

STATE OF MINNESOTA  
OFFICE OF ADMINISTRATIVE HEARINGS  
FOR THE MINNESOTA DEPARTMENT OF COMMERCE

In the Matter of the Securities  
Registration Statement of  
Carlyle Real Estate Limited  
Partnership-XVII.

FINDINGS OF FACT,  
CONCLUSIONS AND  
RECOMMENDATION

The above-entitled matter came on for hearing before Administrative Law Judge George A. Beck on June 8, 1988 at 10:00 A.M., at the Office of Administrative Hearings, 500 Flour Exchange Building, 310 Fourth Avenue South, in the City of Minneapolis, Minnesota. The hearing was concluded that day. The record in this matter closed on July 20, 1988, upon receipt of the final written memorandum by the parties.

Susan Getzendanner, Esq., of the firm of Skadden Arps, Slate, Meagher & Flom, 333 West Wacker Drive, Chicago, Illinois 60606, and John M. Dixon, Esq., of the firm of Chapman Is Cutler, 111 West Monroe Street, Chicago, Illinois 60603, appeared for Carlyle Real Estate Limited Partnership-XVII. Allen E. Giles, Special Assistant Attorney General, 1100 Bremer Tower, Seventh Place and Minnesota Street, St. Paul, Minnesota 55101, appeared for the Minnesota Department of Commerce.

This Report is a recommendation, not a final decision. The Commissioner of the Minnesota Department of Commerce will make the final decision after a review of the record. He may adopt, reject or modify the Findings of Fact, Conclusions, and Recommendations contained herein. Pursuant to Minn. Stat. sec. 14.61, the final decision of the Commissioner shall not be made until this Report has been made available to the parties to the proceeding for at least ten days. An opportunity must be afforded to each party adversely affected by

this Report to file exceptions and present argument to the Commissioner.  
Parties should contact Michael A. Hatch, Commissioner, Minnesota Department of Commerce, 500 Metro Square Building, Seventh and Robert Streets, St. Paul, Minnesota 55101, to ascertain the procedure for filing exceptions or presenting argument.

#### STATEMENT OF ISSUE

The issue in this case is whether or not the securities registration filed by Carlyle Real Estate Limited Partnership-XVII complies with Minn. Rule 2875.5010 and, if not, whether a waiver of the rule should be granted by the Commissioner of Commerce.

Based upon all of the proceedings herein, the Administrative Law Judge makes the following:

## FINDINGS OF FACT

1. Carlyle Real Estate Limited Partnership-XVII ('Carlyle') is a real estate limited partnership which invests in income-generating commercial and residential real properties. (Ex. 1, p. 1). The general partners of Carlyle are Carlyle-XVII Managers, Inc. and Realty Associates-XVII. The sponsor of the Carlyle partnership is JMB Realty Corporation (NJNB"). The sponsor controls the day-to-day operations of the partnership including what property is purchased and how it is financed. (Tr. 76). The general partners and the sponsor of Carlyle are affiliates. (Tr. 19).

2. Prior Carlyle Limited Partnership offerings have attracted some \$59 million in investments in Minnesota and have raised the most capital nationally of any partnership series currently in the market. Investors Diversified Services (IDS) sells 60% of the Carlyle offerings in Minnesota. (Tr. 30-31, 67). The average investment is \$10,000 per individual. (Tr. 41). No Carlyle program has ever failed to make a quarterly distribution when one was scheduled to be made. (Tr. p. 17). JMB Realty is the largest sponsor of real estate partnership programs in the country. (Tr. 66). It has raised approximately three and a half billion dollars over the past several years. (Tr. pp. 17-18). Both JMB and Carlyle are well respected in the investment community. (Tr. 66-67, 86).

3. Minnesota securities law requires registration of securities to be sold in Minnesota. Carlyle applied for registration of its real estate limited partnership with the Department of Commerce on October 27, 1986. The Department reviewed the registration application for compliance with Minnesota securities laws and, on December 26, 1986, sent a deficiency letter to Carlyle pointing out several needed corrections or clarifications. Subsequently, all issues were resolved regarding registration of Carlyle in Minnesota with one exception.

4. The one remaining point of contention centered upon a provision of the Carlyle prospectus under the section entitled 'Possible Inability to Make Future Payments in Connection with Some Partnership Investments.' The provision reads, in part, as follows:

The Partnership may acquire, during 1988 or 1989, real property investments, the terms for the purchase of which will require down payments and other initial cash payments during 1988 and subsequent years in excess of the funds which will be available for investment from the expected sale of Interests in 1988 or 1989. . . .

In the event that the Partnership is unable to raise sufficient funds from the sale of additional Interests in 1989 (or the receipt of installment payments if that is permitted) to meet such contractual obligations, the Partnership would seek to obtain required funds on alternative bases in the form of borrowing through second mortgages, sale-leasebacks of land underlying Partnership properties or other forms of financing from other sources, which could include (except in the case of permanent financing) affiliates of the General Partners. See, 'Conflict of Interest-Possible Sales to, and Financing and

other Relationships with, Affiliates' above. However, there is no assurance that sufficient alternative financing will be available on any terms or that such financing (which would increase leverage) would be permitted under the Partnership Agreement. In the event that such alternative financing is not available, it is expected that some Partnership properties would be acquired by JMB or affiliates of JMB. Any such acquisition to be made by JMB or such affiliate is expected to involve cash payments to the Partnership equivalent to the Partnership's cash payments in connection with the acquisition of the property. . . .  
(Ex. 1, p . 33).

5. This provision authorizes Carlyle to sell property to JMB, the sponsor, and an affiliate, if Carlyle does not raise sufficient funds to fulfill its purchase agreements. On November 3, 1987, Department employee Susan Bergh informed Carlyle that Minn. Rule 2875.5010 was an absolute prohibition on sales by a program to a sponsor. (Ex. 3).

6. Sometime between November 3 and December 2, 1987, Ms. Bergh discussed the sale of property to the sponsor, in circumstances where the partnership did not have the proceeds to cover a commitment, on the telephone with Carlyle attorney John Dixon. She then discussed the matter with Deputy Commissioner Kristine Eiden. In a letter dated December 2, 1987, Ms. Bergh advised Carlyle that Carlyle's argument that the sales provision functions as a 'safety value' was unconvincing. She stated that the properties which could not be paid for by the program proceeds could be placed on the market and could obtain a price higher than the cost to the program, which the sponsor is permitted to pay. She was of the opinion that such a provision would encourage overcommitment to properties on the part of the partnership. Finally, Ms. Bergh repeated that Minn. Rule 2875.5010 did not contemplate exceptions. (Ex. 4).

7. In a letter dated January 15, 1988, Mr. Dixon summarized a recent telephone conversation with Ms. Bergh and responded to questions asked by Ms. Bergh. Concerning the provision in question, the letter states the following:

03. Sales to Affiliates. The most difficult of the

remaining issues is the right of the Partnership to sell a property to an affiliate of the Sponsor if the partnership does not raise sufficient funds to fulfill its purchase commitments. You have expressed your concerns about this right, particularly the possibility that the Sponsor would select the "good" properties while leaving the 'bad' ones in the Partnership's hands . . . .

. . . [W]e wish to point out that the feature to which you have objected is a permissive right and not an obligation. The Partnership may sell to an affiliate of the Sponsor under the circumstances described above; it is not obligated to do so. The decision to do so and the selection of the property to be sold must be made by the General Partner of the Partnership (obviously an affiliate of the Sponsor) in light of its fiduciary duties. To

clarify the standard which must be used in exercising such discretion, the following language will be added to the Prospectus:

'The Corporate General Partner must: believe, in good faith, that any such sale of property is in the best interests of the Holders taking into account the investment objectives and financial position of the Partnership, and the cost, characteristics and suitability of the property to be sold when compared to properties to be retained for investment by the Partnership.'

(Ex. 5).

B. The prospectus, dated February 9, 1988, contains the following language:

The Partnership will not sell real property to, or purchase real property from, any affiliate of the General Partners except in the event insufficient subscriptions for Interests are accepted in 1988 to provide net proceeds sufficient to make required payments on a property acquired in 1988, or in the event insufficient subscriptions for Interests are accepted in 1989 (together with installment payments, if any, from subscribers who choose the installment payment option) to make required payments in 1989 and subsequent years on one or more properties acquired, -as described under 'Risk Factors--Possible Inability to Make Future Payments in Connection with Some Partnership Investments'. The Corporate General Partner must believe, in good faith, that any such sale of property is in the best interests of the Holders taking into account the investment objectives and financial position of the Partnership, and the cost, characteristics and suitability of the property to be sold when compared to properties to be retained for investment by the Partnership. The Partnership Agreement permits the Corporate General Partner or an affiliate 'thereof to purchase property in its own name and assume loans in connection therewith and temporarily hold title thereto for the purpose of facilitating the acquisition of a property or the borrowing of money or the obtaining of financing by the Partnership or the completion of construction of a property, or any other purpose related to the business of the Partnership, provided that any such property is purchased by the Partnership for an investment no greater than the cost of such property to the Corporate General Partner or its affiliate.

(Ex. 1, pp. 16-17).

9. On February 9, 1988, the Securities and Exchange Commission declared the Carlyle registration statement effective. Carlyle waived concurrent

effectiveness in Minnesota in accordance with Minn. Stat. sec.  
80A.10, subd. 3  
(1986). (Ex. A).

10. On February 19, 1988, Carlyle's attorney provided Deputy Commissioner Eiden with a detailed legal argument in support of permitting the sales arrangement to the Sponsor. The letter stated, in part. as follows:

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You have cited Minnesota Rules 1983, Chapter 2875, 2875.5010 which provides the following: The program not ordinarily, (emphasis added) be permitted to sell or lease property to the sponsor except that the program lease property to the sponsor under a lease-back arrangement made at the outset and on terms no less favorable to the program than those offered other persons and fully described in the prospectus. You have stated further that Rule 2875.5010 cannot be waived by your office.

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Our interpretation of Rule 2875.5010 is that limited sales by the Partnership to the Sponsor or an affiliate of the Sponsor are permissible. Implicit in the use of the words "not ordinarily" is the suggestion that sales to the Sponsor may be permissible in some circumstances.

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Even if you do not regard the word 'ordinarily' as permitting limited sales by the Partnership to the Sponsor or an affiliate of the Sponsor, it: is our view that the Department clearly has the authority to approve this "safety valve" provision. We also believe that this limited sales -arrangement of the Partnership is fair and consistent with the overall standards and purpose of the Guidelines promulgated by the North American Securities Administrators Association, Inc. ("NASAA"), after which the Minnesota Regulation was modeled, and is protective of the

interests (of the investors in the Partnership.  
In addition, it is our position that the Partnership's  
limited sales arrangement is in the best interests of  
the investors, given the economic realities of  
today's marketplace and the nature of the  
Partnership's investments . . . .  
(Ex. 6, pp. 1-2).

11. In the February 17, 1988 letter, Carlyle also proposed to  
require the review of any sale to the Sponsor by an independent third  
party. The procedure proposed was as follows:

The Corporate General Partner shall submit the  
proposed sale of any real property investment of the Partnership  
to JMB or its affiliate to an  
independent nationally-recognized investment banking firm or  
real estate advisory company . . . which shall be selected  
by the Corporate General Partner on behalf of the  
Partnership specifically with respect to such sale, and the  
Corporate General Partner, on behalf of the Partnership, shall  
not consummate such sale unless such investment banking firm  
or real estate advisory company has determined that such  
sale is fair to the Partnership.  
(Ex. 6, p. 4).

12. in a letter dated February 29, 1988 to Mr. Dixon. Ms. Bergh stated that a compelling basis for waiver of Minn. Rule 2875.5010 had not been provided, because of the conflict of interest inherent in such a sale by the program to the sponsor. Furthermore, Ms. Bergh stated that -the additional safeguards proposed on behalf of Carlyle would not avoid a conflict of interest since an appraisal would not necessarily reflect appreciation or depreciation in value of a property to be sold to the sponsor. The letter concluded that a waiver would not be granted by the Department and unless the application was either altered to comply or withdrawn by March 7, 1988, the Department would initiate administrative proceedings to deny registration. (Ex. 7).

13. on March 8, 1988, Ms. Bergh sent an office memorandum to Deputy Commissioner Eiden describing the chronology of events and communication between Carlyle and the Department and advising her of Carlyle's failure to bring the Registration Statement into compliance or to withdraw the application by March 7, 1988. Ms. Bergh stated her intent to seek a stop order denying effectiveness or an Order to Show Cause why the application should not be denied. (Ex. 8).

14. On March 28, 1988, the Commissioner of Commerce of the State of Minnesota, issued an Order Denying Application for Securities Registration. The Commissioner's order was based upon Carlyle's intentional inclusion of the sales provision in contravention of Minn. Rule 2875.5010 and also alleged that the provision is unfair and inequitable to investors. The order provided that Carlyle could request a hearing regarding the matter. (Order Denying Application for Securities Registration and Notice of Right to Hearing).

15. On April 11, 1988, Carlyle requested a settlement conference. The settlement conference was held on April 18, 1988 at 1:30 P.M. The settlement conference was not successful. Subsequently, a prehearing conference was held May 25, 1988 at 2:00 P.M.

16. Carlyle XVII is presently registered in 48 states. None of the states raised a question about this provision. The same provision has been in prior Carlyle offerings which have been approved in Minnesota and other states. A few other states did question the same provision in other offerings, but ultimately approved the registration. (Tr. 29-30). If Carlyle were to attempt to amend its partnership agreement to eliminate the right to sell property to JMB, it would have to contact each of the states again and possibly offer rescission to those investors who have already subscribed. (Tr. 39).

17. Carlyle believes that the provision in question would only be used during the 12-16 or 20-month offering period when the interests in the limited partnership are being sold. The prospectus does not include such a limitation, however. (Tr. 23; 49-50). JMB has requested and sold some 35 or 36 limited partnerships with similar provisions, but has never had to use the provision. (Tr. 25). It is Carlyle's position that it would not be permitted to sell an appreciated property to JMB for cost since it would violate the 'good faith' requirement in the prospectus. (Tr. 27). However, the prospectus does not specifically prohibit such a sale. (Tr. 52-53). JMB believes that it would be obligated to purchase a depreciated property at cost, under the provision in question.

1e. If real estate properties are acquired in the early phase of construction, it is unlikely that the property will appreciate until the properties are seasoned and the rents are established. (Tr. 70) Appreciation may follow the expiration of the initial leases when new leases at higher rents increase the cash flow. Many commercial leases have a term of five years. (Tr. 93).

19. Carlyle has also stated that it would add a "Minnesota sticker" to its prospectus to alert Minnesota investors to the provision in question. It has also offered to notify the Commissioner of Commerce if the sale to the sponsor provision was ever invoked. It has also proposed making a detailed report to the limited partners if the provision were invoked. (Tr. 35-36).

20. Carolyn Cuthill is a Minnesota resident who is employed as a salesperson for a retirement community. She and her husband invested in Carlyle-XVI, based upon advice from their financial advisor, Paul Allison of IDS. They were attracted to the Carlyle program because of its stability, diversification, the large geographical area of its properties, and the potential for sheltering of income. Mrs. Cuthill further testified that were she an investor in Carlyle-XVII, she would find the sales to the Sponsor provision contained in the Carlyle-XVII prospectus attractive. Based upon JMB's reputation, she felt JMB would not be likely to act for its own benefit and take advantage of the Partnership. (Tr. 9-12).

21. Robert A. Stanger heads an investment research firm and is publisher of two periodicals which analyze investment partnerships. (Tr. 61-62). In Mr. Stanger's opinion the provision in question affords protection to the investors and deleting it would mean a less favorable result for the investor. (Tr. 68-70). He went on to state that he did not feel that the Department's concern about JMB benefiting from the purchase of an appreciated property at cost was a material concern. (Tr. 69-71).

22. Initially, the Department's position in this matter was that Minn. Rule 2875.501() prohibited all sales of property to the Sponsor and that the term "ordinarily" in the rule permitted only lease-backs. At the hearing the Department's position that the rule might permit such sales in extraordinary circumstances. (Tr. 97, 117). The Department does not see this case as extraordinary because:

1. Overcommitment of initial gross proceeds can be controlled by the sponsor.

2. The provision does not limit which properties can be purchased so that appreciated properties can be purchased at cost.

3. The provision does not require the sponsor to purchase a property and does not provide for an independent appraisal.

4. The specific properties to be purchased and the terms of the sale are not adequately disclosed to the investor.

(Tr. 98-99).

23. The Carlyle program would have to disclose in its prospectus what property would be purchased by JMB in order to satisfy the Department's objections. (Tr. 132). This would require the Partnership to commit to the purchase of specified properties prior to the offering. (Tr. 133-145).

24. The Department has recently objected to inclusion of provisions permitting sales by the program to sponsors. On January 5, 1988, it advised Dean Witter Realty Income Appreciation, L.P. of such an objection. (Ex. B). On January 22, 1988, it advised Historic Preservation Properties 1988, L.P. of this objection, (Ex. D), and on February 10, 1988 the Department stated a similar objection to Jiffy Lube Insured Income Partners, L.P. (Ex. C; Tr. 103). The Department advised each of these applicants that Minn. Rule 2875.5010 was an absolute prohibition on sales by the program to the sponsor.

Based upon the foregoing Findings of Fact, the Administrative Law Judge makes the following:

#### CONCLUSIONS

1. The Commissioner of Commerce and the Administrative Law Judge have jurisdiction in this matter pursuant to Minn. Stat. SS 80A.24 and 14.50.
2. The Department of Commerce has fulfilled all relevant substantive and procedural requirements of law and rule.
3. The Department of Commerce has given proper notice of the hearing in this matter as required by Minn. Stat. sec. 80A.24.
4. The Respondent, Carlyle Real Estate Limited Partnership-XVII made a timely request for a hearing in this matter.
5. The burden of proof in this proceeding is on the Respondent, Carlyle Real Estate Limited Partnership-XVII.
6. Minn. Stat. sec. 80A.13, subd. I provides that the Commissioner may deny effectiveness to any 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, order, or condition lawfully imposed under sections

80A.01 to 80A.31 has been willfully violated in connection with the offering, by (i) the person filing the registration statement, (ii) the issuer, any partner officer, or director of the insurer, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling or controlled by the issuer, but only if the person filing the registration statement is directly or indirectly controlled by or acting for the issuer, or (iii) any underwriter; [or)

(6) except with respect to securities which are being registered by notification, the terms of the securities are

unfair and inequitable; provided, however, that the commissioner may not determine that an offering is unfair and inequitable solely on the grounds that the securities are to be sold at an excessive price where the offering price has been determined by arms length negotiation between non-affiliated parties. The selling price of any security being sold by a broker-dealer licensed in this state shall be presumed to have been determined by arms length negotiation;

7. Minn. Rule 2875.5010 provides as follows:

The program will not ordinarily be permitted to sell or lease property to the sponsor except that the program may lease property to the sponsor under a lease-back arrangement made at the outset and on terms no less favorable to the program than those offered other persons and fully described in the prospectus.

8. That Carlyle's registration statement, with appropriate additions complies with Minn. Rule part 2875.5010 and therefore is not in violation of Minn. Stat. sec. 80A.13, subd. 1(b)(2).

9. That Carlyle's registration statement, with appropriate additions does not violate Minn. Stat. sec. 80A.13, subd. 1(b)(6) which prohibits registration of securities whose terms are unfair and inequitable.

10. Minn. Rule 2875.8450 provides as follows:

The requirements of parts 2875.4500 to 2875.8400 may, be weighed by the commissioner upon proof of substantial compliance with rules, statements of policy or guidelines of national or regional securities regulatory organizations composed of securities administrators of this and other states.

Any such waiver shall be granted upon a determination by the commissioner that compliance with such rules, statements of policy, or guidelines is consistent with the purposes fairly, intended by the policy and provisions of Minnesota Statutes 1978, sections 80A.01 to 80A.31, as amended; appropriate for the protection of investors; and promotive of uniformity of regulation.

11. That Minn. Rule part 2875.8450 does not provide authority to grant a waiver in this case.

12. That any of the Findings of Fact which are more properly termed Conclusions are hereby adopted as such.

13. That the above Conclusions are arrived at for the reasons set out in the memorandum which follows and which is incorporated into these Conclusions.

Based upon the foregoing Conclusions, the Administrative Law Judge makes the following:

RECOMMENDATION

IT IS RESPECTFULLY RECOMMENDED that the Commissioner of Commerce approve Carlyle XVII's securities registration statement with appropriate conditions as is discussed in the following Memorandum.

Dated: August 8th 1988.

GEORGE A. BECK  
Administrative Law Judge

NOTICE

Pursuant to Minn. Stat. sec. 14.62, subd. 1, the agency is required to serve its final decision upon each party and the Administrative Law Judge by first class mail.

Reported: Court Reported. Southwest Reporters, Inc.  
Peggy A. St. Clair  
(507) 532-6817 or (800) 622-5058  
Transcript Prepared.

MEMORANDUM

Burden of Proof

Each party asserts that the other has the burden of proof in this proceeding. Minn. Rules 1400.7300, subpart 5 (1987) provides that. "[t]he party proposing that certain action be taken must prove the facts at issue by a preponderance of the evidence, unless the substantive law provides a different burden or standard." The Department argues that Carlyle is proposing that its registration statement be granted effectiveness so as to authorize it to engage in the public sale of securities and that it is

therefore proposing that certain action be taken. Carlyle, on the other hand, points out that it is the Department that has denied registration and that this action requires the Department to assume the burden of proof in this case.

It is appropriate to look to the case law to help interpret the rule. The general rule in Minnesota is that an applicant for relief, benefits, or a privilege has the burden of proof." In re City of White Bear Lake, 311 Minn. 146, 247 N.W.2d 901, 904 (1976). The court observed in that case that the burden of proof generally rests on the one who seeks to show he is entitled to

the benefits of a statutory provision. The Respondent points out that a state agency proposing an action, such as a particular high water level on a lake, has the burden of proof. In re Determining the Natural Ordinary High Water Level of Lake Pulaski, 384 N.W.2d 510, 515 (Minn.App. 1986). In this case however the appropriate "action" to focus on is the Respondent's request that its limited partnership be approved for registration in Minnesota. The Respondent is certainly in the best position to explain the provision in question in this proceeding -- how it operates and what its effect would be upon investors. It is generally true that the burden of proof should rest with the party who has the "best knowledge" of the facts of a particular situation. Old Ben Coal Corp. v. Interior Board of Mine Operations Appeals 523 F.2d 25, 34-37 (7th.Cir. 1975). It would not be appropriate to focus upon the Commissioner's issuance of the order as the "action" being taken because then the burden of proof would always be on the administrative agency. That is clearly not intended by the rule. In this case, where Carlyle seeks to show that it is entitled to registration under Minnesota law, it must bear the burden of proof.

#### The Alleged Rule Violation

The provision in Carlyle XVII's registration statement which is at issue in this contested case proceeding is quoted at Finding of Fact No. 4. It permits the sale of partnership properties to the sponsor, JMB, in the event that the partnership is unable to raise sufficient funds to meet its contractual obligations to purchase properties and in the event that alternative financing is not available. Minn. Rule 2875.5010 provides that a program will not ordinarily be permitted to sell property to the sponsor. Both parties agree that there is a conflict of interest involved in such a sale. Carlyle and JMB are essentially the same entity. The Department asserts that the rule recognizes that program sales to the sponsor creates a conflict of interest situation highly susceptible to abuse.

The Department's initial position was that the language of the rule created an absolute prohibition on sales to the sponsor. In the course of this contested case proceeding, however, the Department changed its interpretation to recognize that certain property sales to the sponsor might be permitted in extraordinary circumstances. Its present position is that the Respondent would have to meet the same conditions applicable to a lease of property to the sponsor. That is, the properties to be sold and the order in which they are to be sold would have to be identified in the prospectus, the terms would have to be no less favorable to the program than those offered to other persons and the situation must be fully described in the prospectus. Carlyle cannot meet these requirements with the present structure of its program since only one property is identified in its prospectus. Ironically were Carlyle to identify all properties to be purchased in its prospectus and thereby commit to their purchase, it would render the use of the provision in question more likely since the partnership would be committed to purchase all properties no matter how much capital was later raised.

As a general rule deference is due to an agency's interpretation of its rules when language is so technical that only a specialized agency has the expertise needed to understand it, when the language is ambiguous, or when the agency interpretation is one of longstanding. Resident v. Noot, 305 N.W.2d 311, 312 (Minn. 1981). No deference is due when there are compelling indications that the agency's interpretation is wrong Buhs v. Department of

Public Welfare, 306 N.W.2d 127, 129 (Minn. 1981). Additionally, the Minnesota Court of Appeals has observed that deference by an Administrative Law Judge to staff interpretations is unwarranted, although respect is due to the contemporaneous construction of a statute by those charged with responsibility of setting its machinery in motion. In the Matter of the Contested Case of Mapleton Community Home, 373 N.W.2d 815, 820 (Minn.App. 1985).

In this case the agency interpretation is not a longstanding one. The language of the rule however, is not unambiguous. The use of the words not ordinarily' requires further interpretation by the agency in order to enforce this rule. under the Mapleton case, supra, it does not appear that the staff interpretation is due any particular deference at this level of the proceeding. Neither is this a situation where the agency is first interpreting a newly adopted rule. Rather, it has revised its interpretation of a rule which has been adopted- for some time. This raises the question of whether or not the Department's interpretation constitutes an unadopted rule. Generally, where an agency adopts policy inconsistent with its rules without following rulemaking procedures, the agency action may be invalidated. However, where the interpretation of a rule is consistent with its plain meaning, the agency is not deemed to have adopted a new rule. Cable Communications Board in Norwest Cable Communications Partnership, 356 N.W.2d 658, 667 (Minn. 1984). Whether or not the Department's revised interpretation constitutes rulemaking may not be of great significance in this case. Under either interpretation the Respondent would be in violation of the rule. The consequence of a determination of improper rulemaking in a situation such as this is likely to be that the interpretation does not have the force of law which the rule itself has but rather can be considered as a relevant factor. In short, unadopted rules are not entitled to any deference. Northern Messenger it. Airport Couriers, 359 N.W.2d 302, 304 (Minn.App. 1984)

Therefore, at this level of the proceeding, whether analyzed under a "deference" or "improper rulemaking" analysis, the result is the same, namely that little deference is due to the Department's interpretation.

The proper interpretation of Minn. Rule 2875.5010 must flow from a determination of the meaning of the words 'not ordinarily'. The Department concedes that these words mean that such sales are sometimes permissible. It argues however that they are only permissible on the same terms as a lease. Those terms are set out in the rule. However, if the drafter of the rule intended the same qualifications to apply to both sales and leasebacks, it is difficult to understand why the rule doesn't simply so state. Although this rule is a guideline of the North American Securities Administrators Association ("NASSA") and has been adopted in other states, no case law or other precedent has been advanced to support the Department's interpretation. The Respondent has pointed out that its program has been accepted for registration in 48 states. The Department acknowledges in its reply brief (Reply Brief of the Department of Commerce, p. 2) that the conditions that apply to sales are not identified in the rule as it is for leases. Nonetheless, the Department believes its interpretation is consistent with the investor protection policy of Minn. Stat. Ch. BOA. However, the 'not ordinarily' language requires the Commissioner to make a judgment as to whether or not the registration statement submitted by Carlyle is a situation which is out of the ordinary and where, consistent with the purposes of Chapter BOA., a sale of property to a sponsor should be permitted. In order to make such a judgment, the Commissioner must examine the entire registration statement submitted, including the proposals made by the Respondent to bring

it into compliance with the rule.

The Department argues in its initial brief (p. 10) that an appropriate analysis in this matter is to balance the risk to the investor created by the provision against any benefit it creates. Such an analysis is a more reasonable interpretation of the "not ordinarily" language in the rule than simply conforming the requirements to that set out for lease-backs. The Department concludes that there is no benefit since this provision has never been used in the past and is not believed by Carlyle to be a material item in its offering. However, the testimony of an investor and an investment analyst in this proceeding indicates that this provision can act as a 'safety net' because it requires JMB to purchase a property where there is a lack of funds to do so. A distress sale of property might result in a loss to the partnership. As Carlyle points out, the risk of loss due to capital accumulation not being sufficient to pay for properties is not one which an investor normally assumes as a part of the deal. The Department argues however, that any benefit from the provision is far outweighed by the possible abuse. Its main concern is that JMB can 'cherry pick' an attractive high revenue producing property as the one it will purchase. The Department is concerned that in the event a property has appreciated JMB may purchase it and gain the benefit of that appreciation.

The Respondent has demonstrated by a preponderance of the evidence that the possibility of abuse in this situation is unlikely and is outweighed by the benefit of the provision for the investor, taking into consideration the safeguards which the Respondent has proposed. The Respondent points out that this provision, if it were to be exercised, would only be exercised during a relatively short time period, namely the 12-16 month offering. In the case of commercial properties purchased for a limited partnership such as this it is not likely that they will appreciate in such a short amount of time.

Appreciation normally accompanies the seasoning of a property and an increase in rents as leases turn over. Respondent also convincingly argues that there is no economic incentive for it to overcommit to the purchase of properties and thereby bring this provision into play. Although the Department has argued that this provision might encourage overcommitment, as the Respondent points out, an insurance policy does not necessarily encourage an accident or disability. Additionally, there has been no such abuse in the past demonstrated.

The Respondent further argues that this provision will only be used if the partnership cannot borrow or refinance to acquire funding and that the provision 'Is an option only, that is, the property can always be sold to a third party. In fact, Carlyle argues that the fiduciary duty language which it has inserted in the prospectus requires it to sell a property in a situation such as this at its appreciated or depreciated fair market value. If this is true it would mean that JMB could not purchase an appreciated property at cost from the partnership. The Respondent also urges that its reputation which, based upon this record, is a very good one, be considered. The Department believes that it cannot consider this factor if it is to apply this rule uniformly among all applicants for registration. However, in considering whether or not abuse is likely to occur it is clearly a factor of some consequence. Although the Commissioner is bound to promote uniformity of interpretation, he must also consider each case on its own merits. In this case, there appears to be little likelihood of abuse.

### The Alleged Statutory Violation

The Department has also argued that the provision in question is unfair and inequitable under the statute apart from Minn. Rule 2875.5010. It suggests that an investor cannot analyze the situation based upon the prospectus if the sales language is included and further- argues that the possibility of the property appreciating and then being purchased by the sponsor is unfair to investors. As the foregoing discussion indicates, the provision does provide certain benefits to investors. The possibility of abuse must be considered in judging whether language is unfair or inequitable. The same considerations discussed above in relation to the alleged violation of the rule are relevant to this alleged statutory violation. Consistent with the foregoing discussion, it is concluded that the Respondent has demonstrated that the language in question, together with its suggested additional protections, is not unfair or inequitable.

### Possible Conditions on Approval

The Respondent has also suggested a number of measures to meet the concern of the Department in this case. It has suggested it would make a specific report to its investors in the event this provision was exercised. It has offered to give notice to the Commissioner of Commerce in the event that this provision was exercised. It is also proposed a third party fairness opinion be obtained before a sale to the sponsor were permitted. Finally, the Respondent has offered to place a 'Minnesota sticker' on its prospectus to draw the attention of Minnesota investors to the provision in question. Other conditions to registration might also be possible. The sales provision could be limited to the first 12 to 16 months. (Tr. 41). The identity of a third party to review a sale might be further specified, so as to, for instance, exclude any vendor of Carlyle XVII. Specific requirements might be made to require a sale at a fair market value or to require a sale to a third party in

the event of significant appreciation. Finally, the Respondent might be required to consent to some specified type of review by the Commissioner in the event that this provision is exercised.

#### Waiver

The Respondent has also argued that even if its registration statement is found to be in violation of Minn. Rule 2875.5010, a waiver is permissible in this situation and should be granted. It argues that this should be done in order to make Minnesota's interpretation consistent with other states. It argues that the rule as it is presently interpreted in Minnesota is not the same as the NASAA guideline and that therefore a waiver is permissible under Minn. Rule 2875.8450. That rule permits a waiver upon proof of substantial compliance with the rules or guidelines of a national securities regulatory organization if it is consistent with Minnesota securities law, appropriate for the protection of investors and promotive of uniformity of regulation. The rule under consideration here relating to sales and leases to a sponsor is identical to the NASAA guideline. Therefore, this does not seem to be a situation to which the waiver rule can apply. The waiver rule appears to come into play when compliance with the rules of a regulatory organization is a reasonable substitute for a Minnesota role while still protecting Minnesota investors and recognizing the need for uniformity of regulation.

G.A.B.