

No. A05-705

STATE OF MINNESOTA
IN COURT OF APPEALS

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

Appellants/Petitioners,

vs.

Miller & Schroeder Financial, Inc., Miller & Schroeder, Inc.,
James A. Arias, John M. Clarey, Kenneth E. Dawkins,
James F. Dlugosch, Theodore G. Glasrud, Jr., Thomas S. Nelson,
Realco, Inc., Residential Funding Corporation, State of Minnesota, Heller
Financial, Inc., Fredrikson & Byron, P.A., Ernst & Young LLP,

Defendant/Respondent.

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LEGAL ISSUES

- I. Whether the State is immune from torts based on its regulation of securities.

The court held in the positive.

Apposite authority: Minn. Stat. § 3.736, subd. 3(b) and (k)

Minn. Stat. § 80A.13

- II. Whether the Minnesota Securities Act provides a cause of action against the State.

The Court held in the negative.

Apposite authority: Minn. Stat. § 80A.23, subd. 11

- III. Whether Appellant has waived issues that it did not raise below.

The court did not have this issue before it.

Apposite cases: *Pole v. Trudeau*, 516 N.W.2d 217, 222 (Minn. Ct. App. 1994)

- IV. Whether Appellant failed to allege facts stating a claim under the Minnesota Consumer Fraud Act.

The Court held in the positive.

Apposite authority: Minn. Stat. § 325F.69

STATEMENT OF THE CASE

On or about June 25, 2003, Appellants filed their Third Amended Complaint naming for the first time the State of Minnesota, Department of Commerce (“Department”), as a Defendant. Appellants allege counts of common law negligence, misrepresentation and fraud against the Department. In addition, Appellants allege against the Department violations of the Minnesota Securities Act and the Minnesota Consumer Fraud Act.

On or about October 16, 2003, the State of Minnesota brought its motion for dismissal. First, the State showed that it did not waive its sovereign immunity for common law torts stemming from the State’s role in securities regulation. Second, the State showed that it is not an entity liable for alleged security laws violations under the Minnesota Securities Regulation Act and, even if it were, the statute of limitations had expired. Finally, the State demonstrated that Appellants failed to factually allege a claim against the State under the Consumer Fraud Act. In response, Appellants argued only the immunity and Consumer Fraud Act issues. Appellants did not respond to the State argument with respect to its Securities Act defenses.

On April 16, 2004, the district court issued its order dismissing Appellants’ claims against the State in their entirety. The court held that the State has immunity to Appellants’ tort claims because the decision to issue a stop order on the sale of a security is a discretionary act within the meaning of Minn. Stat. § 3.736, subd 1b. The court held, alternatively that because securities regulation is a form of licensure within

the terms of Minn. Stat. § 3.736, subd. 1(k), the State is immune. The court dismissed Appellants' claim under the Minnesota Securities Act because the Act's liability provisions identify no alleged act of State as a basis for liability. The court also held that any claim against the State under the Act was barred by the . Finally, the court concluded that Appellant had failed to state a claim against the State under the Minnesota Consumer Fraud Act.

Appellant filed a timely notice of appeal on or about March 8, 2005.

STATEMENT OF FACTS

Appellants' causes of action against the State are based upon the Department's regulatory activity with respect to an issuance of debt security debentures by United Homes, Inc. ("UHI"). According to the Complaint, UHI debentures were sold between November 1997 and November 1999. Complaint ¶ 3. The Department issued its Notice of Effectiveness by Coordination pursuant to Minn. Stat. § 80A.10 on November 14, 1997. *Id.* at ¶ 167. By this Notice, the Department declared that the debentures were registered with the Department effective on the notice date. *Id.* Appellants allege that the Department failed to enforce its rules and that, had it enforced such rules, the debentures could not have been sold in Minnesota and elsewhere. *Id.* ¶ 5. The gravamen of Appellants' claim is that the Department wrongfully failed to issue a stop order under Minn. Stat. § 80A.13, subd. 1 (2002), allegedly because the issuance violated Department rules. The rules identified by Appellants relate to income coverage of the debenture interest payment, Minn. R. 2875.3070 and 2875.3800 (2001).

In addition to the Department and the issuer, UHI, the Complaint names as Defendants, Miller Schroeder Financial, Inc. (the underwriter), Realco (an affiliate of Miller Schroeder), Residential Funding Corp. (a creditor), Heller Financial, Inc. (a creditor), Frederikson & Byron, P.A. (legal counsel), and Ernst & Young, LLP (UHI's accountant).

STANDARD OF REVIEW

Minnesota Rule of Civil Procedure 12.02(e) permits a complaint to be dismissed for failure to state a claim upon which relief can be granted. For purposes of such a motion, the allegations in the complaint are considered true. *See Elzie v. Comm'r of Pub. Safety*, 298 N.W.2d 29, 32 (Minn. 1980). Nevertheless, a court need not accept as true wholly conclusory allegations or unwarranted factual inferences. *See Hanten v. School Dist. of Riverview Gardens*, 183 F.3d 799, 805 (8th Cir. 1999). Moreover, the Court should not "blindly accept the legal conclusions drawn by the pleader from the facts." *See Westcott v. City of Omaha*, 901 F.2d 1486, 1488 (8th Cir. 1990). Accordingly, dismissal of a claim is appropriate where it is clear that no set of facts could be introduced consistent with the pleading that would support the granting of the relief demanded. *See Northern State Power Co. v. Franklin*, 265 Minn. 391, 122 N.W.2d 26 (1963). Dismissal of a claim also is appropriate where it is clear from the face of the complaint that the claim is legally deficient. *Id.* Whether a government entity is protected by statutory immunity is a legal question reviewed *de novo* in this Court. *Johnson v. State*, 553 N.W.2d 40, 45 (Minn. 1996).

ARGUMENT

I. DISMISSAL IS APPROPRIATE BECAUSE THE STATE IS IMMUNE FROM TORT LIABILITY INVOLVING LOSSES BASED UPON ITS REGISTRATION OF SECURITIES.

The district court dismissed all tort claims against the State holding that the State enjoyed both discretionary act immunity and licensure immunity. Since each common law count of Appellants' complaint is explicitly based on alleged State acts involving the registration of securities, the State is immune from liability on all common law tort counts as the district court held.

In 1975, the Minnesota Supreme Court abrogated State sovereign immunity for "torts." *Nieting v. Blondell*, 235 N.W.2d 597, 603 (Minn. 1977). This decision was limited in important ways, however. First, the Court limited its holding to the "tort" area. Second, the Court held that its decision "should not be interpreted as imposing liability on any government body in the exercise of discretionary functions or in the exercise of legislative, judicial, quasi-legislative and quasi-judicial functions." *Id.* Third, the Court made its ruling prospective only, "subject to any appropriate action by the legislature." *Id.*

The State legislature responded by enacting the Tort Claims Act in 1976, Minn. Stat. § 3.736, subd. 1, which provides:

The State will pay compensation for injury to or loss of property or personal injury or death caused by an act or omission of an employee of the State while acting within the scope of office or employment or a peace officer who is not acting on behalf of a private employer and who is acting in good faith under section 629.40, subdivision 4, under circumstances where the State, if a private person, would be liable to the claimant,

whether arising out of a governmental or proprietary function. Nothing in this section waives the defense of judicial or legislative immunity except to the extent provided in, subdivision 8.

Importantly, the legislature did not waive immunity for all State acts. Minn. Stat.

§ 3.736, subd. 3 provides in pertinent part:

Without intent to preclude the courts from finding additional cases where the State and its employees should not, in equity and good conscience, pay compensation for personal injuries or property losses, the legislature declares that the State and its employees are not liable for the following losses:

(b) a loss caused by the performance or failure to perform a discretionary duty, whether or not the discretion is abused;

....

(k) a loss based on the failure of a person to meet the standards needed for a license, permit, or other authorization issued by the State or its agents;

Minn. Stat. § 3.736, subd. 3(b) & (k) (2002).

Here, dismissal is appropriate because: 1) Appellants' claims are based upon a loss in connection with the alleged failure of an issuance of securities to meet the securities' registration standards, which is a form of "license, permit, or other authorization issued by the State" within the meaning of Minn. Stat. § 3.736, subd. 3(k); and 2) registration of securities and the decision whether or not to issue a stop order is a discretionary act within the meaning of Minn. Stat. § 3.736, subd. 3(b).

A. The Decision To Deny A Registration Or Issue A Stop Order Of Securities Is A Discretionary Duty.

The decision to register a security and the decision whether or not to issue a stop order for the registration of a security involve the discretionary balancing of important

and legally valued policy goals. Thus, the State is entitled to discretionary or statutory immunity for tort liability based upon its regulatory activities.

As discussed above, the State has not abrogated its sovereign immunity 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) (2002). A discretionary act conferring immunity is one that a State agent is not legally obligated to perform and that involves questions of public policy requiring the evaluation of factors, such as the financial, political, economic and social effects of a contemplated plan or policy. *Holmquist v. State*, 425 N.W.2d 230, 232 (Minn. 1988). Each case must be analyzed by determining “whether the legislature intended to immunize the particular government activity that is the subject of the tort action.” *Nusbaum v. County of Blue Earth*, 422 N.W.2d 713, 719 (Minn. 1988).

1. The complaint is based on the Department’s alleged failure to issue a stop order.

Appellants’ tort counts against the State are based upon the Commissioner’s alleged failure to issue a stop order. The Complaint purports to identify two decisions made by the Commissioner: a decision to register the securities under Minn. Stat. § 80A.11 (Complaint at ¶ 468) and an inferred decision not to issue a stop order pursuant to Minn. Stat. § 80A.13. *Id.* at ¶ 469. It is apparent from the four corners of the Complaint, however, that it is premised on only the second decision, the decision not to issue a stop order. First, the Complaint fails to identify how the Commissioner

violated any law in the registration decision. The debenture at issue was registered pursuant to Minn. Stat. § 80A.11. This section provides:

Any security for which a registration statement has been filed under the Securities Act of 1933 in connection with the same offering *may* be registered by coordination.

There is no dispute that the UHI debentures were registered under the Securities Act of 1933. Therefore, as a matter of law, the issuance qualified for registration under Minn. Stat. § 80A.11. Consequently, Minn. Stat. § 80A.11 is not the basis of Appellants' allegations.

Second, Appellants' theory of State liability is focused on rules, which are not implicated in the section 80A.11 regulatory scheme, but rather were promulgated pursuant to Minn. Stat. § 80A.13. Consequently, the gravamen of Appellants' Complaint is the Commissioner's failure to issue a stop order under Minn. Stat. § 80A.13.

2. Minn. Stat. § 80A.13 expressly vests discretionary authority in the Department.

In Minn. Stat. § 80A.13, the Legislature explicitly grants the Commissioner wide discretion and expressly identifies his decision as one involving the public interest. Minn. Stat. § 80A.13 reads in part:

Subdivision 1. The commissioner *may* issue a stop order denying effectiveness to, or suspending or revoking the effectiveness of, 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 issuer, 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;

....

Minn. Stat. § 80A.13, subd. 1(1)-(2) (2002) (emphasis added).

Thus, this section establishes three important conclusions for the Court's analysis of the State's immunity. First, the Legislature's use of the permissive "may" shows that the Commissioner's stop-order decision is discretionary, not ministerial. Second, the Legislature's express invocation of "the public interest" shows that the Legislature considered the Commissioner's decision to be one of planning rather than operations. Finally, this section establishes that an alleged violation of a rule does not mandate the issuance of a stop order. That is, the failure of an issuance to satisfy a rule does not make the decision to issue a stop-order ministerial. Rather, under Minn. Stat. § 80A.13, subd. 1(2), the rule violation must be willful, and the Commissioner must determine that a stop order is in the public interest. Thus, the decision to issue a stop order involves numerous decisions with respect to legal and economic standards. Indeed, with respect to securities regulation, Minnesota is considered a "merit" state as opposed to a "notice" state. *State by Spannaus v. Coin Wholesalers, Inc.*, 311 Minn. 346, 250 N.W.2d 583, 588 (1976). As such, the Commissioner ultimately may have to balance conflicting risk measurements for a particular sale or issuance in deciding whether to issue a stop order.

On a larger scale, the Department must balance the risks for the purchaser associated with a certain type of stock against the benefits of capitalization through issuance of securities, such as economic development, which the issuance might support. Thus, the Legislature created a discretionary act expressly involving policy consideration, demonstrating its intent that the State be immune from liability for causes of actions allegedly arise on a Commissioner's stop-order decisions.

3. The regulatory scheme is discretionary.

In addition to the statutory language granting discretion to the Commissioner, the rules that complete the regulatory process similarly vest wide discretion in the Department. Indeed, the Commissioner is empowered to waive rules or to permit the omission of any documents from any registration statement.

The Commissioner's discretionary role with respect to securities registration rules provides the basis for the Commissioner's designee to vary Minn. R. 2875.3500. Appellants allege that the Commissioner did not have authority to waive Rule 2875.3500 in connection with UHI's application to register its securities. Complaint ¶ 82. In particular, Appellants allege that UHI's cash flow was not sufficient pursuant to Minn. R. 2875.3500, and therefore, the securities should not have been approved for registration by the Commissioner.

Again, the Legislature vested the Commissioner with the discretion to waive such requirements. Thus, Minn. Stat. § 80A.12 specifically provides that the Commissioner "may by rule or otherwise permit the omission of any item of

information or document from any registration statement.” Minn. Stat. § 80A.12.

Similarly, Minn. R. 2875.0990 provides that:

Notwithstanding any of the provisions of parts 2875.0950 to 2875.0980, the commissioner may by order or otherwise waive such provisions as the commissioner considers to be appropriate under the circumstances of a particular case.

Minn. R. 2875.0990 (2001).

Minnesota Statutes § 80A.12 and Minn. R. 2875.0990 allow the Commissioner or his designee to waive any provision, including the cash flow requirement under Minn. R. 2875.3500. Even if one were to interpret Minn. R. 2875.0990 narrowly and argue that the waiver only applies to parts 2875.0950 to 2875.0980, the result is the same. If the Commissioner has the authority to waive “financials” altogether, he similarly has the authority to vary the rules, including the cash flow requirement, which could not be calculated absent the financial statements.

Appellants’ allegations support the conclusion that that the Department did indeed exercise discretion by varying the particular rules at issue. Appellants’ Complaint reads:

185. The Department determined that, because of its financial condition, UHI could not satisfy the requirements of Rule 2875.3500. In a memorandum dated August 22, 1997, the Department’s financial analyst, in commenting on Rule 2875.3500 and UHI’s financial condition, concluded that, without the adjustment proposed by the analyst, “they [UHI] obviously don’t make it.” Thus, UHI’s debentures could not be sold to the public in Minnesota.

....

187. In the August 22, 1997 memorandum, the accounting analyst said:

Attached is the schedule you requested regarding the interest rate which would exactly meet the coverage test for the new issuance. Without the adjustment I made, they obviously don't make it. This appears to me to be a special situation (industry) in which the Company is growing and their primary asset (78% of the balance sheet) is the inventory they carry for generating sales. They finance their inventory through the use of developmental loans and other notes payable. Thus on the statement of cash flows the increase in inventory is charged against cash flow and the related loans and financing are not credited as a source of cash on the "from operating activities" line. Therefore this Company probably will never have a positive cash flow.

I have adjusted the analysis to include the source of funds for the increase in the inventory which I feel better portrays what is really happening here. It does not appear the Company would not have these funds available. In addition, the Company has been profitable in each of the past three years and has had funds to distribute to investors in the past two years.

Thus, the allegations of Appellants' Complaint confirm the legal analysis that the Department exercised discretion with respect to varying the particular rules at issue. As described above, every aspect of securities regulation supports the district court's conclusion that the Commissioner's failure to issue a stop order is discretionary. Consequently, the court's decision should be affirmed.

4. Immunity is in the public interest.

Immunity for losses alleged to have been caused by securities regulation is in the public interest. In the absence of immunity, regulators would be forced always to balance the threat of liability when making a registration decision. In *Cairl v. State*, 323 N.W.2d 20, 23, n.3 (Minn. 1982), the Supreme Court stated "[a] significant consideration in determining the applicability of discretionary immunity is the extent to which the threat of liability would impair the effective performance of the government act complained of." If the State were not immune from losses occasioned by the

decisions of regulators to register or perhaps even not to register securities, the State would be forced to blindly require adherence to specific rules and standards and not consider the public interest, limiting the options for possible economic development and other important public policy decisions.

The legislature has unmistakably manifested its intention that the State not be liable for such regulatory activity. As detailed above, the Commissioner is expressly vested with discretion to issue a stop order if he or she determines that an order is in the public interest. In addition, in the Minnesota Securities Act, the legislature carefully identified causes of action for securities violations but did not include language identifying the State as an entity which could be liable for alleged losses. *See* Section II, *infra*. Consequently, the Legislature has unmistakably expressed its intent that the Department is immune with respect to its securities regulatory activity.

5. A legal reasonableness standard does not apply in this case.

Appellant urges this Court to change the law in Minnesota by creating a “legal reasonableness” standard. To the same end, Appellant argues that a grant of immunity presumes that the State acts in good faith when it applies its laws. Appellant further states that the Commissioner did not act in a good faith. Brief at 24. This allegation of bad faith and express allegation of willful and reckless conduct are flatly contradicted by Appellants’ allegations. Indeed, Appellants allege that the Department acted with great particularity with respect to the requirements of Minn. R. 2875.330. Complaint at ¶¶ 185-197. Appellants allege that the Department expressly varied this rule because

otherwise members of the industry could never issue debt, facially a legitimate public policy consideration. Thus, since there are no facts alleged showing bad faith or disregard of Minnesota law, this court is not obliged to accept Appellants' legal conclusions. *Westcott v. City of Omaha*, 901 F.2d 1486, 1488 (8th Cir. 1990). Moreover, Appellants factual allegations are inconsistent with such conclusions. See *Northern States Power Co. v. T. Franklin*, 265 Minn. 391, 395, 122 N.W.2d 29 (1963) (holding that dismissal is appropriate where it is certain that no set of facts consistent with the pleadings could be introduced to support the claims). Hence, licensing immunity applies to the allegations of this case and dismissal is appropriate.

More significantly, the concept of "legal reasonableness" does not apply to statutory immunity. Appellant incorrectly imports official immunity analysis in to the statutory immunity issue. Brief at pg. 21-22. Thus, Appellant contends that since an official is not immune if he or she acted in such a way to violate a known right, discretionary immunity should be subject to the same constraint. Applicants have identified no statute or case authority for the proposition that official immunity analysis applies to statutory immunity and the State is unaware of any such authority. Indeed, such a limitation conflicts with the Legislature's manifest intent with respect to immunity. Significantly, Minn. Stat. § 3.736, subd. 3(b) provides that a decision is immune "whether or not the discretion is abused."

This case is a poor vehicle for creating such a change. The legislature has unmistakably vested the Commission with wide discretion in the regulation of

securities. As discussed above, the facts alleged in the Complaint demonstrates that the waiver of rules relating to income coverages was a decision made for demonstrable reasons. A glance at the provisions of the Minnesota Securities Act and its regulations will confirm that the Commissioner and staff may make dozens of decisions with respect to a given registration. The potential for litigation would be immense if each decision were subject to a standard as loose as “legal reasonableness.” Indeed, a “legal reasonableness” standard is no more or less than the negligence standard in a different verbal skin.

6. Other courts have held that government entities are immune for losses allegedly caused by economic regulation.

Courts have ruled that the federal government is immune from liability from alleged resulting regulatory activities. *See, e.g., F.S.L.I.C. v. Williams*, 599 F. Supp. 1184, 1198 (D. Maryland 1984) (holding that the F.S.L.I.C. was immune from liability relating to alleged negligence of agents in taking control of a bank).

The Ohio Court of Appeals determined that liability does not attach to states, observing that State liability for losses attributed to the sale of securities is contrary to the history and purpose of securities regulation.¹ *See, e.g., Smith v. Wait*, 46 Ohio Ct. App. 281, 286, 350 N.E.2d 431, 435 (1975) (holding that the State was not liable for losses occasioned by securities regulation). In *Smith*, the court stated:

¹ Research has failed to discover any case authority holding that a state has tort liability for an alleged wrongful registration of securities.

Registration of securities by the State in no way makes the State an insurer or guarantor of the securities so registered, nor does registration constitute a warranty of the securities in any respect. Likewise, registration by the State does not constitute a representation to the public at large, much less to a trustee of the issuer of the securities, that the securities are safe to buy, are good investments, or are not fraudulently issued. No one has any right to rely upon the state's registration of securities as an indication that there is no fraud connected with their issuance.

Id.

In sum, since the decision whether or not to revoke the registration of a particular securities offering requires the analysis of a myriad of complex factors and the application of discretion, the Department's decision to register a security or alternatively, not to issue a stop order for a particular security, should be protected from tort liability, as the legislature intended.

B. The State Is Immune From Tort Liability Because Any Loss Allegedly Resulted From The Failure Of UHI's Debentures To Meet The Standards Needed For A License, Permit Or Other Authorization Issued By The State Or Its Agents.

As discussed above, the district court alternatively held that, under Minn. Stat. § 3.736, subd. 3(k), the State is not liable for losses occasioned by "the failure of a person to meet the standards needed for a license, permit, or other authorization issued by the State." Since the State's registration of a security is, as a matter of law, "an issuance of a license, permit or other authority," it is immune from the liability Appellants seek to impose. Therefore, the decision of the district court should be affirmed.

There can be no doubt that a security's State registration is a form of a license, permit, or authorization as a matter of law. Since these terms are not defined by Minn. Stat. § 3.736, as a matter of statutory construction, the terms are construed according to their normal and customary definitions. Minn. Stat. § 645.08(1). The American Heritage College Dictionary, 3rd Ed., defines "license" as "official *or* legal permission to do or own a specified thing," "permit" as "a document or certificate giving permission to do something; a license or warrant" and "authorization" as "the act of authorizing." The American Heritage College Dictionary 782, 1018, 92 (3d ed. 1997).

As held by the court below, registration of a security satisfies the elements of Minn. Stat. § 3.736, subd. (1)(k) because registration is the formal permission by the State for a covered person to sell securities in Minnesota. Minn. Stat. § 80A.08 provides:

It is unlawful for any person to offer or sell any security in this State unless (a) it is registered under sections 80A.01 to 80A.31 or (b) the security or transaction is exempted under section 80A.15 or (c) it is a federal covered security.

All of Appellants' common law causes of action are predicated on the debentures at issue not meeting the standards for security registration. Thus, with respect to their negligence count, Appellants' Complaint, ¶ 475, reads:

As a result of the Department's negligent breach of its duty to enforce Minnesota's securities statutes and rules, UHI's debentures were allowed to be sold in Minnesota, notwithstanding that Rules 2875.0960 and 2875.3500 barred the sale of UHI's debentures in Minnesota at the time that UHI's registration was declared effective by the Commissioner and notwithstanding that suspicious material self-dealing transactions were disclosed after UHI's registration was declared effective without an examination regarding whether such disclosures satisfied Rule 2875.3070.

Similarly, Appellants' remaining common law claims against the State involving negligent misrepresentation and common law fraud also are premised upon the alleged failure of the issuance to meet the State's standards pursuant to chapter 80A. See Complaint ¶¶ 545 and 610 respectively.

In this case, the security was registered under Minn. Stat. § 80A.10, which provides that "[a]ny security for which a registration statement has been filed under the Securities Act of 1933 in connection with the same offering may be registered by coordination." Minn. Stat. § 80A.10, subd. 1 (2002). There is no question that the registration of securities and any failure to issue a stop-order emanates from the Department in its securities regulation role. Consequently, each element of section 3.736, subdivision 3(k) is satisfied. That is, the alleged loss stems from the decision of the Department to authorize the security by not issuing a stop order. Therefore, dismissal of Appellants' common law tort claims is appropriate under Minn. Stat. § 3.736, subd. 3(k), and the decision of the district court should be affirmed.

In support of their argument that the State is not immune, Appellants advance *Gertken v. State*, 493 N.W.2d 290, 292 (1992). The *Gertken* Court held that the State was immune from a wrongful death claim under the licensing clause of Minn. Stat. § 3.736. In *Gertken*, the plaintiff argued that the State was negligent when a day-care inspector advised the owner only to clean the chimney regularly and otherwise approved the day-care facility. The *Gertken* Court observed that the State inspector made no express representation, but reserved judgment with respect to the immunity analysis if

an express representation had been made contrary to licensing standard. 493 N.W.2d at 292 n.3.

As the district court held, Appellants incorrectly argue that the facts of the instant case fall within the *Gertken* Court's reservation. Here, the State made no express representation to Appellants beyond the bare licensing statement that the debentures at issue were registered by coordination. That is, this case involves only the notice of the licensing decision and not any other express representation. Thus, Appellants fail to allege that the Department or its agents made any express representation in contrast to licensing standards. Therefore, the reservation made by the *Gertken* Court does not apply.

II. SINCE THE STATE IS NOT A "SELLER" OF SECURITIES, THERE IS NO CAUSE OF ACTION FOR SECURITIES LAWS VIOLATIONS AGAINST THE STATE.

In Count VI of their Complaint, Appellants allege that the State violated the Minnesota Securities Act. Specifically, Appellants allege violations of Minn. Stat. §§ 80A.08, 80A.19, 80A.10, 80A.13, 80A.25, and Minn. R. 2875.0960, 2875.3070 and 2875.3500. (Complaint at ¶ 281.) In its motion to dismiss the State showed that Appellants have no viable cause of action under the Securities Act for several reasons. Appellants did not respond to the State's memorandum with respect to this count. The district court dismissed this count holding that the Securities Act does not create a cause of action for the violations alleged by Appellants. The court also held that any such

claims are stale. Since it is not clear from Appellants' brief whether they are appealing this aspect of the dismissal, Respondent will brief the issue.²

The Legislature has expressly denied the existence of a cause of action under the statutes identified by Appellants. Minn. Stat. § 80A.23, subd. 11 provides in pertinent part:

The rights and remedies promulgated by section 80A.01 to 80A.31 are in addition to any other right or remedy that may exist at law or in equity, but sections 80A.01 to 80A.31 do not create any cause of action not specified in this section or section 80A.05, subdivision 5.

Minn. Stat. § 80A.23, subd. 11(2002). The particular sections alleged by Appellant to have been violated by the State do not contain any statutory cause of action against the State, which is not a "seller" of securities under the Act. *See Hagert v. Glickman*, 520 F. Supp. 1028 (D. Minn. 1981) (holding that plaintiff could not maintain cause of action for misleading filing involving an annual report under Minn. Stat. § 80A.17 because independent cause of action did not exist under Minn. Stat. § 80A.23). Thus, in the absence of statutory authorization to allow a plaintiff to sue the State as a "seller" of securities in connection with its regulatory role, this count was properly dismissed. *See Jacona v. Schrupp*, 509 N.W.2d 185, 187 (Minn. Ct. App. 1993) (law does not presume that the legislature has intended to create a cause of action unless that intent is clearly expressed or implied).

² By failing to respond to the State's motion, Appellants have waived their arguments on appeal. *See Pole v. Trudeau*, 516 N.W.2d 217, 222 (Minn. Ct. App. 1994) citing *Thiele v. Stich*, 425 N.W.2d 580, 582 (Minn. 1988) (holding that unless an injustice would result, appellate courts will not address issues raised for the first time on appeal or raised on a theory not presented to the district court).

In addition, Minn. Stat. § 80A.23, subs. 1-3 establishes only that *sellers* are liable for violations in connection with the sale of securities. There is no express indication of legislative intent in the Securities Act to create any type of cause of action for alleged securities violations by the State, which is not a “seller” of a securities. Minn. Stat. § 80A.23, subs. 1-3 provide as follows:

Subdivision 1. Any person who sells a security in violation of sections 80A.08 or 80A.18, or of any condition imposed under section 80A.11, subdivision 4, or 80A.12, subdivisions 5 and 6, is liable to the person purchasing the security, who may sue either in equity for rescission upon tender of the security or at law for damages if that person no longer owns the security. In any action for rescission, the purchaser shall be entitled to recover the consideration paid for the security together with interest at the legal rate, costs, and reasonable attorney’s fees, less the amount of any income received on the securities. In an action at law, damages shall be the consideration paid for the security together with interest at the legal rate to the date of disposition, costs, and reasonable attorney’s fees, less the value of the security at the date of disposition.

Subd. 2. Any person who violates section 80A.01 in connection with the purchase or sale of any security shall be liable to any person damaged thereby who sold such security to that person or to whom that person sold such security, and any person who violates section 80A.03 in connection with the purchase or sale of any security shall be liable to any person damaged by the conduct prescribed by section 80A.03. Any person who violates section 80A.02 in connection with the purchase or sale of any security shall be liable to any investment advisory client who is damaged thereby. Damages in an action pursuant to this, subdivision shall include the actual damages sustained plus interest from the date of payment or sale, costs and reasonable attorney’s fees.

Subd. 3. Every person who directly or indirectly controls a person liable under, subdivision 1 or 2, every partner, principal executive officer or director of such person, every person occupying a similar status or performing a similar function, every employee of such person who materially aids in the act or transaction constituting the violation, and every broker-dealer or agent who materially aids in the act or transaction constituting the violation, are also liable jointly and severally with and to

the same extent as such person. There is contribution as in cases of contract among the several persons so liable.

Minn. Stat. § 80A.23, subd. 1-3 (2002).

Since the State is not a “seller” of securities, it has no liability under, subdivision 1. Moreover, Appellants have made no allegations that the State violated § 80A.01, subd. 2. Finally, the State does not control, in the corporate sense, any of the participants in the issuance of securities which is the subject of this case, so it is not liable under section 80A.01, subdivision 3.

Since the legislature explicitly imposed regulatory responsibilities on the Commissioner of the Commerce Department through the Minnesota Securities Act, it is natural to expect that had the legislature also intended to impose liability on the State, in connection with its role as a regulator, it would have done so expressly.³ There is no indication of such a legislative intent. Consequently, the decision of the district court should be affirmed.

B. Appellants’ Securities Act Claim Against The State Is Barred By The Statute Of Limitations.

If the Court were to find that the State is a “seller” of securities subject to liability under the Securities Act, any such claim against the State would be time barred.

Minn. Stat. § 80A.25, subd. 7 (2002) prescribes a three year statute of limitations for

³ Minn. Stat. § 645.27 (2002) provides:

The State is not bound by the passage of a law unless named therein, or unless the words of the act are so plain, clear, and unmistakable as to leave no doubt as to the intention of the legislature.

lawsuits alleging violations involving the sale of securities. This three year period commences with the particular sale. *Id.* Appellants' Third Amended Complaint unambiguously identifies the sales in question as occurring between November 1997 and November 1999. Third Amended Complaint at ¶ 3. The Third Amended Complaint was served and filed on or about June 26, 2003.

The statute of limitations defense is appropriate for determination by judgment on the pleadings. *See, e.g., Ericksen v. Winnebago Indus., Inc.*, 342 F. Supp. 1190, 1194 (D. Minn. 1972) ("The defense of the statute of limitations may be raised by . . . motion for judgment on the pleadings"); *Cotton v. Mosele*, 738 F.2d 338 (8th Cir. 1984) (Rule 12(c) motion granted on basis of lapsed statute of limitations); *Phelps v. McClellan*, 30 F.3d 658, 663 (6th Cir. 1994) ("[j]udgment on the pleadings under Fed. R. Civ. P. 12(c) is uniquely suited to disposing of a case in which a statute of limitations provides an effective bar against a plaintiffs claim") (citations omitted); *S and S Const., Inc. v. Reliance Ins. Co.*, 42 F. Supp.2d 622 (D.S.C. 1998) (Rule 12(c) motion granted on basis of lapsed statute of limitations). On the face of their Complaint, Appellants' Securities Act count against the State is stale, and dismissal is appropriate.

III. APPELLANTS HAVE WAIVED NUMEROUS CERTAIN ISSUES BY FAILING TO RAISE THE ISSUES BELOW.

Appellants raise several issues for the first time on appeal. Specifically, Appellants on appeal argue that the application of immunity violates the Minnesota Constitution by eliminating a cause of action at common law predating the Constitution. Brief at 29. In addition, Appellants argue that immunity renders Minn. Stat. § 80A.13

in conflict with Minn. Stat. § 645.17(1), (Br. at 33) and that the same analysis deprives investors of property without due process of law. Br. at 30. Since Appellants raised none of these arguments below, Appellants have waived them in this Court. *Pole v. Trudeau*, 516 N.W.2d 217, 222 (Minn. Ct. App. 1994) citing *Thiele v. Stich*, 425 N.W.2d 580, 582 (Minn. 1988) (holding that unless an injustice would result, appellate courts will not address issues raised for the first time on appeal or raised on a theory not presented to the district court).

In addition, none of these issues have merit. Thus, the recognition of sovereign immunity in this case does not eliminate a cause of action existing at common law before the promulgation of the Minnesota Constitution for several reasons. First, a cause of action premised on Minnesota securities law did not exist before 1973, the first appearance of the Minnesota Securities Act. This Act postdated the 1857 Constitution by 116 years. Likewise, no tort cause of action against the State predated the existence of the State.

Issues premised on alleged violation of Minn. Stat. § 80A.13 are also precluded for several reasons.⁴ As discussed above and as the court held below, the Legislature has explicitly denied causes of action based upon that section. *See* Minn. Stat.

⁴ Appellants' waived its alleged substantive "due process" issue on a different scale because Appellants did not plead a due process count in their Complaint.

§ 80A.23, subd. 11 (2004).⁵ Moreover as discussed above, if the Court were to find the State liable under Minn. Stat. § 80A.13, any such claim against the State would be time barred. *Id.*

Since Appellants have waived issues not raised below, this Court should affirm the decision of the district court.

IV. DISMISSAL IS APPROPRIATE FOR APPELLANTS' CONSUMER FRAUD ACT CLAIM FOR FAILURE TO PLEAD A FRAUDULENT PRACTICE.

Finally, in Count III, Appellants claim that the State violated Minn. Stat. § 325F.69, subd. 1 of the Consumer Fraud Act. Dismissal is appropriate because Appellant has failed to plead any specific facts showing a violation of Minn. Stat. § 325F.69.

Minn. Stat. § 325F.69, subd. 1 proscribes consumer fraud as follows:

The act, use, or employment by any person of any fraud, false pretense, false promise, misrepresentation, misleading statement or deceptive practice, with the intent that others rely thereon in connection with the sale of any merchandise, whether or not any person has in fact been misled, deceived, or damaged thereby, is enjoined as provided herein.

Appellants have failed to identify with specificity any fraudulent practice committed by the Department. The only Departmental communication identified or alleged in the Complaint is its notice that the debentures were registered by coordination pursuant to Minn. Stat. § 80A.11. As the district court found, this statement by the

⁵ Below, Respondent briefed the issues of whether Appellants Minnesota Securities Act claims should be dismissed because such claims were not authorized by statute and because the alleged claims were state. Appellants did not respond to the State's motion with respect to the Securities Act counts.

Department is undeniably a true statement of fact — the debentures were registered as such — and is not susceptible to being either fraudulent or misleading.

The only other act complained of is the Commissioner's decision not to issue a stop order. The complaint identifies no statement or act of any kind in connection with this inferred decision. From the decision not to issue a stop order, Appellants conclude that the Commissioner implied that UHI's issuance satisfied all rules in connection with securities regulation. This factual or legal inference is demonstrably unwarranted for many reasons. First, as discussed above, the Commissioner is not obligated to issue a stop order even if a rule is violated. Rather, the Commissioner undertakes a public interest determination when he believes that a rule has been willfully violated. Appellants have failed to plead any specific facts showing that the Commissioner was aware of a willful violation on the part of the sellers of the debentures at issue or that he determined that a stop order was in the public interest but declined to issue it. Because the factual or legal inference that the absence of a stop order implied satisfaction of all rules is unwarranted, the court is not obligated to accept the pleadings at face value. *See Hanten v. School Dist. of Riverview Gardens*, 183 F.3d 799, 805 (8th Cir. 1999). Since Appellants have failed to plead specific facts showing a violation of Minn. Stat. § 325F.69, the decision of the district court should be affirmed.

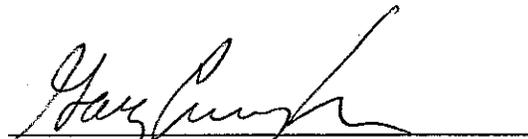
CONCLUSION

For the reasons identified above, the State of Minnesota, Department of Commerce, respectfully requests that the Court affirm the decision of the district court.

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Respectfully submitted,

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