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No. A06-1233

STATE OF MINNESOTA

IN SUPREME COURT

Charles Risdall, Len Dozier, and John Risdall, in his capacity as personal representative of the Estate of Mary Risdall,

Petitioners,

vs.

Christopher C. Brown and funeral.com, inc.,

Respondents.

BRIEF OF *AMICUS CURIAE* STATE OF MINNESOTA

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STATEMENT OF AMICUS CURIAE

As a matter of public policy and investor protection, the securities industry is jointly regulated by State and federal law. State law is not preempted by federal law unless Congress expressly or impliedly displaced the possibility of State regulation. The Court of Appeals incorrectly analyzed preemption and ruled that State law does not apply when the unregistered offering simply purports to be exempt under federal law. The Court of Appeals also improperly applied the integration doctrine, which holds that multiple securities offers and sales made within a 6 month window should be consolidated to prevent unscrupulous issuers from abusing federal exemptions. Left uncorrected, the Court of Appeals' decision strips away civil remedies and regulatory safeguards provided to investors in the State of Minnesota.

LEGAL ISSUES

Issue No. 1: Federal law does not preempt State law where the regulations coexist, unless Congress expressly or impliedly displaced the possibility of State regulation. Under State and federal securities law, when a security "is a covered security," it is exempt from State law. In this case, the purchasers alleged that the security was not a "covered security" because the issuers improperly made a public offering on an integrated security. The district court agreed and granted the purchasers summary judgment. The Court of Appeals reversed, adopting a new preemption standard that automatically displaces State regulations when an issuer of a security claims to have complied with federal law, regardless of Congressional intent or the issuer's actual compliance with federal law. Under these circumstances, should federal preemption be expanded to situations where the issuer of a security merely purports to comply with federal law?

Issue No. 2: To prevent issuers of securities from exploiting federal exemptions, federal law integrates related offerings made by the issuer within a 6 month window. Here, after purportedly making a private offering to the purchasers, the issuers made a public offering on a related security. After the Securities and Exchange Commission intervened, the issuer abandoned the public offering. The Court of Appeals reversed the district court and held that, notwithstanding the undisputable public offerings, the absence of sales on that offering precluded integration with the first offering. Under these circumstances, should federal integration doctrine apply to preclude the issuers' reliance on a private offering exemption following their public offering of a related security?

INTRODUCTION

The State of Minnesota, by its Attorney General and Commissioner of Commerce ("Commissioner"), respectfully submits this brief in support of the Petitioners and in the public interest.[1] The Attorney General may appear in court whenever the interests of the State require it. Minn. Stat. § 8.01 (2006). The Attorney General is charged with enforcement of Minnesota's consumer protection laws. Minn. Stat. § 8.31, subd. 1 (2006). It is part of the Commissioner's mission to coordinate the Department of Commerce's activities with the activities of other governmental agencies. Minn. Stat. § 45.012(c)(3) (2006). The Commissioner is charged with enforcement of Minnesota's securities regulations, including adopting rules and issuing orders. *See* Minn. Stat. §§ 45.011, subds. 1 and 4, 80A.01-.31, and 80A.40-.90 (2006).[2]

This amicus brief addresses why this Court should reverse the Court of Appeals' decision, which would grant issuers of unregistered securities immunity from State law by simply claiming that the offering was purportedly made pursuant to federal law. According to the Court of Appeals, the mere assertion that an unregistered security was

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[1] Pursuant to Minn. R. Civ. App. 129.03, the Attorney General's Office states that it jointly prepared and paid for this brief with the Minnesota Department of Commerce.

[2] Effective August 1, 2007, sections 80A.01-.31 were repealed, and sections 80A.40-.90 were added. 2006 Minn. Laws, ch. 196, art. 1, §§ 1-52. Generally, under the former and current State regulations, it is unlawful for issuers to sell unregistered securities in Minnesota, unless the security is exempt under federal law. *Compare* Minn. Stat. § 80A.08 (2006), *with* Minn. Stat. § 80A.49 (2006). Consequently, even though it considered the repealed law, the Court of Appeals' opinion may have equal applicability under the new law.

offered pursuant to federal law preempts State law, regardless of whether the security actually complies with any federal exemption.

In addition, the Court of Appeals reversed the district court's determination that multiple offerings made by the same issuer within months of each other should be integrated. Specifically, the district court ruled that the issuer lost its purported exemption under the first "private" offering after the issuer publicly advertised and solicited the second offering. The Court of Appeals disagreed and held that, notwithstanding the undisputed general solicitations, the absence of any resulting sales precluded integration as a matter of law.

The preemption issue represents an emerging area in state securities regulation and, as such, this Court's ruling will likely influence other courts' consideration of this subject. Likewise, to the best of the State's knowledge, the Court of Appeals' decision regarding integration is an anomaly in the securities field. Unless this Court reverses the Court of Appeals' decisions on these issues, investors may be more easily duped, the State will be stymied in its efforts to regulate, and unscrupulous issuers will have a roadmap to manipulate laws designed to protect the public.

REGULATORY HISTORY AND FRAMEWORK

The State of Minnesota enacted the Minnesota Securities Act in 1917 after the U.S. Supreme Court upheld the constitutionality of Blue Sky laws[3] in several other states.[4] Three years later, this Court iterated that the law is designed to protect the public from unsound, visionary, and fraudulent investment schemes:

> The purpose of the statute is to protect the public against imposition. It is a new form of regulatory law which, in the course of a few years, has swept over 33 states. It has been said that its popular name indicates the evil at which it is aimed, that is, speculative schemes having no more basis than so many feet of blue sky, and that it is intended to put a stop to the sale of shares in visionary oil wells, nonexistent gold mines, and other "get-rich-quick" schemes calculated to despoil credulous individuals of their savings. *It is a proper and needful exercise of police power of the state and should not be given narrow construction*; for it was the evident purpose of the Legislature to bring within the statute the sale of all securities not specifically exempted.

State v. Gopher Tire & Rubber Co., 146 Minn. 52, 55, 177 N.W. 937, 938 (Minn. 1920) (emphasis added). The public policy that supported and necessitated State regulation of securities ninety years ago has not changed.

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[3] In 1911, Kansas was the first state to pass a law to regulate the sales of securities. Such laws, commonly called "Blue Sky" laws, are believed to be so-called because the purpose of the Kansas statute was "to protect the Kansas farmers against the industrialists selling them a piece of the blue sky." Thomas Hazen, *The Law of Securities Regulation*, § 1.2[2], p. 27 (5th ed. 2005).

[4] Minn. Laws 1917, ch. 429; *see generally* Lawrence Perlman, *A Critical Analysis of the Registration Provisions of the Minnesota Securities Act,* 56 Minn. L. Rev. 523 (1972).

Under the current and recently repealed State securities regulations, generally, it is unlawful to offer or sell a security[5] that has not been registered with the Commissioner, unless the security is exempt from registration or "a federal covered security." Minn. Stat. § 80A.08 (2006) (repealed 8/1/07); Minn Stat. § 80A.49 (2006) (effective 8/1/07); *see also* 15 U.S.C. § 77r(b) (defining "covered securities"); Minn. Stat. § 80A.15 (2006) (exemptions) (repealed 8/1/07); Minn. Stat. §§ 80A.45, 80A.46, and 80A.47 (2006) (exemptions) (effective 8/1/07).

In 1933, sixteen years after Minnesota passed its first securities regulations, Congress enacted the Securities Act of 1933 ("Securities Act").[6] *See* 15 U.S.C. §§ 77a - 77aa.[7] Generally, the Securities Act prohibits issuers from selling or offering securities unless such securities are either registered with the Securities and Exchange Commissioner ("SEC") or otherwise exempt from the registration requirement. *See* 15 U.S.C. §§ 77d, 77e, and 77f.

Several examples of federal exemptions are contained in Regulation D, a series of six federal rules that create three distinct exemptions. *See* 17 C.F.R. §§ 230.501 -

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[5] *See* Minn. Stat. § 80A.14, subd. 18 (2006) (defining "security") (repealed 8/1/07); Minn. Stat. § 80A.41(28) (2006) (defining "security") (effective 8/1/07).

[6] Securities Act of 1933, ch. 38, 48 Stat. 74 (1933).

[7] When the Securities Act was codified, its sections were assigned a corresponding letter in the alphabet in section 77. For example, section 1 was assigned the first letter of the alphabet and codified at section 77a, and section 5(b)(1) was assigned the fifth letter of the alphabet and codified at section 77(e)(b)(1). *See* Thomas Hazen, *The Law of Securities Regulation*, § 1.0[2], p. 8 (5th ed. 2005). For purposes of simplicity, this brief will cite to the codified statute.

230.506.[8] Among other limitations, Rules 504 and 505 establish monetary caps applicable to the offerings. *See* 17 C.F.R. §§ 230.504(b)(2) and 230.505(b)(2)(i). Rule 506 is designated as the corresponding rule to section 77d(2), which exempts from the registration requirement transactions not involving a public offering.[9] 17 C.F.R. § 230.506(a).

From 1933 until 1996, the state and federal law provided parallel regulation of the securities industry. That approach changed in 1996 when Congress limited the role of the states in securities regulation by passing the National Securities Markets Improvement Act of 1996 ("NSMIA").[10] Under an amended section 77r, NSMIA established that an offering that "is a covered security" is typically exempt from state regulation.[11]

ARGUMENT

As a threshold matter, the Court of Appeals ruled that if a securities issuer simply raises the defense that its unregistered offering "is a covered security," preemption applies to trump State law and preclude State courts from considering the merits of whether the offering is, in fact, "a covered security." In *dicta*, the Court of Appeals

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[8] Rule 501 refers to 17 C.F.R. § 230.501, Rule 502 refers to 17 C.F.R. § 230.502, and so on. *See generally* Thomas Hazen, *The Law of Securities Regulation*, § 4.20, pp. 421-35 (5th ed. 2005).

[9] Thomas Hazen, *The Law of Securities Regulation*, § 4.24, pp. 447-59 (5th ed. 2005 and Supp. 2007).

[10] Pub. L. 104-290, 110 Stat. 3416 (1996).

[11] 15 U.S.C. § 77r(a), (b), and (c); *see also* Thomas Hazen, *The Law of Securities Regulation*, § 1.2[3][E], pp. 38-39 (5th ed. 2005).

stated that, even if a State court could examine whether an unregistered offering was a "covered security," the offering in question was exempt from State and federal registration requirements. The Court of Appeals arrived at this conclusion based on a unique "plain language" reading of a federal regulation that rendered superfluous conjunctive phrases and otherwise has no support in federal securities law.

The State submits that the Court of Appeals' analysis was flawed on both issues and, as a result, unscrupulous issuers have new tools to circumvent the law and prey on Minnesota consumers. First, the Court of Appeals failed to apply the correct legal test regarding preemption, which begins and ends with Congressional intent. Second, the Court of Appeals misinterpreted the integration doctrine and, in the process, ignored its underlying public protection policies. The Court of Appeals' decision should be reversed, and the district court's grant of summary judgment for the Petitioners should be reinstated.

I. CONGRESS DID NOT INTEND TO PREEMPT REGULATION OF NON-COVERED SECURITIES.

"Preemption analysis begins with the assumption that the 'historic police powers of the [s]tates' are not to be eclipsed unless to do so was 'the clear and manifest purpose of Congress.'" *Dahl v. Charles Schwab & Co., Inc.*, 545 N.W.2d 918, 922 (Minn. 1996) (*quoting Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)), *cert. denied*, 519 U.S. 866 (1996). When reviewing whether a state statute is preempted by federal law, the "sole task is to ascertain the intent of Congress." *Cal. Fed. Savings & Loan Ass'n v. Guerra*, 479 U.S. 272, 280 (1987).

"The clearest indication of such Congressional intent is express language; if Congress expressly preempts state action, the matter is settled." *Dahl*, 545 N.W.2d at 922. Absent express language, intent to preempt may be inferred "if Congress has entirely displaced the possibility of state regulation or if state regulation conflicts with federal law." *Id.* at 924. Significantly, "preemption is not to be lightly presumed." *Guerra*, 479 U.S *at* 281. When two plausible interpretations of a federal law are offered, courts "have a duty to accept the reading that disfavors pre-emption." *See Bates v. Dow Agrosciences, LLC,* 544 U.S. 431, 449 (2005).

A. Congress Preempted "Covered Securities."

Congress did not preempt the entire securities field from State regulation when it passed the National Securities Markets Improvement Act of 1996 ("NSMIA").[12] Congress limited the preemptive impact of NSMIA to any offering that "*is* a covered security." 15 U.S.C. § 77r(a)(1)(A) (emphasis added). This is significant because Congress declined to use the blanket-term of "securities" when defining the scope of the exemption. Rather, Congress created a term of art -- "covered security" -- and provided a detailed definition for that phrase. 15 U.S.C. § 77r(b).

Included in the definition of "covered security" is "a transaction that *is exempt from registration* under this subchapter pursuant to . . . (D) Commission rules or regulations issued under section 77d(2) of this title . . . ." 15 U.S.C. § 77r(b)(4)(D) (emphasis added). Section 77d(2) is limited to "transactions by an issuer not involving

[12] Pub. L. 104-290, 110 Stat. 3416 (1996).

any public offering." The reference to "rules and regulations issued under section 77d(2)" encompasses Rule 506 of Regulation D, concerning private offerings of securities. *See* 17 C.F.R. § 230.506(a).

Critically, this case is not about whether an issuer must register a *bona fide* "covered security" with the Commissioner. The answer to that question is obvious. Rather, the Court of Appeals held that -- regardless of any evidentiary proof or actual compliance with federal law -- an offering will be treated as "covered security" and State law will be preempted upon the issuer simply raising the affirmative defense that an unregistered offering "is a covered security." As such, the Court of Appeals determined that State law was automatically preempted based on nothing more than Respondents' *mere assertion* that the security "purported to be exempt under [Rule 506]." *Risdall v. Brown-Wilbert, Inc.*, 733 N.W.2d 827, 832 (Minn. Ct. App. 2007), *rev. granted* (Minn. 2007).

The Court of Appeals, regrettably, handed unscrupulous issuers of securities a perfect defense to any civil or regulatory action that alleges violations of State securities laws. This Court should correct the Court of Appeals' erroneous decision before con artists have the opportunity to capitalize on it at the expense of Minnesota consumers. Indeed, left uncorrected, the ability of the State to protect its citizens from unsound or visionary investment schemes will be substantially compromised.

1. Preemption analysis focuses on Congressional intent.

In 1996, this Court provided the analytical framework to consider when determining whether federal securities regulations preempt State law. *Dahl*, 545 N.W.2d

at 922-25. Under *Dahl,* this Court held that the proper test to evaluate preemption begins and ends with Congressional intent. Absent express language, State law will only be preempted "if Congress has entirely displaced the possibility of state regulation or if state regulation conflicts with federal law." *Id.* at 924. Applying that test, in *Dahl,* this Court determined that, due to a conflict with federal securities law regarding "order flow payments,"[13] State common law and consumer protection statutes were preempted. 545 N.W.2d at 920-26.

Here, the Court of Appeals neglected to evaluate whether State regulations were expressly or impliedly preempted, or whether State law conflicts with federal law. *See Risdall,* 733 N.W.2d at 831-33. The Court of Appeals, instead, determined that State law was preempted based on its belief that federal courts were "uniquely qualified" to address federal securities exemptions:

> Because federal courts are uniquely qualified to address issues of federal law, such as the availability of a Regulation D exemption, we conclude that the better view is that an offering purporting to be exempt under Regulation D is governed exclusively by federal law, and any claim under state law relating to the offering is therefore preempted.

Risdall, 733 N.W.2d at 832. This Court should reject the Court of Appeals' flawed analysis because a court's purported "qualification" is not a determinative factor in

[13] *See Dahl,* 545 N.W.2d at 921 (describing "order flow payments").

preemption.[14] The correct test analyzes Congressional intent as set forth in *Dahl.* 545 N.W.2d at 922-25.

Other courts have examined this identical preemption issue with divergent results. As the Court of Appeals noted, three federal district courts have ruled that -- regardless of actual compliance with federal law -- the mere assertion that an offering is a "covered security" is sufficient to preempt state regulation. *See Temple v. Gorman,* 201 F.Supp.2d 1238, 1243-44 (S.D. Fla. 2002); *Lillard v. Stockton*, 267 F.Supp. 1081, 1115-16 (N.D. Okla. 2003); *Pinnacle Commc'n Int'l, Inc. v. Am. Family Mortgage Corp.*, 417 F.Supp.2d 1073, 1087 (D. Minn. 2006).[15] These cases ignore the plain language of federal law and any other plausible interpretation and, instead, preempt state law under an inference that "Congress expressed its intent in NSMIA that federal regulations alone should govern the registration of national securities offerings." *Temple,* 201 F.Supp.2d at 1244.

Temple, *Lillard*, and *Pinnacle* represent the minority view and have been criticized by courts and commentators alike. Indeed, other than the Court of Appeals' decision in this case, every reported opinion adjudicating this issue since *Pinnacle* has rejected the

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[14] A court's purported "qualification" could be relevant to *abstention* under the *Colorado River* doctrine; however, "qualification" is immaterial to *preemption*. *Compare United States Fid. & Guar. Co. v. Murphy Oil USA, Inc.*, 21 F.3d 259, 263 (8th Cir. 1994) *with Dahl*, 545 N.W.2d at 922-24; *see also Colorado River Water Conservation Dist. v. United States*, 424 U.S. 800 (1976).

[15] Notwithstanding the Court of Appeals' suggestion that federal courts are "uniquely qualified" to address federal securities exemptions, in *Pinnacle,* Judge Davis held that the question of whether an issuer "violated its claims of exemptions under Rules 505 or 506 *is a genuine issue of material fact, best decided by a jury.*" 417 F.Supp.2d at 1087 (emphasis added); *see also Risdall,* 733 N.W.2d at 832.

minority view's analysis as flawed. *See Brown v. Earthboard Sports USA, Inc.*, 481 F.3d 901, 909-12 (6th Cir. 2007); *Grubka v. Webacccess Int'l, Inc.*, 445 F.Supp.2d 1259, 1269-70 (D. Colo. 2006); *In re Blue Flame Energy Corp.*, 871 N.E.2d 1227, 1241-44 (Ohio Ct. App. 2006); *Hamby v. Clearwater Consulting Concepts, LLLP*, 428 F.Supp.2d 915, 920-21 (E.D. Ark. 2006). Likewise, the only state supreme court to rule on this preemption issue aligned itself with the majority view. *Buist v. Time Domain Corp.*, 926 So.2d 290 (Ark. 2005) ("under Rule 506 exemption and preemption are functionally equivalent").[16]

Consistent with this Court's analysis in *Dahl,* the majority courts look to the language of the federal law to evaluate whether Congress expressly or impliedly preempted anything other than *bona fide* "covered securities." Based on the plain language of the federal law, the majority courts found that Congress unambiguously made "preemption and exemption contemporaneous" when it used the phrase "is exempt from registration." *In re Blue Flame Energy Corp.,* 871 N.E.2d at 1243; 15 U.S.C. § 77r(b)(4); *see also Brown*, 481 F.3d at 912 ("The statute thus does not expressly preempt state laws with respect to non-'covered' securities, nor does the statute's test reveal an implied intent to preempt all state statutes in the field."); *Grubka,* 445 F.Supp.2d at 1271 ("Nowhere does the statute indicate that a security may satisfy the definition if it is *sold pursuant to* a putative exemption.")(emphasis in original); *Hamby,* 428 F.Supp.2d at 921 ("Thus, the only way to assert federal preemption is to first show

[16] *See also* Thomas Hazen, *Law of Securities,* § 4.1[7], pp. 347-48; § 4.24[4], p. 459; § 4.25, pp. 466-67 (5th ed. 2005 and Supp. 2007).

that an exemption from federal registration actually applies."); *Buist*, 926 So.2d at 298 ("a failure to comply with a requirement of Rule 506 'voids' the exemption, thereby eliminating the possibility of preemption.").

In contrast, the minority view incorrectly construes the federal law as ambiguous by ignoring the repeated use of the word "is" in section 77r. Indeed, conspicuously absent from the analysis of any court adopting the minority view is a plausible alternative interpretation for the phrases "is a covered security" or "is exempt from registration." 15 U.S.C. §§ 77r(a)(1)(A), and 77r(b)(4). The express language used in those phrases buttresses the majority view that Congress did not intend to preempt state law unless the offering "is a covered security" and "is exempt" under federal law.

That Congress did not include language to cover offerings "purported to be exempt" is further evidence of its intent to draw a distinction between those offerings that are preempted and those that are not. *See Bates,* 544 U.S. at 449 (holding that the phrase "in addition to or different from" in the Federal Insecticide, Fungicide, and Rodenticide Act did not operate to preempt state common law claims); *see also* 15 U.S.C. §§ 77r(a)(1)(A) and 77r(b)(4). Moreover, as the majority view is, at a minimum, an equally plausible interpretation of the federal law, this Court has a duty to accept the majority view because it disfavors preemption. *See Bates*, 544 U.S. at 449.

Finally, unlike the conflicting regulations at issue in *Dahl*, federal law and state law do not conflict under the exemption/preemption analysis offered by the majority view. Current and former State law concur that a security need not be registered with the Commissioner if the security, indeed, "is a federal covered security." *Compare* Minn.

Stat. § 80A.49(1) (2006) (effective 8/1/07) *with* Minn. Stat. § 80A.08 (2006) (repealed 8/1/07).[17] Consequently, State law cannot and does not conflict with federal law and, as such, preemption is inapplicable. *Dahl*, 545 N.W. 2d at 924.

2. Left uncorrected, the Court of Appeals' decision would reverse long-standing securities law and set poor public policy.

In 1920, this Court held that an issuer's representation regarding whether an offering complied with Minnesota law was not entitled to deference. *Gopher Tire*, 146 Minn. at 56, 177 N.W. at 938 ("The mere fact that the defendant has studiously declared that they are not [securities] does not require a court to hold that they are something else."). This Court noted that it "is better to determine in each instance whether a security is in fact of such a character as fairly to fall within the scope of the statute." *Id.* Moreover, this Court poignantly observed that "a hard and fast rule," such as the one created by the Court of Appeals, "would be to aid the unscrupulous in circumventing the law." *Id.* Left uncorrected, the Court of Appeals' opinion in this case would overturn each of these fundamental principles that have guided Minnesota courts and regulators over the past 87 years.

Likewise, State and federal laws are based on a policy "to protect investors by promoting full disclosure of information thought necessary to informed investment decisions." *Sec. & Exch. Comm'n v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953); *see*

[17] *See also* Minn. Stat. § 80A.31 (2006) ("Sections 80A.01 to 80A.31 shall be construed as to effectuate the general purpose to make uniform the law of those states which enact it and to coordinate the interpretation of sections 80A.01 to 80A.31 with the related federal regulations.").

also Gopher Tire, 146 Minn. at 55, 177 N.W. at 938. Consistent with the broad remedial purposes of securities regulations, issuers of securities bear the burden of proving that an exemption exists. *Ralston Purina,* 346 U.S. at 127; *Van Dyke v. Coburn Enter., Inc.*, 873 F.2d 1094, 1097 (8th Cir. 1989). According to the Court of Appeals, and notwithstanding public policy and precedent to the contrary, an issuer's burden to prove an exemption has been fully satisfied under State law with either (1) hollow language in the offering and/or (2) an affirmative defense upon commencement of a civil or regulatory action. This ruling violates public policy because it allows an unscrupulous issuer to avoid State law at will by merely declaring that its unregistered offering is somehow a "covered security."

Finally, the Court of Appeals' decision sets poor precedent because it provides no guidance on how much effort, if any, is required of an issuer to comply with federal law before State law is preempted. For example, assume that a security issuer made a public offering, but in the boilerplate of the offering claimed to comply with Rule 506, which is expressly limited to private offerings. According to the Court of Appeals, even though the public offering plainly would disqualify the Rule 506 exemption, State law would be preempted.[18] Similarly, assume that the issuer allowed more than 35 purchasers to buy the unregistered security. Despite the fact that the security loses the Rule 506 exemption by exceeding 35 purchasers, according to the Court of Appeals, State law would be

[18] *See* 17 C.F.R. § 230.508(2) (failure to comply with private offering limitation as set forth in 17 C.F.R. § 230.502(c) is not an "insignificant deviation" and will result in loss of exemption as a matter of law).

preempted.[19] Indeed, under both circumstances, the Court of Appeals would hold that State law is preempted even though the security would be ineligible for the applicable federal exemption and, thus, would violate State law unless it was registered with the Commissioner.

B. The Court of Appeals' Opinion Was Too Broad.

In a sweeping opinion, the Court of Appeals held that "an offering purporting to be exempt under Regulation D is governed exclusively by federal law . . . ." *Risdall,* 733 N.W.2d 827. This overbroad ruling is erroneous because Congress (1) preserved several areas for state regulation and (2) did not preempt all offerings under Regulation D. At a minimum, these misstatements of law should be corrected.

First, Congress specifically preserved the states' authority "to investigate and bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer in, connection with securities or securities transactions." 15 U.S.C. § 77r(c)(1). Congress also preserved the states' right to bring an enforcement action "as a result of the failure to submit any filing or fee required under law . . . ." 15 U.S.C. § 77r(c)(3). The Court of Appeals' decision failed to acknowledge the preservation of this regulatory authority with the states.

Likewise, to the extent that preemption applies, "Regulation D" is not synonymous with the definition of "covered security." *See* 15 U.S.C. § 77r(b); 17 C.F.R.

[19] *See* 17 C.F.R. § 230.508(2) (failure to comply with limitation of 35 purchasers as set forth in 17 C.F.R. § 230.506(a)(2)(i) is not an "insignificant deviation" and will result in loss of exemption as a matter of law).

§§ 230.501 - 230.506. As previously mentioned, Rule 504 and Rule 505 are distinct exemptions that are not rendered under the non-public offerings available under section 77d(2). *See* 15 U.S.C. § 77r(b)(4)(D); 17 C.F.R. § 230.506(a) (offers and sales that comply with Rule 506 are "deemed to be transactions not involving any public offerings within the meaning of [15 U.S.C. § 77(d)(2)]").[20] "The only Regulation D exemption that is covered by the federal preemption of state law registration requirements is Rule 506 -- the safe harbor for non public offerings." Thomas Hazen, *The Law of Securities Regulation*, § 4.21, p. 435 (5th ed. 2005).

C. Equitable Considerations Do Not Apply To This Case.

Respondents assert that equity should preclude Petitioners from recovering in this case. The Court of Appeals did not address the issue. Nevertheless, this Court should reject any suggestion that equity precludes recovery in this instance because Petitioners are innocent investors.

Respondents cite two cases to suggest that, notwithstanding Respondents' undeniable violations of State and federal securities regulations,[21] equitable estoppel should apply to bar Petitioners' civil recovery: *Logan v. Panuska,* 293 N.W.2d 359

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[20] "[I]t is misleading to conceive Regulation D as one integrated exemption." Thomas Hazen, *The Law of Securities Regulation*, § 4.20[1], p. 421 (5th ed. 2005). *See also id* at §§ 4.21, 4.22, and 4.24, pp. 421-44, 447-59 (5th ed. 2005 and Supp. 2007).

[21] Scienter is not an element to Respondents' violations of securities laws. *See, e.g., Sec. & Exch. Comm'n v. Marker*, 427 F.Supp.2d 583, 589 (M.D.N.C. 2006). Consequently, any claim by Respondents that they somehow "inadvertently" violated the law by offering unregistered securities over the internet, via e-mail, and by direct mail is irrelevant.

(Minn. 1980) and *McCauley v. Michael*, 256 N.W.2d 491 (1977). In *Logan*, this Court rejected rescission based on technical violations because "plaintiffs actively participated in the management and control of the corporation during their investment." *Logan*, 293 N.W.2d at 363-64. Similarly, in *McCauley,* this Court held that the purchaser could not recover because he was *in pari delicto* with the seller. *McCauley*, 256 N.W.2d at 495-96.

In this case, however, Respondents do not allege that Petitioners actively participated in management or control, or otherwise made an illegal purchase. Instead, Respondents advocate for an unprecedented rule to preclude any and all "accredited investors"[22] from recovering for violations resulting from integrated offerings. Respondents' claim should fail because Petitioners were passive investors who had nothing to do with Respondents' violations of securities regulations. *See McCauley*, 256 N.W.2d at 498 ("Where a contract for the sale of stock contravenes the securities laws, it may be enforced only by the innocent or gullible purchaser . . . ."); *Gen. Life of Mo. Inv. Co. v. Shamburger,* 546 F.2d 774, 785 (8th Cir. 1976) ("a wrongdoer cannot use his own violation of the [Securities Act] as a shield against liability when sued by an innocent party to the transaction.").

II. THE INTEGRATION DOCTRINE APPLIES TO SALES AND OFFERS.

In *dicta,* the Court of Appeals stated that even if preemption did not apply, Petitioners were still barred from recovery. To reach this conclusion, the court decided

[22] *See* 17 C.F.R. § 230.501(a).

that Respondents' multiple offerings were not subject to the integration doctrine as a matter of law.

A. Origin Of The Integration Doctrine.

After the passage of the Securities Act in 1933, issuers sought to exploit the available exemptions from the registration requirement by engaging in a sequence of offerings, such that an individual offering would qualify for an exemption, whereas the entire sequence would not qualify for any exemption when viewed as a whole. To deter such misuse, the SEC formulated the integration doctrine the same year that the Securities Act was passed.[23] Application of the integration doctrine prevents issuers from circumventing the registration requirement and ensures that investors receive adequate, accurate, and required disclosures.

The seminal authority for the modern integration doctrine is Securities Act Release No. 4552, 1962 WL 69540, at **3-4 (Nov. 6, 1962). Under that Release, five factors are relevant to the question of integration:

> [W]hether (1) the different offerings are part of a single plan of financing, (2) the offerings involve issuance of the same class of security, (3) the offerings are made at or about the same time, (4) the same type of consideration is to be received, (5) the offerings are made for the same general purpose.

Id. at *3. Courts regularly adhere to this five-factor test. *See, e.g., Sec. & Exch. Comm'n v. Cavanagh*, 445 F.3d 105, 113 n.17 (2nd Cir. 2006); *Donohoe v. Consol. Operating & Prod. Corp.*, 982 F.2d 1130, 1140 (7th Cir. 1992).

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[23] Securities Act Release No. 97, 1933 WL 28905 (Dec. 28, 1933).

B. The Court Of Appeals Rendered The Words "Offer"/"Offers" Superfluous By Focusing On "Sale"/"Sales."

While section 77d(2) was codified in 1933, Regulation D was not promulgated until 1982. At that time, Rule 502(a) substituted the word "sales" for "offerings" in the five-factor test, yet specified that "offers and sales" could be integrated:

> (a) Integration. All sales that are part of the same Regulation D offering must meet all of the terms and conditions of Regulation D. **Offers and** sales that are made more than six months before the start of a Regulation D offering or are made more than six months after completion of a Regulation D offering will not be considered part of that Regulation D offering, so long as during those six month periods there are no **offers or** sales of securities by or for the issuer that are of the same or a similar class as those **offered or** sold under Regulation D, other than those **offers or** sales of securities under an employee benefit plan as defined in rule 405 under the Act (17 CFR 230.405).
>
> Note: The term *offering* is not defined in the Act or in Regulation D. If the issuer **offers or** sells securities for which the safe harbor rule in paragraph (a) of this § 230.502 is unavailable, the determination as to whether separate sales of securities are part of the same offering (*i.e.* are considered *integrated*) depends on the particular facts and circumstances. Generally, transactions otherwise meeting the requirements of an exemption will not be integrated with simultaneous offerings being made outside the United States in compliance with Regulation S. See Release No. 33-6863.
>
> The following factors should be considered in determining whether **offers and** sales should be integrated for purposes of the exemptions under Regulation D . . . .

17 C.F.R. § 230.502(a) (italics in original, bold added). Despite the federal regulation's use of the words "offer"/"offers" in the conjunctive with "sale"/"sales" in *six* instances, the Court of Appeals held that, in the absence of corresponding sales, offers were irrelevant as a matter of law. *See Risdall*, 733 N.W.2d at 833. In reaching this conclusion, the Court of Appeals rendered superfluous all six references to

"offer"/"offers" in Rule 502(a) in a self-described effort to construe the "plain language." *Id.*[24]

In light of the repeated use of the word "offer"/"offers" in Rule 502(a), the Court of Appeals' "plain language" reading is erroneous and must be reversed by this Court. Indeed, even though this rule was promulgated in 1982, the State is not aware of any other court that refused to integrate an undisputed public offering based solely on the fact that no sales were made on that offering.

The Court of Appeals also incorrectly employed a narrow construction, when public policy demands that securities regulations be viewed expansively to protect investors from anticipated and unanticipated schemes of unscrupulous issuers. *Kerst v. Nelson*, 171 Minn. 191, 195, 213 N.W. 904, 905 (Minn. 1927) ("In view of the ingenuity of those who seek to induce men and women to put their money into far-off speculative enterprises over which the investor has little or no control, and in view of the paternalistic character of Blue Sky Laws, it should be the policy of the courts to refrain from hampering the state officials in the performance of their duties by placing a narrow construction of such laws."); *see also Gopher Tire*, 146 Minn. at 55, 177 N.W. at 938 ("It is a proper and needful exercise of police power of the state and should not be given narrow construction.")

One of the practical flaws with the Court of Appeals' analysis is that the Regulation D safe harbor is non-exclusive, which means that "an issuer's failure to

[24] *See also* Minn. Stat. § 645.16 (2006) ("Every law shall be construed, if possible, to give effect to all its provisions.").

satisfy all the terms and conditions of Rule 506 shall not raise any presumption that the exemption provided by [15 U.S.C. 77d(2)] is not available." 17 C.F.R. pt. 230 n.3 (Preliminary Notes to Regulation D). For instance, assume that an issuer engages in multiple offerings such that they do not comply with Rule 506, but are otherwise exempt under section 77d(2). In determining whether the section 77d(2) offerings should be integrated, the SEC and federal courts would rely on the SEC's seminal 1962 Release, which provided the original five-factor test using the word "offerings." *Cavanagh*, 445 F.3d at 113 n.17.

Thus, on one hand, the "offerings" five-factor test would apply to any sequence of section 77d(2) offerings that could not qualify for the Rule 506 safe-harbor. And, on the other hand, the Court of Appeals would have Minnesota courts and regulators attempt to apply the "sales" five-factor test to a sequence of Rule 506-compliant offerings. The unworkable nature of this dichotomy is exposed when evaluating mixed sequences of Rule 506 offerings and section 77d(2) offerings that do not comply with Rule 506.

The bottom line is that, when determining whether multiple offerings should be integrated, the SEC and the courts have uniformly relied on the "offerings" five-factor test and -- until *Risdall* -- have not attributed any significance to the language variation. The State submits that the Court of Appeals is out of sync with federal authorities, and that the Court of Appeals' ruling on the integration issue should be reversed.

CONCLUSION

Amicus Curiae State of Minnesota respectfully requests that this Court reverse the Court of Appeals on both issues. Specifically, this Court should adopt the majority view on federal securities preemption, which holds that federal exemption and preemption are contemporaneous. Further, this Court should reverse the Court of Appeals' ruling that requires "sales" before multiple offerings of the same security may be integrated.

Dated: 10-25-07

Respectfully submitted,

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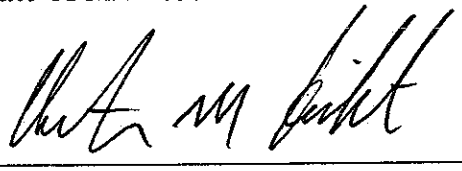

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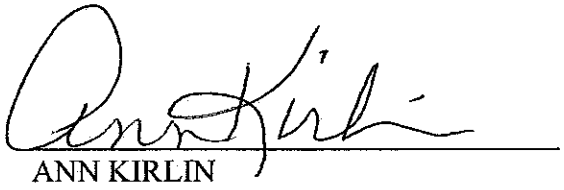
CERTIFICATE OF COMPLIANCE

WITH MINN. R. APP. P 132.01, Subd. 3

The undersigned certifies that the Brief submitted herein contains 6,195 words and complies with the type/volume limitations of the Minnesota Rules of Appellate Procedure 132. This Brief was prepared using a proportional spaced font size of 13 pt. The word count is stated in reliance on Microsoft Word 2003, the word processing system used to prepare this Brief.



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