawfully exacted payment, even at a lawful rate).

remedy for a telephone carrier's violation of law. *AT&T*, 836 F.2d at 1394. Nothing in *AT&T* supports the notion that an insurer should keep monies it received from an illegal payment term.

State Farm also argues that returning the surcharges would conflict with Minn. Stat. § 70A.11, which State Farm claims provides an absolute bar to the return of premiums. State Farm urges this Court to hold that the only remedy available was for the DOC to tell State Farm to stop once its violation of law is discovered. In State Farm's proposed regulatory scheme, an insurer could purposely mislead the DOC, and if caught after several years of redlining, the DOC could not force State Farm to return a cent to policyholders who could not seek their own recovery.

Section 70A.11 does not provide the absolute bar to a return of premiums State Farm proposes. The anti-redlining statute is not in Chapter 70A and State Farm is not entitled to immunity from common law claims under § 70A.11. Chapter 72A expressly allows the Class' common law claims for illegality of contract to proceed notwithstanding any action by the Commissioner:

No order of the commissioner, or order or decree of any district court, under sections 72A.17 to 72A.32 shall in any way relieve or absolve any person affected by such order or decree from any liability under any other laws of this state.

Minn. Stat. § 72A.29, subd. 1 (emphasis added). This statute clearly protects the Class' common law illegality of contract claim. As properly noted by the State of Minnesota, State Farm's alleged public policy is dwarfed by the greater concerns of the citizens of

this State that the laws passed by the Legislature will be followed and their common law claims protected.

Finally, State Farm argues that it could not possibly have engaged in redlining because its policyholders are overwhelmingly white – even though greater concentrations of minorities and minority communities paid surcharges. In this homogenous state, State Farm’s argument misses the mark. Redlining not only affects those who are affluent enough to own homes, but more importantly, those that are barred from becoming homeowners.²⁰ Moreover, a discriminatory practice is not any less so because it adversely impacts a relatively small number of people. Respectfully, the equities are not even close. Public policy does not favor the adoption of a filed rate doctrine.

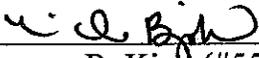
CONCLUSION

In the final analysis, it is unconscionable for State Farm to keep millions of dollars it received in consideration for an invalid contract payment term. This Court should not abrogate its authority to interpret and apply the anti-redlining statute to the Class’ rescission claim. Judicial resolution of this important issue is consistent with long-standing precedent and does not implicate the *Morris* concerns. The Class respectfully requests that the Court reverse the Court of Appeals’ decision and remand the case to the appellate court to determine whether the surcharge contract terms are illegal.

²⁰ The homeownership rate for minorities in Minnesota (41%) falls well below the national average (46%). Governor Timothy Pawlenty’s Office, “Governor Pawlenty Launches Statewide Effort to Increase Minority Home Ownership,” at www.governor.state.mn.us/tpaw_View_Article.asp?artid=1008. (June 28, 2004).

Dated this 24th day of February, 2006. Respectfully submitted,

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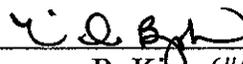
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CERTIFICATE

Pursuant to Rule 132.01, subd. 3(a)(1), the undersigned set the type of the foregoing memorandum of law in Times New Roman, a proportional, 13-point font, on 8 ½ by 11 inch paper with written matter not exceeding 6 ½ by 9 ½ inches. The resulting principal brief contains **6877** words, as determined by employing the word counter of the word-processing software, Microsoft Word XP, used to prepare it.

Dated this 24th day of February, 2006.

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