

NO. A05-705

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State of Minnesota  
**In Court of Appeals**

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

vs.

State of Minnesota,

*Defendant/Respondent.*

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**PETITIONERS' BRIEF**

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## STATEMENT OF THE ISSUES

- I. When authorizing the sale of securities to public investors in Minnesota as part of the scheme for the regulation of the issuance of securities in the State, is the Minnesota Department of Commerce obliged to adhere to its regulations, which applies mandatory financial requirements to issuers of debt securities?

**Trial Court's Holding:** Did not address this issue.

**Apposite Statutes:** Minn. Stat. §§ 3.736, subd. 3(b) and (k), 80A.10, 80A.13, 80A.25.

**Apposite Rule:** Minn. R. 2875.3500

**Apposite Cases:** *Wiederholt v. City of Minneapolis*, 581 N.W.2d 312 (Minn.1998).

- II. Is the action of the Commissioner of the Minnesota Department of Commerce in determining whether to allow the sale of debt securities in the State of Minnesota a ministerial function for purposes of determining whether the State is immune from liability pursuant to Minn. Stat. § 3.736?

**Trial Court's Holding:** No

**Apposite Statutes:** Minn. Stat. §§ 3.736, subd. 3(b) and (k), 80A.10, 80A.13, 80A.25.

**Apposite Rule:** Minn. R. 2875.3500

**Apposite Cases:** *Wiederholt v. City of Minneapolis*, 581 N.W.2d 312 (Minn.1998); *Janklow v. Minnesota Bd. Of Examiners for Nursing Home Adm'rs*, 552 N.W.2d 711 (Minn. 1996); *Johnson v. State*, 553 N.W.2d 40 (Minn. 1996); *Rico v. State*, 472 N.W.2d 100 (Minn. 1991); *Holmquist v. State*, 425 N.W.2d 230 (Minn.1988); *Nusbaum v. Blue Earth County*, 422 N.W.2d 713 (Minn. 1988).

- III. Is the State immune from liability where the State failed, in knowing disregard of the non-waivable mandatory minimum financial requirements applicable to issuers of debt securities, to exercise its discretionary authority to prevent the sale of debt securities by an issuer that did not satisfy those requirements?

**Trial Court's Holding:** Did not address this issue.

**Apposite Statutes:** Minn. Stat. §§ 3.736, subd. 3(b) and (k), 80A.10, 80A.13, 80A.25.

**Apposite Rule:** Minn. R. 2875.3500

**Apposite Cases:** *State by Beaulieu v. City of Mounds View*, 518 N.W.2d 567 (Minn.1994); *Rico v. State*, 472 N.W.2d 100 (Minn. 1991).

- IV. Is the State immune from liability when it issues a license, permit or other authorization in knowing and willful violation of applicable law and rules?

**Trial Court's Holding:** Did not address this issue.

**Apposite Statutes:** Minn. Stat. §§ 3.736, subd. 3(b) and (k), 80A.10, 80A.13, 80A.25.

**Apposite Rule:** Minn. R. 2875.3500

**Apposite Cases:** No Minnesota case has addressed this issue.

- V. Is the State immune from liability where the Minnesota Department of Commerce allowed an issuer of debt securities to register its securities for sale to investors in Minnesota in knowing and willful disregard of a regulation whose purpose is the protection of Minnesota investors from issuers of debt securities that cannot satisfy the non-waivable minimum financial requirements applicable to such issuers?

**Trial Court's Holding:** Did not address this issue.

**Apposite Statutes:** Minn. Stat. §§ 3.736, subd. 3(b) and (k), 80A.10, 80A.13, 80A.25.

**Apposite Rule:** Minn. R. 2875.3500

**Apposite Cases:** No Minnesota case has addressed this issue.

- VI. Is the State immune from liability when it issued a license, permit or other authorization to an issuer of debt securities for sale to investors in Minnesota even though the issuer's financial condition did not satisfy the non-waivable minimum financial requirements applicable to such issuers and even though the State did not adhere to the requirements of the Administrative Procedure Act ("APA") for waiving a statutory requirement?

**Trial Court's Holding:** Did not address this issue.

**Apposite Statutes:** Minn. Stat. §§ 3.736, subd. 3(b) and (k), 14.05, 80A.25.

**Apposite Rule:** Minn. R. 2875.3500

**Apposite Cases:** *Springborg v. Wilson & Co.*, 73 N.W.2d 433 (1955)

- VII. Does the district court's construction of Minn. Stat. § 80A.13 that the Commissioner's discretion in issuing a stop order to prevent a registration statement from going effective does not require the Commissioner to consider whether an issuer of debt securities for sale to investors in Minnesota should be prevented from doing so, even though the issuer's financial condition did not satisfy the non-waivable minimum financial requirements applicable to such issuers and even though the Commissioner did not adhere to the requirements of the APA for waiving a statutory requirement, render Minn. Stat. § 80A.13 unconstitutional as a vio-

lation of Plaintiffs' right not to be deprived of their property without due process of law and, therefore, is an incorrect construction?

**Trial Court's Holding:** Did not address this issue.

**Apposite Constitutional provision:** Minn. Const. Art. I, § 7.

**Apposite Statute:** Minn. Stat. §§ 80A.13, 80A.25, 645.17.

**Apposite Rule:** Minn. R. 2875.3500.

**Apposite Cases:** No Minnesota case has addressed this issue.

- VIII. Does the district court's interpretation of Minn. Stat. § 3.736, subd. 3(k), that the Commissioner's discretion in issuing a stop order to prevent a registration statement from going effective does not require the Commissioner to consider whether an issuer of debt securities for sale to investors in Minnesota should be prevented from doing so, even though the issuer's financial condition did not satisfy the non-waivable minimum financial requirements applicable to such issuers and even though the Commissioner did not adhere to the requirements of the APA for waiving a statutory requirement, render that statute in violation of Minnesota Constitution Article 1, § 8 by denying to Minnesota investors in fixed income securities a common law remedy guaranteed by the Constitution?

**Trial Court's Holding:** Did not address this issue.

**Apposite Constitutional provision:** Minn. Const. Art. I, § 8.

**Apposite Statute:** Minn. Stat. §§ 3.736, 645.17.

**Apposite Rule:** Minn. R. 2875.3500.

**Apposite Cases:** No Minnesota case has addressed this issue.

- IX. Does the district court's construction of Minn. Stat. § 80A.13 that the Commissioner's discretion in issuing a stop order to prevent a registration statement from going effective does not require the Commissioner to consider whether an issuer of debt securities for sale to investors in Minnesota should be prevented from doing so, even though the issuer's financial condition did not satisfy the non-waivable minimum financial requirements applicable to such issuers pursuant to Minn. R. 2875.3500 and Minn. Stat. § 80A.25, render Minn. Stat. § 80A.25 and Minn. R. 2875.3500 thereunder a nullity and violate the statutory requirement that statutes are to be construed so that the entire statute is effective and certain?

**Trial Court's Holding:** Did not address this issue.

**Apposite Statute:** Minn. Stat. §§ 80A.13, 80A.25, 645.17.

**Apposite Rule:** Minn. R. 2875.3500.

**Apposite Cases:** No Minnesota case has addressed this issue.

- X. Did Plaintiffs' Third Amended Complaint allege with the requisite specificity that the State violated the Minnesota Consumer Fraud Act where Plaintiffs allege that the State permitted an issuer of debt securities to sell said securities to investors in Minnesota in knowing disregard of non-waivable minimum financial requirements applicable to such issuers?

**Trial Court's Holding:** No.

**Apposite Statute:** Minn. Stat. § 325F.69.

**Apposite Rule:** Minn. R. 2875.3500; Minn. R. Civ. P. 9.02

**Apposite Cases:** No Minnesota case has addressed this issue.

- XI. Did Plaintiffs' Third Amended Complaint allege with the requisite specificity that the State aided and abetted the other defendants' violations of the Minnesota Consumer Fraud Act where Plaintiffs allege that the State permitted an issuer of debt securities to sell said securities to investors in Minnesota in knowing disregard of non-waivable minimum financial requirements applicable to such issuers?

**Trial Court's Holding:** No.

**Apposite Statute:** Minn. Stat. § 325F.69.

**Apposite Rule:** Minn. R. 2875.3500; Minn. R. Civ. P. 9.02

**Apposite Cases:** No Minnesota case has addressed this issue.

#### **STATEMENT OF THE CASE**

Plaintiffs initiated this action as a putative class action on November 15, 2000 based on § 12(a)(2) of the Securities Act of 1933, Minn. Stat. §§ 80A.01, 80A.03, 80A.23 (securities fraud) and 8.31 and 325F.69 (consumer fraud), negligence, negligent misrepresentation and fraud, and aiding and abetting in connection with the sale of debentures by a non-Minnesota issuer that began in November 1997. In their Third Amended Complaint, dated June 25, 2003, Plaintiffs added the State of Minnesota as a defendant. Plaintiffs' motion to certify a class was denied, and Plaintiffs' petition for discretionary review of the class denial pursuant to Minn. R. Civ. App. P. 105.02 was also denied. Court of Appeals File Number A04-902. Following the denial of discretionary review, Plaintiffs settled their claims with all defendants except the State of Minnesota.

This appeal by Plaintiffs is from a decision of the Hennepin County District Court, the Honorable J. Peter Albrecht, dismissing Plaintiffs' claims against the State of Minnesota for negligence, negligent misrepresentation, violating the Consumer Fraud Act or aiding and abetting other persons' violations of the Consumer Fraud Act, and common law fraud or aiding and abetting other persons' common law fraud. The district court, in its Order Granting Rule 12 Dismissal, dated June April 16, 2004, held that the State was immune from liability from Plaintiffs' claims because, in allowing the issuer's registration statement to become effective, the State's authorization of the sale of debentures in Minnesota was a discretionary, not a ministerial, act, which is immune from liability pursuant to Minn. Stat. § 3.736, subd. 3(b), or an act of authorization, which is immune from liability pursuant to Minn. Stat. § 3.736, subd. 3(k). Appendix ("A-") 3. The district court also held that Plaintiffs' failed to state a claim against the State pursuant to the Consumer Fraud Act. The district court entered judgment pursuant to Minn. R. Civ. P. 54.02 on February 8, 2005. A-1. Plaintiffs timely filed their Notice of Appeal on March 8, 2005.

Plaintiffs allege that the Minnesota Department of Commerce allowed an out-of-state issuer of debt securities to sell those securities to Minnesota investors even though the issuer's financial condition, as shown by the financial statements that it filed with the Department, did not comply with a mandatory requirement that the issuer demonstrate its ability to service those securities. A-90-99 [¶¶163-94], 110-13 [¶¶225-33]. Plaintiffs further allege that the Department knowingly disregarded this non-waivable requirement in allowing the issuer's Minnesota registration statement to become effective, erroneously believing the requirement to be waivable but failing to waive the requirement in accordance with either Department procedures or the Administrative Procedure Act ("APA"), Minn. Stat. § 14.01. A-93-95 [¶¶ 173-83]. The district court did not address these issues.

## **STATEMENT OF FACTS**

### **I. THE PARTIES**

Plaintiff First National Bank of the North is located in Sandstone, Minnesota. Plain-

tiff Prairie National Bank is located in Belle Plaine, Minnesota. Plaintiff Centennial National Bank is located in Walker, Minnesota. Clare Gallagher is a small business owner who resides in Minnesota. Alan R. Stearns, as Trustee of the Alan R. Stearns Trust, resides in California. A-16-17 [¶¶ 11-15]. Each of the Plaintiffs invested in debentures issued by United Homes, Inc. (“UHI”). A-16-17 [¶¶ 11-15].

Defendant is the State of Minnesota, which, through the Commissioner of the Minnesota Department of Commerce (“Commissioner”) and the staff of the Minnesota Department of Commerce (“Department”), is responsible for enforcing the Minnesota Securities Act and the rules adopted by the Commissioner pursuant to the Minnesota Securities Act. A-17 [¶ 16].

## **II. ALLEGATIONS IN THE COMPLAINT**

### **A. Plaintiffs’ Investment in United Homes Debentures.**

Plaintiffs invested approximately \$365,000 principal amount of debentures issued by United Homes, Inc. (“UHI”). Three of the Plaintiffs invested in the initial offering in December 1997, and two of the Plaintiffs purchased in May 1998 and August 1999. A-13, 16-17 [¶¶ 1, 11-15]. Plaintiffs’ investments were part of a total of \$7 million principal amount of UHI’s debentures sold in 13 states, almost \$3 million of which was sold to Minnesota investors. A-24 [¶ 31], 111 [¶ 228]. The debentures became worthless in March 2000 when UHI declared bankruptcy after missing payments of interest and principal on the debentures in 1999. A-34 [¶ 46], 215 [¶¶ 438-42], 224 [¶ 476].

### **B. Minnesota’s Registration Requirement for Securities Sold to the Public in Minnesota.**

UHI could not sell its debentures to residents of Minnesota in a public offering such as was made in this case unless those debentures were registered pursuant to the Minnesota Securities Act. A-90 [¶ 163]; Minn. Stat. § 80A.08. UHI sought to register its debentures pursuant to Minn. Stat. § 80A.10. A-90 [¶ 164], 221 [¶ 468]. A registration statement under Minn. Stat. § 80A.10 automatically becomes effective when the issuer’s

registration statement filed with the SEC becomes effective, if a stop order is not in effect and no proceeding is pending under Minn. Stat. § 80A.13 and two other conditions are satisfied. Minn. Stat. § 80A.10. While the Commissioner may waive either or both of the second and third conditions, the Commissioner cannot waive the first condition. *Id.*

Minn. Stat. § 80A.13 addresses the denial, suspension or revocation of a registration statement in Minnesota. The Commissioner “may issue a stop order denying effectiveness to” a registration statement “if the commissioner finds (a) that the order is in the public interest and (b) that . . . (2) any provision of sections 80A.01 to 80A.31 or any rule . . . or condition lawfully imposed under sections 80A.01 to 80A.31 has been willfully violated in connection with the offering by . . . (ii) the issuer. . . .” § 80A.13, subd. 1(2).

Pursuant to Minn. Stat. §§ 45.023 and 80A.25, subd. 1, the Commissioner adopted Minn. R. 2875.3500. A-92 [¶ 168]. The Commissioner adopted Minn. R. 2875.3500 because the Commissioner found that Minn. R. 2875.3500 is in the public interest or for the protection of investors. *Id.* Once adopted by the Commissioner, Minn. R. 2875.3500 cannot be rescinded, amended or modified unless the Commissioner affirmatively finds that such rescission, amendment or modification is in the public interest or for the protection of investors. Minn. Stat. § 80A.25, subd. 2. Any such rescission or amendment must be done in accordance with the APA. Minn. R. 2875.3500 was in effect on August 22, 1997 and at all times relevant herein. A-92 [¶ 169].

Minn. R. 2875.3500, subp. 2, provides [emphasis supplied]:

In connection with the offering of debentures, notes, bonds, investment certificates, or similar interest-bearing securities . . . the cash flow of the issuer, computed in accordance with generally accepted accounting principles, exclusive of extraordinary income, for its last fiscal year prior to the public offering, or the average of its last three fiscal years prior to the public offering, *shall* be sufficient to cover the interest, including that which is deferred and not paid, on the securities proposed to be offered to the public.

On August 20, 1997, UHI filed with the Department an application to register its debentures pursuant to Minn. Stat. § 80A.10. A-90 [¶ 164]. Two days later, by letter

dated August 22, 1997, the Department advised that the application “has been examined” and that the only two “deficiencies” were items that were not due to be filed until the registration statement relating to the debentures was about to be declared effective by the Securities and Exchange Commission. A-91 [¶ 165].

On November 10, 1997, almost three months after notifying UHI that its application would be granted, the Department completed the required “Debt Securities Examination Checklist.” A-91 [¶ 166]. This checklist reflects that the Department purportedly reviewed the matters required by the applicable regulations, including the requirements of Minn. R. 2875.3500 relating to whether UHI could service the debentures and the fairness of UHI’s debentures pursuant to Minn. Stat. § 80A.13, subd. 1(6). *Id.* The Department declared the UHI registration effective in Minnesota on November 14, 1997. A-91 [¶ 167]. The offering, which was underwritten by Miller & Schroeder Financial, Inc., which has since gone bankrupt, began on November 25, 1997. A-108 [¶ 221].

**C. UHI Failed to Satisfy a Mandatory Financial Requirement Applicable to Issuers of Debt Securities.**

Minn. R. 2875.3500 barred UHI from selling its debentures to investors in Minnesota because its operating cash flow was negative. A-92-93 [¶¶ 170-71]. In order to sell fixed income securities in Minnesota, an issuer must have positive operating cash flow sufficient to “cover the interest” on those securities. *Id.* For its last three fiscal years ended September 30, 1994, 1995 and 1996, UHI’s operating cash flow was a negative \$3,288,607, \$13,703,953, and \$29,467,457, respectively. A-93 [¶ 171].

The Department determined that, because of its financial condition, UHI did not satisfy the requirements of Minn. R. 2875.3500. A-96 [¶¶ 185, 187]. In a memorandum dated August 22, 1997, the Department’s financial analyst, in commenting on whether UHI satisfied Minn. R. 2875.3500, concluded that “they obviously don’t make it.” *Id.* In his analysis, the Department’s analyst acknowledged that UHI was dependent upon its continuing borrowings from its two senior lenders to service the debentures it was pro-

posing to sell in Minnesota. A-97 [¶ 188]. Minn. R. 2875.3500 prohibits funds obtained from continuing borrowings to be included in determining whether an issuer of debentures, such as the UHI debentures, can service such securities. A-97 [¶ 189].

In reaching his conclusion in his August 22, 1997 memorandum, the Department's analyst improperly made the following unfounded assumptions: (i) UHI was part of a "special situation" industry that customarily would not meet the requirements of Minn. R. 2875.3500 for operating cash flow sufficient to service an issuer's existing debt and the debt proposed to be sold in Minnesota, thereby excusing the application of Minn. R. 2875.3500 to UHI; (ii) UHI would be able to continue to borrow from its lenders; (iii) the borrowings could be used to service the debentures; and (iv) UHI was not in jeopardy of losing its funding from its senior lenders. A-97-8 [¶¶ 190-92].

The analyst's assumptions that UHI would be able to continue to borrow from its lenders and that such borrowings could be used to service the debentures were unfounded because of disclosures in the draft prospectus filed with the Department that such borrowings could not be used to service the debentures. A-98 [¶ 192]. In their examination of UHI's application to register its debentures for sale to the public in Minnesota, the Department's staff ignored these disclosures. A-99 [¶ 193]. Additionally, in light of UHI's violations of its senior lender loan agreements, there could be no assurance that such borrowings would continue. A-99 [¶ 194]. The Department did not seek assurance that UHI was in compliance with the loan agreements upon which the Department determined UHI depended to service the debentures. *Id.* UHI was not part of a "special situation" industry that customarily would not meet the requirements of Minn. R. 2875.3500. A-98 [¶ 191].

The August 22, 1997 memorandum was prepared by the financial analyst and addressed to the analyst's supervisor, neither of whom had the authority to waive compliance with Minn. R. 2875.3500, assuming said rule was waivable, which it was not. A-96 [¶ 186]. Only the Commissioner or the Deputy Commissioner for Enforcement at that time had authority to waive rules that were waivable and only if done in accordance with

the APA. *Id.* Neither the Commissioner nor the Deputy Commissioner waived, or purported to waive, Minn. R. 2875.3500 in connection with granting UHI's application to register its debentures for sale in Minnesota or considered, as required by the APA, whether Minn. R. 2875.3500 should be waived with respect to UHI's application. *Id.*

**D. The Department's Failures Allowed UHI to Sell Its Debentures in Minnesota and Elsewhere Even Though the Debentures Were "Unfair or Inequitable" and Even Though UHI Did Not Comply with Minnesota's Statutes and Rules.**

The "Debt Securities Examination Checklist" required a determination that the terms of UHI's debentures were not "unfair or inequitable" under Minn. Stat. § 80A.13, subd. 1(6). A-110 [¶ 225]. The Department's files do not reflect any effort by the Department to determine whether UHI's debentures were "unfair or inequitable." *Id.*

Pursuant to Minn. R. 2875.3500, the Department was obliged to deny UHI's application to register its debentures for sale to the public in Minnesota or to withdraw its prior approval. A-110 [¶ 226]. If the Department had considered whether, under the circumstances, UHI's debentures could be said to be "fair and equitable," then the Department would have been obligated to deny UHI's application to register its debentures for sale to the public in Minnesota or to withdraw its prior approval. *Id.* It may be reasonably inferred that UHI's inability to service its debentures and the revelation that UHI was in violation of its loan agreements with its senior lenders would, if properly considered by the Department, have led the Department to conclude that the UHI debentures were "unfair and inequitable." A-111 [¶ 227].

In reviewing UHI's application for compliance with Minn. R. 2875.3500 and Minn. Stat. § 80A.13, subd. 1(6), the Department staff was performing a ministerial function only. A-112 [¶ 229]. The Department had no discretion regarding whether to apply and enforce said Rule. *Id.* The review of UHI's application for compliance with said Rule did not involve making policy. *Id.* The review, or lack thereof, by the Department was in stark contrast to that of other states. A-112 [¶ 230], A-122-32 [¶¶ 255-281]. Even the

states that ultimately approved UHI's debentures questioned UHI's ability to service the debentures, and some were persuaded only because of the use of the fraudulent earnings to adjusted fixed charges ratio. A-119-28 [¶¶ 247-72].

If the Department had denied the application to register UHI's debentures for sale in Minnesota, UHI would have been obliged to notify those other states. A-112 [¶ 231]. The Michigan Department of Commerce specifically asked the underwriter's counsel to provide the comments of the Minnesota Department of Commerce, which, of course, were negligible. *Id.* Given that Minnesota was the principal market for UHI's debentures, the denial of UHI's application by the Department would have sounded the death knell for the UHI debenture offering. *Id.* In connection with its review of the application to register UHI's debentures, the Department operated with knowing and deliberate disregard of the law and its statutory and regulatory obligations, which were designed to protect Minnesota investors in interest-bearing securities from being exposed to meritless investments like the UHI debentures. A-113 [¶ 233].

#### STANDARD OF REVIEW

When reviewing a dismissal under Minn. R. Civ. P. 12.02(e) of the Minnesota Rules of Civil Procedure, this court determines de novo "whether the complaint sets forth a legally sufficient claim for relief." *Bodah v. Lakeville Motor Express, Inc.*, 663 N.W.2d 550, 553 (Minn.2003). Whether an immunity defense applies is a question of law, subject to independent review. *Bloss v. University of Minnesota Bd. of Regents*, 590 N.W.2d 661 (Minn. App. 1999). Whether government entities and public officials are protected by statutory immunity and official immunity is a legal question that the appellate court reviews de novo. *Johnson v. State*, 553 N.W.2d 40 (Minn. 1996). The construction of a statute presents a question of law subject to de novo review. *In re Estate of Palmen*, 588 N.W.2d 493, 495 (Minn.1999).

In reviewing a complaint dismissed for failure to state a claim on which relief can be granted, the facts in the complaint are accepted as true, and the plaintiff has the benefit

of all favorable and reasonable inferences. *Nolan and Nolan v. City of Eagan*, 673 N.W.2d 487, 493 (Minn. App. 2004); *Pullar v. Indep. Sch. Dist. No. 701, Hibbing*, 582 N.W.2d 273, 275-76 (Minn.App.1998). A claim prevails against a motion to dismiss “if it is possible on any evidence which might be produced, consistent with the pleader’s theory, to grant the relief demanded.” *Martens v. Minn. Mining & Mfg. Co.*, 616 N.W.2d 732, 739-40 (Minn.2000) (quotation omitted).

## ARGUMENT

### I. SUMMARY

Minn. Stat. § 80A.25 and Minn. R. 2875.3500 thereunder forbid the sale to Minnesota investors by a company of its interest-bearing securities if that company does not have a positive operating cash flow. In deliberate disregard of this law and rule, the Department allowed UHI to sell its debentures in Minnesota, and 28 months later UHI was bankrupt. The Department allowed UHI to cheat Minnesota investors out of almost \$ 3 million. Minn. R. 2875.3500 expressed the legislature’s policy embodied in Minn. Stat. § 80A.25 to protect investors from issuers of debt securities that cannot demonstrate the financial strength to assure payment of interest. The Department deliberately opened the door to UHI to sell its debentures to Minnesota investors even though UHI flunked the Department’s own standard designed to protect Minnesota investors from issuers of fixed income securities like UHI that cannot demonstrate an ability to service its debt.

The Department violated Minn. R. 2875.3500 and did so in disregard of the Department’s own rules and the APA. Moreover, the Commissioner never even considered whether a stop order pursuant to Minn. Stat. § 80A.13 should be issued because of UHI’s failure to satisfy the financial requirements of Minn. R. 2875.3500. In allowing UHI’s registration to become effective, the Department engaged in conduct that was explicitly barred by its own rule. The determination whether UHI should be allowed to sell its debentures in Minnesota was a ministerial function and, therefore, is not immune from liability. Even if it was a discretionary function, the Department did not exercise its discre-

tion in a legally reasonable manner because the Department allowed the sales of securities in Minnesota that were explicitly prohibited by the Department's own rule. Nor is the State's conduct immune from liability because it was authorizing a sale of securities; the State's licensure function should be subject to the same standard of legal reasonableness as is the discretionary function. Finally, the complaint properly pleaded a claim against the State under the Consumer Fraud Act.

## **II. THE DEPARTMENT'S REVIEW OF UHI'S APPLICATION TO REGISTER ITS DEBENTURES IS NOT ENTITLED TO IMMUNITY UNDER THE TORT CLAIMS ACT.**

The district court relied on two exceptions to the waiver of immunity in the Tort Claims Act, Minn. Stat. § 3.736: the exception for discretionary acts, Minn. Stat. § 3.736, subd. 3(b), and the exception for licensing, Minn. Stat. § 3.736, subd. 3(k). A-307-18. Discretionary acts involve planning and policymaking. The Department's review and approval of UHI's application to register its debentures did not involve planning or policymaking and was ministerial only. A-112 [¶ 229]. The State is liable for ministerial acts. Even if the Department's review of UHI's application is deemed discretionary, the discretion here does not confer official immunity because the Department acted without legal reasonableness and violated the right of investors in Minnesota to be protected from fraudulent investments. The licensing exception is also not applicable, because authorization was granted in violation of rules that prohibited the registration of UHI's debentures.

Discretionary immunity is an exception to general rule of governmental liability and must, therefore, be narrowly construed. *Koellin v. Nexus Residential Treatment Facility*, 494 N.W.2d 914 (Minn. App. 1993). Sovereign immunity is an exception to the general tort rule that one should be liable for the harm one causes. *Wilson v. City of Eagan*, 297 N.W.2d 146, 149 (Minn. 1980). In *McCorkell v. City of Northfield*, 266 Minn. 267, 123 N.W.2d 367, 370 (Minn. 1963), the court said: "Because the doctrine of sovereign immunity is repugnant to basic principles of justice, there falls upon us the obligation to subordinate it to any authority which would lead us to the just conclusion."

The State has the initial burden of demonstrating facts showing that it is entitled to immunity. *Bloss*, 590 N.W.2d at 664; *Dokman v. County of Hennepin*, 637 N.W.2d 286 (Minn. App. 2001).

**A. Determining Compliance with Minn. R. 2875.3500 Is a Ministerial Act, and the State Has No Immunity for Ministerial Acts.**

The district court held that Plaintiffs are not able to establish facts that the Department's decision to allow UHI's debentures to be sold in Minnesota was a ministerial rather than a discretionary act involving questions of public policy. The district court erred because (i) Plaintiffs have alleged the Department was performing a ministerial function, had no discretion regarding whether to enforce Minn. R. 2875.3500, and enforcing Minn. R. 2875.3500 did not involve making policy; (ii) the district court was obliged to accept Plaintiff's allegations as true; and (iii) the district court did not address Plaintiff's assertion, supported by specific allegations, that, in carrying out discretionary acts, the Department is obliged, but failed, to adhere to the law. A-92-99 [¶¶ 168-194], A-112 [¶ 229], A-6-8.

In the Minnesota Tort Claims Act, the legislature waived its governmental tort immunity by creating a general rule of liability "where the state, if a private person, would be liable to the claimant." Minn.Stat. § 3.736, subd. 1 (2005). This waiver of immunity is subject to the discretionary function exception, which provides that "the state and its employees are not liable for . . . a loss caused by the performance or failure to perform a discretionary duty, whether or not the discretion is abused." Minn.Stat. § 3.736, subd. 3(b) (2005). The district court held that this exception applies because the Department's approval of UHI's application was discretionary, not ministerial. A-5-7.

That Minn. Stat. § 80A.13, subd. 1, says that the Commissioner "may issue a stop order" under certain circumstances does not necessarily mean that the function is discretionary. Although almost every government function involves some degree of discretion, Minnesota courts have recognized that the legislature did not intend the discretionary

function exception to nullify the general rule of liability. *Rico v. State*, 472 N.W.2d 100, 104 (Minn. 1991), citing *Holmquist v. State*, 425 N.W.2d 230, 231 (Minn.1988) (legislature did not intend that the immunity exception swallow the general rule of recovery for negligent governmental operations). Government action at the planning level is generally protected from liability, while government action at the operational level is generally not protected from liability. *Id.* Government action at the operational level “simply involves applying an established policy to a particular fact situation and is, therefore, unprotected.” *Id.*

The court must narrowly construe the immunity exception to liability and focus on its underlying purpose. *Holmquist*, 425 N.W.2d at 231. The purpose of immunity is to shield from liability any decisions involving the evaluation and weighing of social, political, and economic considerations. *Id.* at 232. “Planning level decisions are those involving questions of public policy, that is, the evaluation of factors such as the financial, political, economic, and social effects of a given plan or policy. Operational level decisions, on the other hand, involve decisions relating to the ordinary day-to-day operations of the government.” *Id.* at 232-33. “That public policy decisions and the professional decisions involved in carrying out settled policies have in common the evaluation of complex and competing factors cannot be gainsaid. It is, however, the evaluation and weighing of social, political, and economic considerations underlying public policy decisions, not the application of scientific and technical skills in carrying out established policy, which invokes the discretionary function exception affording governmental immunity.” *Id.*

The “critical inquiry” regarding the application of the discretionary exemption “is whether the challenged governmental conduct involved a balancing of policy objectives,” “rather than merely a professional or scientific judgment.” *Nusbaum v. Blue Earth County*, 422 N.W.2d 713, 719, 722 (Minn. 1988), citing *Griffin v. United States*, 500 F.2d 1059 (3rd Cir.1974), and *Hendry v. United States*, 418 F.2d 774, 783 (2d Cir.1969) (“The fact that judgments of governmental officials occur in areas requiring professional expert

evaluation does not necessarily remove those judgments from the examination of courts by classifying them as discretionary functions under the [Federal Tort Claims] Act.”); *see In re Alexandria Acc. of Feb. 8, 1994*, 561 N.W.2d 543 (Minn. App. 1997) (discretionary immunity protects government only when the government can produce evidence its conduct was of policymaking nature involving social, political, or economic considerations, rather than merely professional or scientific judgments).

“Not all acts involving the exercise of judgment by agents of the government are protected as discretionary functions.” *Nusbaum*, 422 N.W.2d 713 at 722 (citing *Cairl v. State*, 323 N.W.2d 20, 23 (Minn.1982)). “The protection afforded by the discretionary function exception *does not extend to professional or scientific judgment* where such judgment does not involve a balancing of policy objectives.” *Id.* (citing *Blessing v. United States*, 447 F.Supp. 1160, 1185 (E.D.Pa.1978) (emphasis supplied). “Instead, government conduct is protected only where the state produces evidence that the conduct was of a policy-making nature involving social, political, or economical considerations.” *Id.* (citing *United States v. Varig Airlines*, 467 U.S. 797, 814, 104 S.Ct. 2755, 2764 (1984)). *See also Abo El Ela v. State*, 468 N.W.2d 580 (Minn. App. 1987) (discretionary immunity normally does not extend to the implementation of policy; although implementation usually requires professional or scientific judgments, it does not require the balancing of policy factors); *Janklow v. Minnesota Bd. Of Examiners for Nursing Home Adm’rs*, 552 N.W.2d 711 (Minn. 1996) (while certainly almost every act involves some measure of discretion, not every act of government is entitled to discretionary, meaning statutory, immunity). Where a duty exists and it is apparent that action must be taken, discretion is exhausted, for purposes of governmental discretionary immunity under Minn. Stat. § 3.736, subd. 3(b). *Diedrich v. State*, 393 N.W.2d 677 (Minn. App. 1986).

In *Griffin*, the Third Circuit stated that, to determine the applicability of the discretionary function exception, “we must analyze not merely whether judgment was exercised but also whether the nature of the judgment called for policy considerations.” 500

F.2d at 1064. *Griffin* was very similar to this case. It involved a suit against the United States for its negligence in approving the use of a particular lot of polio vaccine that did not meet specified regulations and ultimately caused severe injuries to plaintiff after she ingested the vaccine. The court held that, although implementation of the regulation required judgment based on the safety criteria, it was professional judgment rather than “that of a policy-maker promulgating regulations by balancing competing policy considerations in determining public interest.” *Id.* at 1066. The court also said that “[w]here the conduct of Government employees in implementing agency regulations requires only performance of scientific evaluation and not the formulation of policy, we do not believe that the conduct is immunized from judicial review as a ‘discretionary function.’” *Id.*

Plaintiffs allege that the Department performed no policy-making functions in approving the registration of UHI’s debentures for sale to Minnesota investors and that the Department had no discretion whether to apply and enforce the applicable rules. A-112 [¶ 229]. The district court’s conclusion that Plaintiffs are unable to establish the facts that the Department’s decision to allow UHI to sell its debentures in Minnesota was ministerial ignores the allegations in the complaint. Additionally, the district court erred in not addressing Minn. R. 2875.3500 and the Department’s conduct in willfully refusing to apply the prohibition of that rule to bar the sale by UHI of its debentures in Minnesota. *See Huttner v. State*, 637 N.W.2d 278 (Minn. App. 2001) (the existence of a ministerial act, for purposes of official immunity, cannot be determined without a review of the duty underlying the challenged conduct).

A ministerial duty is defined as “absolute, certain, and imperative, involving merely the execution of a specific duty arising from fixed and designated facts.” *Johnson v. State*, 553 N.W.2d 40, 46 (Minn. 1996) (citation omitted). Minn. R. 2875.3500 leaves no room for discretion. The Rule provides that in connection with an offering of debentures, “the cash flow of the issuer, computed in accordance with generally accepted accounting principles, . . . shall be sufficient to cover the interest . . . on the securities pro-

posed to be offered to the public.” Minn. R. 2875.3500, subp. 2 [emphasis supplied].

The term “shall” is mandatory. Minn.Stat. § 645.44, subd. 16. That the issuer’s cash flow is to be calculated in accordance with generally accepted accounting principles is likewise mandatory. Minn. R. 2875.3500. If the issuer’s financial condition does not comply with this requirement, its debentures cannot be sold in Minnesota. Minn. R. 2875.3500 is, in its entirety, mandatory. Therefore, reviewing UHI’s application for compliance with this rule was ministerial. The Department’s staff had no discretion regarding whether to apply and enforce Minn. R. 2875.3500, and the review of UHI’s application for compliance with the Rule did not involve making policy. A-112 [¶ 229]. These allegations must be accepted as true. *Pullar*, 582 N.W.2d at 275-76; *Nolan*, 673 N.W.2d at 493.

**B. Even if the Rule Ignored by the Department Were Waivable, the Department’s Purported Waiver Was Not Done in accordance with Department Policy and the APA.**

The Commissioner does not have a general ability to waive certain rules promulgated under the Minnesota Securities Act. While parts of the regulatory scheme set out in the Act and the rules for the sale of securities in this state may, at the Commissioner’s discretion, be waived or omitted, other parts most clearly are not subject to that discretion. Rule 2875.3500 is clearly not a rule that the Commissioner had discretion to waive.

Even if the Commissioner did have authority to waive Minn. R. 2875.3500 in connection with UHI’s application to the Department to register UHI’s debentures for sale to Minnesota investors, assuming that the Department did seek to waive said rule, the Department failed to comply with the requirements of the APA. In order for the Commissioner to grant a variance from, or waive, the application of Minn. R. 2875.3500 in connection with UHI’s application to register its debentures, the APA required that certain procedures be followed. The APA, Minn. Stat. § 14.05, subd. 4, provides the following regarding the manner in which the Department could grant a variance to Minn. R. 2875.3500:

Unless otherwise provided by law, an agency may grant a variance to a

rule. Before an agency grants a variance, it shall adopt rules setting forth procedures and standards by which variances shall be granted and denied. An agency receiving a request for variance shall set forth in writing its reasons for granting or denying the variance. This subdivision shall not constitute authority for an agency to grant variances to statutory standards.

The Department had no rules or procedures, and no criteria or standards, in 1997 for granting or denying variances to, or waivers from, Rule 2875.3500. A-94 [¶ 177]. Consistent with Minn. Stat. § 80A.25 (pursuant to which Rule 2875.3500 was adopted), such a standard might be that the waiver was for the protection of investors. The Department's then Deputy Commissioner responsible for the registration process has refused to state that, notwithstanding § 80A.25, Rule 2875.3500 could not be waived unless the Commissioner determined that the waiver was for the protection of investors. *Id.*

In applying to register UHI's debentures for sale in Minnesota, UHI did not seek a waiver or variance from the application of Minn. R. 2875.3500. A-94 [¶ 178]. In clearing the UHI debentures for sale in Minnesota and granting the application to register said debentures for sale in Minnesota, the Department did not set forth in writing its reasons for granting the apparent variance from Minn. R. 2875.3500 that reflected the application of standards or criteria that supported such reasons. A-94 [¶ 179]. The Deputy Commissioner responsible for overseeing the Department's review of applications to register securities for sale in Minnesota at the time that the UHI debentures were registered mistakenly believes that all provisions of the Minnesota Securities Act and the rules thereunder can be waived by the Commissioner or his designee on an *ad hoc* basis. A-95 [¶ 180]. The Deputy Commissioner is unable to provide authority for his belief. *Id.* The Deputy Commissioner is wrong. Once an agency rule is adopted, the agency does not have discretion to disregard it, and the rule has the force and effect of law and binds the agency that adopts it. *Springborg v. Wilson & Co.*, 245 Minn. 489, 73 N.W.2d 433, 435 (1955).

The Deputy Commissioner believed that the Commissioner in 1997 had designated in writing those members of the Department's staff who had authority to waive

compliance with the Minnesota Securities Act and the rules thereunder, including Minn. R. 2875.3500. A-95 [¶ 181]. There was no such writing in 1997, and there is no such writing now. *Id.* The Deputy Commissioner did not review UHI's application to register its debentures for sale in Minnesota. A-95 [¶ 182]. The Deputy Commissioner was not consulted when the UHI debenture application was cleared by the Department in November 1997 without enforcing Minn. R. 2875.3500 as it was required to do. *Id.*

Minn. R. 2875.0990 grants to the Commissioner authority to waive Rules 2875.0950 to 2875.0980 but not Rule 2875.3500. A-314. Indeed, the grant of explicit authority to waive certain rules and not others supports the conclusion that the other rules are not to be waived, because the Commissioner knew how to provide for those rules to be waivable that it wanted to be waivable. *See, e.g., Matter of Wang*, 441 N.W.2d 488, 496 (Minn. 1989) ("Plainly, the legislature knows how to specifically authorize the recovery of attorney fees and investigation costs when it intends such recovery"). Moreover, the specific grant of the ability to waive some provisions but not others necessarily limits the blanket authority the State argues is to be found in Minn. Stat. § 80A.12, subd. 4. Borrowing further from the rules for statutory construction, specific provisions of an act prevail over prior, general provisions. *State v. Corbin*, 343 N.W.2d 874, 876 (Minn.App.1984) (citing Minn.Stat. § 645.26, subd. 1).

In interpreting statutes, the general rule is that courts cannot supply words omitted or overlooked by the legislature. *Wallace v. Commissioner of Taxation*, 289 Minn. 220, 184 N.W.2d 588, 594 (1971). Authority to waive a statute is not to be found where not explicitly provided. *See, e.g., State v. Humes*, 581 N.W.2d 317, 319 (Minn.1998) ("[W]e reject the argument that the legislature must append language prohibiting waiver to every mandatory statute to ensure that the statute is given effect. The canons of statutory construction provide that "shall" is mandatory.") (citing Minn.Stat. § 645.44, subd. 16 (1996) (footnote omitted)). It is a salutary rule of law that when a statute is founded upon public policy, those to whom it applies should not be permitted to waive its provisions. *Shank v.*

*Fidelity Mut. Life Ins. Co.*, 221 Minn. 124, 21 N.W.2d 235, 238 (1945).

Even assuming the Commissioner has authority to ignore Rule 2875.3500, such authority must be exercised rationally, setting standards and giving reasons, and not by willful neglect, arbitrarily or capriciously. Minn. Stat. § 14.05, subd. 4. That was not the case here. Such authority must also be exercised by persons who have been delegated authority by the Commissioner. Nor was that the case here. Any authority that the Commissioner may have had to waive Rule 2875.3500 was not delegated to the Department officials who “waived” the requirements of Rule 2875.3500 here. A-95-96 [¶¶ 181-82, 186].

**C. The Commissioner Did Not Exercise His Discretion in accordance with Applicable Law and, therefore, the State Is Not Immune pursuant to the Discretionary Exception to the Waiver of Immunity because (1) the Department Staff Acted without Legal Reasonableness in that the Department Acted in Knowing and Willful Disregard of a Mandatory Standard for Issuers of Debt Securities in Minnesota and (2) the Commissioner Never Considered whether a Stop Order Should Be Issued in Light of UHI’s Failure to Satisfy the Applicable Financial Requirement for Issuing Its Debentures.**

The State’s securities registration scheme affords limited and defined discretion to the Commissioner. The Commissioner is not given discretion to ignore the law or to disregard the provisions of mandatory Rule 2875.3500 applicable to UHI as an issuer of debt securities to be able to sell its debentures in Minnesota. Thus, although the Commissioner, pursuant to Minn. Stat. § 80A.13, “may” issue a stop order, his discretion to do so is necessarily limited by the financial condition of the issuer—if the issuer fails to satisfy a mandatory financial requirement intended for the protection of investors in Minnesota, the Commissioner does not have discretion to ignore it. Were it otherwise, the financial requirement would be meaningless. Moreover, in this case, the issue of whether the Commissioner should issue a stop order to enforce Rule 2875.3500 was never even considered; the discretion was exercised by Department staff who did not have authority to do so, and the matter was never considered by the Commissioner. A-94-96 [¶¶ 176-86].

The exception from liability for a discretionary act must be read narrowly. *Ra-*

*sivong v. Lakewood Community College*, 504 N.W.2d 778 (Minn. App. 1993). A discretionary act, unlike a ministerial act, is one in which an official must exercise “judgment or discretion.” *Johnson*, 553 N.W.2d at 46 (citation and internal quotation marks omitted). Operational-level activity is not protected by statutory immunity if it relates to the ordinary day-to-day operation of government. *Gerber v. Neveaux*, 578 N.W.2d 399 (Minn. App. 1998); *In re Alexandria Acc. of Feb. 8, 1994*, 561 N.W.2d 543 (Minn. App. 1997) (operational decisions by government agents relate to day-to-day operation of government are not protected under statutory discretionary immunity).

An official, although performing duties that require the exercise of judgment and discretion, nonetheless may not assert the defense of immunity if she acted without legal reasonableness in violating a known right. *State by Beaulieu v. City of Mounds View*, 518 N.W.2d 567, 571-72 (Minn.1994) (the exception for discretion contemplates “an objective inquiry into the legal reasonableness of an official’s actions”). An official’s actions are legally unreasonable if the official commits those acts while having reason to believe they are prohibited. *Beaulieu*, 518 N.W.2d at 571-72 (citing *Rico*, 472 N.W.2d at 107-08). An official seeking to qualify for official immunity in Minnesota must show (1) that his or her conduct was “legally reasonable,” *Beaulieu*, 518 N.W.2d at 571, or (2) that “no clearly established law or regulation prohibited [the] conduct,” *Rico*, 472 N.W.2d at 107.

“The intentional doing of a wrongful act without legal justification or excuse, or, otherwise stated, the willful violation of a known right” abrogates official immunity. *Rico*, 472 N.W.2d at 107 (internal quotes and citations omitted). An official seeking immunity in Minnesota must show that “no clearly established law or regulation prohibited [the] conduct.” *Id.* Allowing the registration of UHI’s debentures in contravention of applicable mandatory standards was not legally reasonable because it was clearly prohibited. *See id.* at 107-08; *see also*, *Pelerin v. Carlton County*, 498 N.W.2d 33, 35-36 (Minn.App. 1993) (standard for immunity for discretionary acts focuses on the “objective legal reasonableness of an official’s acts” and “gives ample room for mistaken judg-

ments” by protecting “all but the plainly incompetent or those who knowingly violate the law” (citations omitted)); *Dokman*, 637 N.W.2d at 292 (official performing discretionary functions is entitled to qualified immunity if the official’s conduct does not violate clearly established constitutional or statutory rights that a reasonable person would have known, thus protecting all official conduct but the plainly incompetent or those who knowingly violate the law).

Official immunity analysis applies a two-step inquiry to the identified conduct: first, the court determines whether the conduct required the exercise of judgment and discretion and is therefore the type of conduct protected by official immunity; and second, the court determines whether the alleged acts, even though discretionary, were stripped of the immunity’s protection because the official acted without legal reasonableness in violating a known right. *Davis v. Hennepin County*, 559 N.W.2d 117, 122 (Minn.App.1997).

The law is the same in other states. In order to avail itself of immunity for discretionary acts, the governmental entity must exercise its discretion by considering all relevant information in making its judgment and by complying with its own established regulations and procedures.<sup>1</sup> Discretionary immunity does not encompass decisions that are palpably unreasonable;<sup>2</sup> where the government actions involved malice, wantonness, or an intent to injure;<sup>3</sup> or constitute an abuse of discretion.<sup>4</sup> Sovereign immunity does not apply when a state officer or employee is alleged to have acted illegally, fraudulently, in

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<sup>1</sup> *Public Adm’r, Bronx County v. City of New York*, 271 A.D.2d 220, 706 N.Y.S.2d 40 (1st Dep’t 2000).

<sup>2</sup> *Brown v. Brown*, 86 N.J. 565, 432 A.2d 493 (1981).

<sup>3</sup> *Burns v. Board of Educ. of City of Stamford*, 228 Conn. 640, 638 A.2d 1 (1994) (exceptions to qualified immunity for discretionary acts include where the circumstances make it apparent to the public officer that his or her failure to act would be likely to subject an identifiable person to imminent harm).

<sup>4</sup> *Harris v. State*, 48 Ohio Misc. 27, 2 Ohio Op. 3d 358, 358 N.E.2d 639 (Ct. Cl. 1976).

bad faith, beyond his authority, in violation of or under a mistaken interpretation of the law,<sup>5</sup> or in such a manner that the action can be characterized as willful misconduct, gross negligence, or bad faith so as to fall within exception to general immunity.<sup>6</sup>

Minn. R. 2875.3500 is a clearly established regulation that prohibited the conduct that the Commissioner by default authorized. The failure to consider whether to issue a stop order and the failure to issue a stop order in light of UHI's inability to satisfy the financial requirement found in Minn. R. 2875.3500 deprives the State of the defense of immunity for discretionary acts because the Commissioner "acted without legal reasonableness in violating a known right." Minn. R. 2875.3500 provided Minnesota investors with the right to be protected from fixed income securities issued by companies like UHI that are unable to service them.

Nor did the Commissioner act in "good faith." This "'subjective component,' to the extent that it is retained in Minnesota's official immunity analysis, simply allows an official to argue that, despite the lack of an 'objective' legal justification for the violation, the offending acts were taken in good faith." *Gleason v. The Metropolitan Council Transit Operations*, 563 N.W.2d 309, 318 (Minn. App. 1997) *aff'd in part and remanded* 582 N.W.2d 216 (Minn. 1998). In sum, immunity for the discretionary act applies when the official demonstrates: (1) that the conduct was "objectively" legally reasonable, that is, legally justified under the circumstances; (2) that the conduct was "subjectively" reasonable, that is, taken with subjective good faith; or (3) that the right allegedly violated was not clearly established, that is, that there was no basis for knowing the conduct would

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<sup>5</sup> There is no sovereign immunity when a complaint alleges that a state agent acted in violation of statutory or constitutional law or in excess of his authority. *CGE Ford Heights, L.L.C. v. Miller*, 306 Ill. App. 3d 431, 239 Ill. Dec. 477, 714 N.E.2d 35 (1st Dist. 1999), *as modified on denial of reh'g*, (Aug. 4, 1999) *and appeal denied*, 186 Ill. 2d 571, 243 Ill. Dec. 563, 723 N.E.2d 1164 (1999); *see also Ex parte Alabama Dept. of Forensic Sciences*, 709 So. 2d 455 (Ala. 1997); *Mitchell v. Davis*, 598 So.2d 801 (Ala. 1992).

<sup>6</sup> *Lawry v. County of Sarpy*, 254 Neb. 193, 575 N.W.2d 605 (1998).

violate the plaintiff's rights. *Id.* Given that the Commissioner never even considered the issue, and that the Department's staff, without authority, waived Minn. R. 2875.3500, the "good faith" defense is not available.

**D. The State Is Not Immune pursuant to the Licensing Exception to the Waiver of Immunity because (1) the Department Staff Acted without Legal Reasonableness in that the Department Acted in Knowing and Willful Disregard of a Mandatory Standard for Issuers of Debt Securities in Minnesota and (2) the Commissioner Never Considered whether a Stop Order Should Be Issued in Light of UHI's Failure to Satisfy the Applicable Financial Requirement for Issuing Its Debentures.**

The second exception to the waiver of immunity cited by the district court is for losses attributable to "the failure of a person to meet the standards needed for a license, permit, or other authorization by the State." Minn. Stat. § 3.736, subd. 3(k); A-7. In so ruling, the district court did not address whether this exception applies only where the State's licensing activity is exercised in accordance with applicable standards, not in violation or disregard thereof—i.e., whether the "legal reasonableness" standard applicable to the exception from liability for discretionary acts pursuant to Minn. Stat. § 3.736, subd. 3(b), likewise applies to § 3.736, subd. 3(k). Implicit in the licensing exclusion is that the grant of an authorization is a matter of discretion. Thus, the considerations that have led the courts to limit immunity for discretionary acts should apply with equal force to limit immunity for authorizations. Accordingly, where the official has intentionally committed an act that he or she had reason to believe is prohibited in the course of granting an authorization (e.g., registering securities), there would be no immunity, just as there is no immunity for discretionary acts in that circumstance. *See Rico*, 472 N.W.2d at 107-08.

In *Gertken v. State*, 493 N.W.2d 290 (Minn.App. 1992), *review denied* (Feb. 9, 1993), in holding that a state inspector's advice regarding ventilation of a chimney was not inconsistent with the standards for a day care license and, thus, the state was immune in an action arising from such representation pursuant to the exception under the Tort Claims Act for licensing, the Court of Appeals took care to confine its holding to the

facts of that case. In *Gertken*, a state inspector inspecting the fireplace of a day care center licensed by the state told plaintiff “‘only’ to ‘clean the chimney every couple of years.’” *Id.* at 292. The court noted: “There is no evidence that Berg expressly represented the safety of the fireplace venting, nor is there any suggestion that cleaning the chimney is germane to any cause of action here.” *Id.* The court further noted that “this case does not involve a claim of express representations which are said to contrast with the subject matter of licensing implications” and that its holding is “confined to the facts of this case and does not address the issue of an express representation which differs from the representations implied by licensing.” *Id.*

Thus, the *Gertken* court carefully noted that it was not ruling on a case where a state official made representations that were contrary to, or inconsistent with, the requirements for a license, permit or authorization, or where the state’s conduct was inconsistent with, or contrary to, such requirements. The case at bar is a case of the type explicitly distinguished in *Gertken*—i.e., the State’s conduct and representations did, in fact, “differ[] from the representations implied by licensing.” Registering UHI’s debentures necessarily implied that there was a reasonable likelihood that UHI would be able to service the debt, because that is what Minn. R. 2875.3500 required be demonstrated for the debentures to be registered. Thus, the State’s conduct, by registering the debentures, plainly “differ[ed] from the representations implied by” said registration.

Other courts have limited the immunity provided for licensing activities. In *Steinke v. South Carolina Dept. of Labor, Licensing and Regulation*, 336 S.C. 373, 520 S.E.2d 142 (1999), the court held that a state licensing department was subject to liability under the licensing powers exception to the state’s tort claims act for deaths that occurred when a cage holding bungee jumpers fell to the ground, where the department was grossly negligent in failing to investigate whether it should suspend or revoke the license after learning of the potentially dangerous modifications to the licensed lifting device. In *Collins v. Commonwealth of Ky. Natural Resources and Environmental Protection Cabinet*, 10

S.W.3d 122 (Ky. 1999), the court held that a state department could be held liable for the drowning of a child in a culvert based on the negligence of the department in issuing permits and conducting inspections but failing to require the removal of the culvert. *See also Lotter v. Clark County By and Through Bd. of Com'rs*, 106 Nev. 366, 793 P.2d 1320 (1990) (where county inspectors knew of structural defects but nevertheless approved construction of house, statutory immunity for inspections would not bar claim).

The licensing exclusion necessarily assumes that the State in good faith applies its laws and regulations in determining to grant a license, permit or authorization. “[P]ublic officials clearly have a duty to adhere to ordinances and statutes.” *Huttner v. State*, 637 N.W.2d 278, 285 (Minn.App. 2001) (citing *Wiederholt v. City of Minneapolis*, 581 N.W.2d 312, 316 (Minn.1998); *see also, Waste Recovery Co-op. of Minnesota v. County of Hennepin*, 517 N.W.2d 329, 332 (Minn.1994) (discretionary function immunity did not immunize county from liability for damages caused by employee’s erroneous conclusion, based on his professional judgment, that telephone books collected at depositories for recycling were “waste”). Because the Department acted in knowing, deliberate, and willful disregard of Minn. Stat. § 80A.25 and Minn. R. 2875.3500, the licensing exception does not apply, just as the exercise of discretion does not allow immunity if done without legal reasonableness (i.e., in deliberate disregard of the law), as discussed above.

The application of Minn. R. 2875.3500, by its terms, allowed no discretion. Under the Minnesota Securities Act, UHI could not sell its debentures in Minnesota unless it registered them, and it could not register them because it failed Minn. R. 2875.3500. The registration of UHI’s debentures involved no discretion; clearing the UHI offering simply violated the law, for which there can be no immunity. Although no Minnesota court has so held, it is sensible that the legal reasonableness test applied to immunity for discretionary acts be likewise applied to immunity for licensing. Not to do so produces the anomalous result that discretionary conduct, in connection with which the State engaged in the “intentional doing of a wrongful act without legal justification or excuse, or, oth-

erwise stated, the willful violation of a known right,” is not immune but licenses granted in clear and willful violation of the law—i.e., without “legal reasonableness”—is immune. *See Rico*, 472 N.W.2d at 107; *Beaulieu*, 518 N.W.2d at 571-72 (inquiring whether official had reason to believe given conduct was proscribed). Here, the Department’s staff knew UHI was prohibited by Minn. R. 2875.3500 from selling its debentures in Minnesota. A-96 [¶ 187] (“they [UHI] obviously don’t make it;” UHI “probably will never have a positive cash flow”).

The Commissioner’s function under Minn. Stat. § 80A.13 and Minn. R. 2875.3500 does not involve the balancing of social, political, or economic considerations; nor do Minn. Stat. § 80A.13 and Minn. R. 2875.3500 facially involve policy considerations. *See Waste Recovery*, 517 N.W.2d at 332 (conduct was based on his professional judgment that the phone books were “waste,” a decision that did not involve the balancing of social, political, or economic considerations; neither did the relevant statutes facially involve policy considerations, or require conduct of a policy-making nature). Plaintiffs do not challenge the underlying policies regarding the issuance of debt securities in Minnesota. *See Id.* (Waste Recovery’s challenge to the decision was not a challenge to the underlying policies of designation and recycling). The Commissioner’s obligation was to enforce Minn. R. 2875.3500; therefore, immunity does not apply to the Commissioner’s failure to enforce that rule. *See Id.* at 333 (official’s determination regarding what constituted recyclable waste did not involve discretion, because his obligation was to enforce the ordinance in conformity with state statutes, and was not entitled to official immunity).

This is not a case where liability is sought to be imposed on the State as a result of negligent conduct by someone licensed to engage in a profession or vocation, where the licensing act itself was blameless, as, e.g., malpractice committed by a licensed professional. Here, it is the act of registering UHI’s debentures itself that is the basis for liability. Plaintiffs contend the State is liable for registering UHI’s debentures in complete violation of applicable laws and rules that prohibited such registration.

**III. THE DISTRICT COURT'S CONSTRUCTION OF MINN. STAT. §§ 3.736 and 80A.13 IS ERRONEOUS BECAUSE IT RENDERS THE STATUTE UNCONSTITUTIONAL AND BECAUSE IT OTHERWISE VIOLATES MINN. STAT. § 645.17.**

**A. The District Court's Constructions of Minn. Stat. §§ 3.736 and 80A.13 Renders the Statutes Unconstitutional and Were, Therefore, Erroneous.**

**1. The District Court's Interpretation of Minn. Stat. § 3.736, subd. 3(k), Puts that Statute in Violation of Minnesota Constitution Article 1, § 8 by Denying to Plaintiffs a Common Law Remedy Guaranteed by the Constitution.**

The district court's construction of Minn. Stat. § 3.736, subd. 3(k), renders the statute unconstitutional because it deprives Plaintiffs of a remedy for a wrong actionable under Minnesota's common law before the Minnesota Tort Claims Act was passed. Section 8 of the Minnesota Constitution provides: "Every person is entitled to a certain remedy in the laws for all injuries or wrongs which he may receive to his person, property . . . ." M.S.A. Const. Art. 1, § 8. Thus, a statute cannot abrogate a common law remedy. *See Black v. NuAire, Inc.*, 426 N.W.2d 203, 209 (Minn.App. 1988) (Minn. Const. art. I, § 8 guaranties common law remedies); *Haney v. International Harvester Co.*, 294 Minn. 375, 383, 201 N.W.2d 140, 145 (1972) (worker's compensation statute indirectly abrogated third party's common law right to contribution).

It has long been the settled law in Minnesota that a public official charged by law with duties which call for the exercise of his judgment or discretion is not liable for damages unless he has engaged in willful or malicious wrongdoing.<sup>7</sup> As noted above, malice "means nothing more than the intentional doing of a wrongful act without legal justifica-

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<sup>7</sup> *Pletan v. Gaines*, 494 N.W.2d 38, 40 (Minn. 1992); *Elwood v. Rice County*, 423 N.W.2d 671, 677 (Minn. 1988); *Susla v. State*, 311 Minn. 166, 175, 247 N.W.2d 907, 912 (1976); *Johnson v. Callisto*, 287 Minn. 61, 176 N.W.2d 754 (1970); *Thiede v. Town of Scandia Valley*, 217 Minn. 218, 14 N.W.2d 400 (1944); *Wilbrecht v. Babcock*, 179 Minn. 263, 228 N.W. 916 (1930); *Stevens v. North States Motor, Inc.*, 161 Minn. 345, 201 N.W. 435 (1925); *Roerig v. Houghton*, 144 Minn. 231, 175 N. W. 542 (1919); *Christensen v. Plummer*, 130 Minn. 440, 153 N. W. 862 (1915); *Stewart v. Cooley*, 23 Minn. 347, 23 Am. Rep. 690 (1877).

tion or excuse, or, otherwise stated, the willful violation of a known right.” *Rico*, 472 N.W.2d at 107. Because Minnesota’s common law has long provided for a remedy for wrongs willfully committed by government officials in the exercise of their discretion, this exception must likewise apply to Minn. Stat. § 3.736, subd. 3(k). Not applying such an exception renders it unconstitutional. Minn. Stat. § 645.17(3).

The doctrine of sovereign immunity is inconsistent with this constitutional protection. *See Nieting v. Blondell*, 306 Minn. 122, 128, 235 N.W.2d 597, 601 (1975) (the doctrine of sovereign immunity is an exception to the fundamental concept of tort law that liability follows tortious conduct and that individuals and corporations are responsible for the acts of their employees acting in the course of their employment). “It is plainly unjust to refuse relief to persons injured by the wrongful conduct of the State.” *Id.* (quoting *Willis v. Dept. of Conservation and Economic Development*, 55 N.J. 534, 537, 264 A.2d 34, 36 (1970)). In *Nieting*, the Supreme Court also stated:

One of the paramount interests of the members of an organized and civilized society is that they be afforded protection against harm to their persons, properties, and characters. The logical extension of that interest is that, if harm is wrongfully inflicted upon an individual in such a society, he should have an opportunity to obtain a reasonable and adequate remedy against the wrongdoer, either to undo the harm inflicted or to provide compensation therefor. If the state is properly to serve the public interest, it must strive, through its laws, to achieve the goals of protecting the people and of providing them with adequate remedies for injuries wrongfully inflicted upon them. So long as the state fails to do so, it will be functioning in conflict with the public interest and the public good.

*Id.* at 602-03.

**2. The District Court’s Interpretation of Minn. Stat. 80A.13 Puts that Statute in Violation of Minnesota Constitution Article 1, § 7 because the Minnesota Department of Commerce Can Deprive Minnesota Investors of Their Property Arbitrarily and Capriciously without Due Process of Law.**

The district court’s construction of Minn. Stat. § 80A.13 renders the statute unconstitutional because it allows the Commissioner to deprive Minnesota investors of their

property without due process of law. Section 7 of the Minnesota Constitution provides: “No person shall be . . . deprived of . . . property without due process of law.” M.S.A. Const. Art. 1, § 7. Minn. R. 2875.3500, which was promulgated pursuant to Minn. Stat. § 80A.25 for the protection of investors, protects Minnesota investors from being deprived of their property by issuers of fixed income securities, like UHI, which cannot satisfy a non-waivable requirement that measures the issuer’s ability to service a fixed income investment. Under the district court’s interpretation of Minn. Stat. § 80A.13, this critical protection for Minnesota investors, who seek the greater safety of fixed income investments (as compared with equity investments), can be arbitrarily and capriciously abrogated by the Commissioner. In this case, the Department allowed UHI’s registration to become effective notwithstanding the Department’s acknowledgment of UHI’s’ failure to comply with the rule’s financial requirements.

The Minnesota Securities Act is economic regulation. Due process demands that an economic regulation (1) serve to promote a public purpose; (2) not be an unreasonable, arbitrary, or capricious interference; and (3) is rationally related to the public purpose sought to be served. *Pomrenke v. Commissioner of Commerce*, 677 N.W.2d 85 (Minn. App. 2004); *see also Contos v. Herbst*, 278 N.W.2d 732, 741 (Minn., 1979) (where an economic regulation is involved, due process requires that legislative enactments not be arbitrary or capricious). The district court’s interpretation of Minn. Stat. § 80A.13 renders the protection afforded by Minn. Stat. § 80A.25 and Minn. R. 2875.3500 capricious and arbitrary. Under that court’s interpretation, a non-discretionary standard applicable to issuers of fixed income securities for the protection of investors can be deliberately ignored at the whim of the Commissioner.

The district court’s interpretation of Minn. Stat. § 80A.13 and sanction of the Department’s deliberate disregard of its own rule one of the most fundamental principles underlying this nation’s polity: we are a government of laws, not of men. This principle was prominently articulated by Chief Justice Marshall in *Marbury v. Madison*, 5 U.S. (1

Cranch) 137, 163 (1803), when he spoke of the American system as “a government of laws, and not of men.” In *Olmstead v. United States*, 277 U.S. 438, 469, 471, 48 S.Ct. 564, 569-70 (1928), Justice Brandeis addressed the meaning of a “government of laws”:

In a government of laws, the existence of the government will be imperilled if it fails to observe the law scrupulously. Our government is the potent, the omnipresent teacher. For good or for ill, it teaches the whole people by its example. Crime is contagious. If the government becomes a lawbreaker, it breeds contempt for law; it invites every man to become a law unto himself; it invites anarchy. [Citations omitted].

See also *Daniels v. Williams*, 474 U.S. 327, 331, 106 S.Ct. 662, 665 (1986) (“Historically, this guarantee of due process has been applied to *deliberate* decisions of government officials to deprive a person of life, liberty, or property.” (emphasis in original)).

The Minnesota Supreme Court has likewise recognized the primacy of law as the indispensable element of our legal system. In *Anderson v. City of St. Paul*, 226 Minn. 186, 193-194, 32 N.W.2d 538, 543 (1948), the Supreme Court noted “such universally accepted maxims as: ‘All men are equal before the law’; ‘This is a government of laws and not of men’; ‘No man is above the law,’” citing *Truax v. Corrigan*, 257 U.S. 312, 332, 42 S.Ct. 124, 129 (1921).

This bedrock principle has been applied to administrative determinations. In *Dillard v. Minnesota Dept. of Human Services*, 529 N.W.2d 438, 445-46 (Minn. App. 1995), this Court held that it is inappropriate for agencies to adopt policy in a case-by-case method covering issues of broad social and political importance, citing *In re Appeal of Jongquist*, 460 N.W.2d 915, 917 (Minn. App. 1990). This Court said in *Jongquist*:

The purpose of the Administrative Procedure Act is to ensure that we have a government of law and not of men. Under that act, administrative officials are not permitted to act on mere whim, nor their own impulse, however well intentioned they might be, but must follow due process in their official acts and in the promulgation of rules defining their operations.

460 N.W.2d at 917 (quoting *Monk & Excelsior, Inc. v. Minn. State Board of Health*, 302 Minn. 502, 509-10, 225 N.W.2d 821, 825 (1975)). If the Department’s approval of UHI’s

registration was the product of an anti-regulation philosophy of less regulatory interference with the markets, then this was an impermissible case-by-case adoption of a policy covering an issue of broad economic importance in direct contradiction of a rule adopted in accordance with applicable statutory requirements for the protection of investors.

The Department's action in allowing UHI to register its debentures in deliberate disregard of Minn. R. 2875.3500, which required UHI to meet a minimum financial standard to protect investors in fixed income securities, violated Plaintiffs' right not to be deprived of their property without due process of law—i.e., not to be cheated out of their property by the State by allowing the issuance of fixed income securities in violation of a law prohibiting such issuance by a company like UHI. By interpreting Minn. Stat. § 80A.13 in such a way as to render it unconstitutional, the district court did not apply the guidance of Minn. Stat. § 645.17(3) (legislature does not intend to violate the constitution of the United States or of this state).

**B. The District Court's Constructions of Minn. Stat. §§ 3.736 and 80A.13 Violated Minn. Stat. § 645.17 and Were, Therefore, Erroneous.**

The district court failed to follow the guidance of Minn. Stat. § 645.17 in its interpretations of Minn. Stat. §§ 3.736 and 80A.13. Accordingly, the district court erred.

The licensing exception to the waiver of immunity in the Tort Claims Act necessarily assumes the applicant's failure to meet the prescribed standards was concealed from the State when granting the permit. Any other interpretation would produce the absurd result of enabling the State to ignore its own laws and mandatory standards, so that applicants would be free to tell the state licensing authority that they do not meet the standards but should be licensed anyway, eliminating the need for the government to grant licenses. In interpreting statutes, courts are to presume that the legislature does not intend a result that is absurd, impossible of execution, or unreasonable. Minn. Stat. § 645.17(1). UHI did not conceal its inability to satisfy Minn. R. 2875.3500. To apply the licensing exception to the waiver of immunity in this case produces an absurd result.

Additionally, the courts are to interpret statutes so as to carry out the legislative intent that the entire statute is effective and certain—i.e., avoid conflicts and to avoid rendering a statutory provision a nullity as the result of how another provision of the same statute is construed. Minn. Stat. § 645.17(3). The district court’s interpretation of Minn. Stat. § 80A.13 renders Minn. Stat. § 80A.25 and Minn. R. 2875.3500 thereunder a nullity because it gives the Commissioner unfettered discretion to ignore rules promulgated pursuant to Minn. Stat. § 80A.25 for the protection of investors, such as Minn. R. 2875.3500. The rules of statutory construction require the courts to harmonize apparently conflicting provisions where possible. *Septran, Inc. v. Independent School Dist. No. 271, Bloomington*, 555 N.W.2d 915 (Minn. App. 1996).

Finally, as discussed at greater length below, enforcing this State’s securities laws is in the public interest. The district court’s construction of the Minnesota Securities Act resulted in preferring the private interests of UHI in raising capital over the public interest expressed in the statute of protecting the interests of Minnesota investors in fixed income securities and, therefore, failed to apply the guidance of Minn. Stat. § 645.17(5) (the legislature intends to favor the public interest as against any private interest). When statutes are in conflict, a statute serving the public interest is favored over a statute protecting private interests. *In re Estate of Rosenberger*, 495 N.W.2d 234 (Minn. App. 1993).

#### **IV. ENFORCING THIS STATE’S SECURITIES LAWS IS IN THE PUBLIC INTEREST.**

The clear purpose of the Minnesota Securities Act and the regulations thereunder is to protect the public from fraudulent investments. As the Supreme Court said in *State v. Coin Wholesalers, Inc.*, 311 Minn. 346, 250 N.W.2d 583, 584 (Minn. 1976): “This state has historically viewed securities regulation expansively in order to protect investors by regulating the merits of securities offered for sale to the public.” *See also* Minn. Stat. § 80A.25, subd. 2 (rules cannot be made, amended, or rescinded unless “the commissioner finds that the action is necessary or appropriate in the public interest or for the protection of investors and consistent with the purposes fairly intended by the policy and provisions

of sections 80A.01 to 80A.31”). The purpose behind licensing statutes is to protect the public. *Duncan v. Missouri Bd. for Architects, Professional Engineers and Land Surveyors*, 744 S.W.2d 524, 531 (Mo.App. E.D. 1988).

A significant consideration when determining the applicability of the discretionary function exception to government liability is whether the threat of liability would impair effective performance of the government act complained of. *Koellin*, 494 N.W.2d at 919. Minn. R. 2875.3500 is clearly intended to protect investors in Minnesota; the threat of liability would not impair but only encourage the effective enforcement of that protection. The Minnesota Securities Act contains a carefully calibrated balance of discretionary and mandatory provisions. Unquestionably, a certain amount of discretion is required for the regulation of investment activity in this state, and that discretion has been provided. Also unquestionably, certain standards and requirements are fixed, and are not subject to waiver or discretion, and Minn. R. 2875.3500 is one of those.

The State argued below that, in the absence of blanket immunity for its securities regulation, it would be “forced to blindly require adherence to specific rules and standards” and that this would somehow impede potential “economic development and other important public policy issues.”A-315. This argument is baseless. Where mandatory standards for the protection of investors are imposed, the State cannot “blindly” ignore them; certainly, “blind” adherence to such mandatory requirements is to be preferred over “blind” disregard.

Although UHI was allowed to cheat Minnesota investors out of almost \$3 million, UHI was not contributing to the economic development of Minnesota; all of its business was in Michigan, Illinois, and Arizona. More importantly, the State ignores the interests of investors. If investors—particularly investors in fixed income securities, who seek relative safety in their investments—are to be denied the protection of diligent adherence to those mandatory standards designed to provide reasonable assurance that the bonds and debentures they are being offered have a reasonable prospect of paying the promised

interest, then that source of capital will disappear, to the clear detriment of the public interest. Confidence in the integrity of securities markets is critical, and enforcing laws and non-waivable regulations designed to protect investors, as distinguished from issuers and underwriters, is crucial to maintaining (or restoring) that confidence. “The legislature intends to favor the public interest as against any private interest.” Minn. Stat. § 645.17(5).

Minn. R. 2875.3500 necessarily operates to discourage issuers who cannot comply with it from seeking to register their fixed income securities for sale to Minnesota investors. However, if such unworthy issuers are discouraged only because they are ignorant of the fact that such rules are ignored, these rules lose their prophylactic effect. This kind of regulation by stealth is hardly conducive to efficient capital markets or make for a level playing field for all seekers of capital in Minnesota. Finally, to the extent that discretion is to be employed in regulating the offer and sale of securities in Minnesota, that discretion must be exercised in accordance with applicable standards and criteria, as required by the APA.

**V. PLAINTIFFS STATE A CLAIM AGAINST THE STATE UNDER THE CONSUMER FRAUD ACT.**

The district court held that Plaintiffs have not stated in their Third Amended Complaint with the requisite specificity that the Department violated the Consumer Fraud Act or that it aided and abetted violations of the Consumer Fraud Act by the other defendants. A-10. In so holding, the District Court erred.

In issuing its notice that UHI’s debentures were registered, the Department did not disclose that UHI’s financial condition failed to satisfy Minn. R. 2875.3500 or that UHI’s failure to satisfy these rules raised serious questions about UHI’s ability to service the debentures. Given the general duty imposed upon the Department to enforce the State’s securities laws and regulations and the requirements for registering fixed income securities like UHI’s debentures, the issuance of the notice constituted a fraudulent and deceptive practice. In saying that the Department truthfully said it was issuing the notice of reg-

istration, the District Court ignored Minn. R. 2875.3500 and the Department's duty to enforce that Rule.

To say that the Department's statement that the debentures were registered was a true statement of fact because the debentures were registered ignores the fact that the debentures could not be registered because UHI was unable to show that it could service them. That is what makes the notice of registration fraudulent. Given Minn. R. 2875.3500, the Department's notice of registration was its seal of approval that UHI's was able to service its debentures. That, of course, was false; UHI was not able to service its debentures and eventually defaulted. To the extent that Minnesota investors are presumed to know the law [*see Brekke v. THM Biomedical, Inc.*, 683 N.W.2d 771, 778 (Minn. 2004)], they would interpret the Department's approval of UHI's sales of its debentures in Minnesota as evidence that UHI complied with the financial requirements of Minn. R. 2875.3500.

Minn. Stat. § 325F.69, subd. 1 proscribes the "act, use, or employment by any person of any fraud, false pretense, . . . or deceptive practice, with the intent that others rely thereon. . ." Plaintiffs have detailed with great specificity the failures and violations by the Department in allowing UHI's debentures to be sold in Minnesota. A-92-113 [¶¶ 168-233]. For example, plaintiffs allege that if the Department had (i) considered whether, under the circumstances, UHI's debentures could be said to be "fair and equitable," or (ii) enforced Minn. R. 2875.3500 regarding UHI's inability to service the debentures, then the Department would have been obligated to deny UHI's application to register its debentures for sale to the public in Minnesota or to withdraw its prior approval. A-110 [¶ 226]. The Department did none of these things—in fact, the Commissioner did not even consider these matters—and the Department's conduct operated as a fraud on at least the Minnesota investors who purchased UHI's debentures.

Plaintiffs plead specific facts showing that the Commissioner was aware of a willful violation. Plaintiffs plead that the Department willfully and knowingly violated or ig-

nored the Department's own rules. See, e.g., A-92-113 [¶¶ 168-233], ¶ 233 (Department "operated with reckless disregard for the law and without regard to its statutory and regulatory obligations to protect investors from being exposed to meritless investments like the UHI debentures"), A-268 [¶ 575] ("Despite UHI's inability to service its debentures. . . , the State negligently, carelessly, recklessly, or willfully and deliberately or maliciously allowed MSF to sell UHI's debentures in Minnesota" in violation of the Consumer Fraud Act), A-282 [¶ 611] (the Department, "in knowing, deliberate, willful or reckless disregard of applicable law, concluded that UHI could sell its debentures in Minnesota and thereby intentionally, knowingly, deliberately, willfully and falsely, or with reckless disregard for the truth, implicitly misrepresented to [the debenture underwriter] that UHI's debenture offering complied with Minnesota law").

Plaintiffs allege that the Deputy Commissioner did not review UHI's application to register its debentures for sale in Minnesota. A-103 [¶ 203]. The Deputy Commissioner was not consulted when the UHI debenture application was cleared by the Department in August 1997. *Id.* That the Commissioner himself, or someone with authority to waive those rules that were waivable or to make the decisions called for by UHI's application, was wholly ignorant of these issues is simply part of Plaintiffs' claims that the State recklessly and willfully disregarded a mandatory rule that, if enforced, would have prevented this fraud, and that the State recklessly and willfully disregarded procedures for waiving those rules that the Commissioner did have authority to waive.

These allegations also constitute aiding and abetting by the State. Without the Department's wrongful allowance of the sale of UHI's debentures, the fraudulent sale of these debentures by UHI could not have occurred. The Department's wrongful allowance was indispensable to UHI's sales of its debentures. Minnesota has "long relied on the 'well recognized' rule 'that all who actively participate in any manner in the commission of a tort, or who procure, command, direct, advise, encourage, aid, or abet its commission, or who ratify it after it is done are jointly and severally liable' for the resulting in-

jury.” *Witzman v. Lehrman, Lehrman & Flom*, 601 N.W.2d 179, 185 (Minn. 1999).

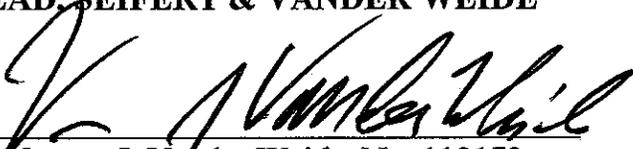
**CONCLUSION**

For the reasons set forth herein, Plaintiffs respectfully request that the district court’s order dismissing the complaint be reversed.

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