MINNESOTA STATE LAW LIBRARY

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,

v.

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

Respondents.

BRIEF AND APPENDIX OF RESPONDENTS CHRISTOPHER C. BROWN AND FUNERAL.COM, INC.

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2).

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STATEMENT OF THE ISSUES

I. WERE THE PURCHASERS OF STOCK ENTITLED, AS A MATTER OF LAW, TO THE EQUITABLE REMEDY OF RESCISSION UNDER MINNESOTA LAW WHERE THE SECURITIES WERE PURCHASED IN AN OFFERING MADE PURSUANT TO RULE 506 OF REGULATION D, 17 C.F.R. § 230.506, UNDER THE FEDERAL SECURITIES LAW?

The Court of Appeals held in the negative, reversing the district court.

Lillard v. Stockton, 267 F. Supp. 2d 1081 (N.D. Okla. 2003).

Pinnacle Communications Int'l, Inc. v. Am. Family Mortgage Corp., 417 F. Supp. 2d 1073 (D. Minn. 2006).

Temple v. Gorman, 201 F. Supp. 2d 1238 (S.D. Fla. 2002).

17 C.F.R. § 230.506.

II. EVEN IF THE PURCHASERS' CLAIMS UNDER MINN. STAT. CH. 80A ARE HELD TO NOT BE PREEMPTED BY FEDERAL LAW, ARE THEIR PURCHASES NONETHELESS EXEMPT UNDER MINN. STAT. § 80A.15, SUBD. 2(h) FROM REGISTRATION UNDER MINN. STAT. § 80A.08?

The Court of Appeals held in the affirmative, reversing the district court.

17 C.F.R. § 230.502(a).

Logan v. Panuska, 293 N.W.2d 359 (Minn. 1980).

McNeice v. City of Minneapolis, 250 Minn. 142, 84 N.W.2d 232 (1957).

STATEMENT OF THE CASE AND FACTS

The Court of Appeals decision reversed the district court's grant of summary judgment in favor of Appellants/Plaintiffs Charles Risdall, Len Dozier, and John Risdall, in his capacity as personal representative of the Estate of Mary Risdall.[1] (Risdall Appendix [A.A.] 1.) Plaintiffs challenge that ruling and the State of Minnesota has filed a brief of Amicus Curie.[2] (A.A. 14.)

Unfortunately, Plaintiffs have replaced actual facts with a series of conclusory legal arguments in their "Statement of Facts." For example, Plaintiffs assert that "[t]his case arises out of Defendants' illegal sale of $220,000 worth of unregistered securities to Plaintiffs." (Plaintiffs' Brief, p. 5.) This legal conclusion stated as fact is simply not true by Plaintiffs' own admission. (Plaintiffs' Brief, p. 21.) Plaintiffs' "Statement of Facts" is designed to obfuscate the undeniable fact that Plaintiffs purchased their shares in an offering that, in fact fully complied with Rule 506 of Regulation D.

Contrary to the Plaintiffs' assertion, on review, this Court must view the facts in the light most favorable to Defendants, because Plaintiffs seek to have the district court's grant of summary judgment in their favor reinstated by this Court. (Plaintiffs' Brief, p. 9

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[1] When referred to jointly, Appellants will be referenced as Plaintiffs and Respondents will be referenced as Defendants. When referred to separately, Plaintiff Leonard B. Dozier will be referenced as Plaintiff Dozier, Plaintiff Charles Risdall as Plaintiff C. Risdall, and Plaintiff John Risdall as personal representative of Estate of Mary Risdall as Plaintiff M. Risdall.

[2] The State of Minnesota will be referenced as Amicus.

n. 4.) As such, their argument that this Court must evaluate the facts most favorable to them is without merit. The material facts are as follows.

A. March 2000 Confidential Private Placement Offering Memorandum (PPM1) Was Provided to Plaintiffs.

Defendant funeral.com (funeral.com) was incorporated in the fall of 1999. Defendant Christopher C. Brown (Brown) is its chief executive officer. (A.A. 120, 124.) Funeral.com is principally engaged in the development and marketing of an internet website where those with funeral needs can find information and alternatives. (A.A. 79.)

1. The terms of PPM1.

On March 2, 2000, funeral.com issued a Confidential Private Placement Offering Memorandum (PPM1) for the sale of funeral.com common stock. (A.A. 76.) In PPM1, funeral.com's stock was offered at a price of $6.00 per share and required a minimum investment of $50,000. (*Id.*) The prospective investor was informed that an investment in the offered shares would "involve a high degree of risk and immediate substantial dilution, and should be purchased only if you can afford to lose your entire investment." (*Id.*) The offeree was informed that if the minimum number of shares were sold,

> we intend to use $375,000 of the proceeds to repay a promissory note held by Christopher C. Brown, evidencing costs and expenses incurred by Mr. Brown for the development of the site design, maintenance of the site and associated costs over the past four years.

(A.A. 80.) The proceeds of PPM1 were also to be used to "[i]ncrease marketing and promotional expenses, web-site development, purchase equipment, salaries and general working capital." (*Id.*)

The shares offered were not registered under the 1933 Securities Act or any state securities or "blue sky" laws. The shares were being offered pursuant to an exemption from registration – Regulation D.

> Such exemptions from registration provide that we may sell the Shares offered hereby only to investors who are "accredited investors" as such term is defined in Rule 501(a) of Regulation D promulgated under the 1933 Act. . . . The shares offered hereby are highly speculative, involve a high degree of risk and are not liquid.

(A.A. 100.)

Funeral.com also informed the offeree that in addition to the proceeds raised by PPM1, "[w]e will likely need to raise additional capital immediately in order to fund our expansion . . . . The timing and amount of our future capital needs will depend on a number of factors, including the amount of proceeds received in this offering . . . ." (A.A. 85.)

2. Plaintiffs purchased $220,000 worth of stock.

Ted Risdall served on funeral.com's Board of Directors from January 2000 to February 2001. (A.A. 92, 128.) Plaintiff C. Risdall is Ted Risdall's uncle and Plaintiff M. Risdall is his grandmother. (Brown Appendix [R.A.] 43-44.) Plaintiff Dozier is a friend of Ted Risdall. (R.A. 42.) In 2000, Ted Risdall was excited about funeral.com and thought it was a good business opportunity. (R.A. 40.) Ted Risdall facilitated Plaintiffs' investment. All Plaintiffs received a copy of PPM1 before making their investment. (R.A. 45, 48.)

On March 13, 2000, Plaintiff Dozier signed two subscription agreements to purchase 25,000 shares of funeral.com for $100,000. (R.A. 1, 7.) On that same day, Plaintiff C. Risdall signed two subscription agreements to purchase 20,000 shares of funeral.com for $70,000. (R.A. 12, 19.) And on April 28, 2000, Plaintiff M. Risdall signed two subscription agreements to purchase 16,677 shares of funeral.com for $50,000. (R.A. 25, 31.)

The initial private placement memorandum raised a total of $760,006. (A.A. 124.) Of the $760,006 raised, $220,000 was as a result of Plaintiffs' purchase of stock. (*Id.*)

3. Plaintiffs acknowledge that shares were offered under PPM1 pursuant to an exemption from registration.

In their executed subscription agreements Plaintiffs acknowledged receipt of PPM1. (R.A. 1, 7, 12, 19, 25, 31.) All acknowledged they were accredited investors. (R.A. 9, 15, 27.) Plaintiffs represented to funeral.com as follows:

- I have been advised that the Shares have not been registered under the Securities Act of 1933, as amended (the "1933 Act"), or under applicable state securities laws (the "State Laws"), and are offered pursuant to exemptions from registration under the 1933 Act and the State Laws.

- I have been given access to full and complete information regarding the Company (including the opportunity to meet with Company officers and review all the documents described in the Memorandum and such other documents as I may have requested in writing) and have utilized such access to my satisfaction for the purpose of obtaining information in addition to, or verifying information included in, the Memorandum.

- I understand that investment in the Shares is highly speculative and involves a high degree of risk. . . . I can bear

> the economic risk of an investment in the Shares for an indefinite period of time and can afford a complete loss of such investment.

(R.A. 1-2, 7-8, 13-14, 25-26, 31-32.)

4. Defendants believed at the time of PPM1 there would be only one stock offering.

At the time of PPM1, Defendants believed PPM1 was the only stock offering they would need. (A.A. 121.) There was no intent by Defendants to avoid the securities laws governing registration by splitting a single plan of financing into several different offers. (A.A. 120.)

Subsequent stock offerings were necessitated based on the different needs of funeral.com at the time the decisions to make offerings were made. (*Id.*) In May 2000, funeral.com was told that Corio, a major website developer, needed millions of dollars to develop the funeral.com site. (A.A. 121.) This need made a second stock offering necessary. (*Id.*)

B. No Sales Were Made Under the May 2000 Confidential Private Placement Offering Memorandum (PPM2).

On May 17, 2000, a private placement memorandum (PPM2) for a second offering was issued by funeral.com. In this offering, the share price was $3.00 per share with a minimum investment of $10,000. (A.A. 108.) Unlike PPM1, the shares were being offered on a "best efforts" basis and there was no minimum amount which must be sold before funeral.com may accept subscriptions and begin using the proceeds received from the investors. (*Id.*) In PPM2, the potential investor was informed the intended use of the

proceeds included funding marketing and promotional activities, to further develop and maintain the website, to purchase necessary computer and office equipment and for general working capital. (A.A. 109.) Funeral.com also stated that its "actual uses and allocations of the proceeds may vary . . . ." (*Id.*)

In May 2000, funeral.com posted the private placement memorandum on the vfinance.com website. (A.A. 125.) At about the same time, mailings of the May 17, 2000 private placement memorandum were sent to funeral directors by funeral.com. (*Id.*)

To be exempt from the registration requirement of the Securities Act under Regulation D, there can be no public advertising or general solicitation of the offering. 17 C.F.R. § 230.502(c). Plaintiffs state as fact that PPM2 remained available on the website when PPM3 was issued on July 20, 2000. (Plaintiffs' Brief, p. 7.) In fact, as stated above, PPM2 was issued on May 17, 2000. (A.A. 107.) According to Plaintiffs' own submitted Affidavit from Ted Risdall, on May 31, 2000 when he first learned of the web posting, he personally called the webmaster and directed him to remove the offending material from the website immediately. (A.A. 129.) He explained to Brown and the other directors of funeral.com that such solicitation was not permissible. (*Id.*) It is undisputed that the May 17, 2000 PPM2 was withdrawn and abandoned and no sales were made under PPM2. (A.A. 121.) PPM3 was not issued until July 20, 2000. (A.A. 115.)

C. A Preferred Offering and July 20, 2000 Private Placement Offering Memorandum (PPM3) Resulted in Sales.

Subsequently, a Series A Preferred Stock offering as well as a July 20, 2000 common stock offering (PPM3) were made. (A.A. 115-118.) The stock was offered at

$1.50 a share. The minimum investment was $9,000. (A.A. 116.) Under PPM3, funeral.com informed potential investors it may use up to $688,000 to fund the redemption of the outstanding Preferred Stock if $2 million was raised. (A.A. 117.)

D. The SEC Made Inquiry, But Took No Action Against Defendants.

On August 3, 2000, the Securities and Exchange Commission (SEC) made inquiry into funeral.com's possible violation of the no-solicitation rule with regard to PPM2. (A.A. 110.) The SEC letter specifically stated:

> This letter should not be construed as an indication by the Commission or its staff that any violation of law has occurred, or as a reflection upon any person, entity or security.

(A.A. 111.)

On August 10, 2000, funeral.com's board of directors was informed of the SEC inquiry. It was explained this possible violation was done inadvertently, corrected immediately, and no securities were sold as a result. (A.A. 112.)

A formal response was offered to the SEC by funeral.com's counsel, Winthrop & Weinstein, on August 14, 2000. (A.A. 113.) The SEC was informed that all references to the private placement had been removed from websites. No subscriptions would be accepted from anyone who requested a PPM through the websites. Funeral.com informed the SEC that "the Company will make every effort to ensure that its offering efforts remain limited and focused and that investors are not sought or identified through any form of general solicitation." (A.A. 114.) The SEC was invited to call counsel if it had "any additional questions or concerns" regarding funeral.com's activities. (A.A. 114.)

The SEC has taken no action against Defendants based on their inadvertent possible violation of the no solicitation rule with regard to PPM2 and the SEC has not asserted that PPM1 and PPM2 should be treated as a single transaction under the doctrine of integration. (A.A. 126.)

STATEMENT OF THE CASE

A. Plaintiffs' Complaint Made No Allegation of Integration.

Almost three years later, in March 2003, Plaintiffs brought this action against Defendant Brown-Wilbert, Inc., Brown and funeral.com. (A.A. 48.) Plaintiffs asserted causes of action premised on their purchase of stock in March/April 2000, asserting claims of consumer fraud, negligence, fraud, securities fraud, unjust enrichment and rescission. (*Id.*)

Plaintiffs asserted that Defendants made false statements in connection with the sale to them of securities and, had they known the truth, Plaintiffs would not have invested in funeral.com. (A. 54.) Plaintiffs realleged the same factual premise for all of their claims. (A.A. 54-56.)

Based on the assertions of Plaintiffs, various third-party claims were also asserted.[3] (A.A. 31-32, 92.)

[3] The third-party claims are no longer relevant to this lawsuit. This action is solely between Plaintiffs and funeral.com and Brown.

B. The Parties' Brought Motions for Summary Judgment.

1. Plaintiffs' motion for summary judgment.

In March 2004, Plaintiffs sought summary judgment on two grounds. (A.A. 67.) Plaintiffs asserted that Defendants engaged in the sale of unregistered securities in violation of Minnesota's securities laws. Plaintiffs acknowledge they purchased their shares in the PPM1 offering and that the PPM1 offering was made pursuant to Rule 506 of Regulation D. Even though their sales were made pursuant to PPM1, Plaintiffs assert PPM2 retroactively removes the exemption for PPM1. Plaintiffs' claim, which was not made in their Complaint, is that PPM1 and PPM2 were "integrated" and, therefore, both should be deemed to be part of the same offering. Plaintiffs argue the violation resulting from Defendants' posting of its PPM2 on the internet removed any protections available to Defendants under the federal securities laws for PPM1. (Plaintiffs' March 3, 2004 Memorandum in Support of Summary Judgment, pp. 7-10.)

This integration theory is not alleged in Plaintiffs' Complaint. (A.A. 48.) Plaintiffs' Complaint makes no mention of PPM2 or the doctrine of integration. Nor does the Complaint allege that Defendants failed to comply with Rule 506 of Regulation D. (*Id.*) There is nothing in Plaintiffs' Complaint that remotely resembles this theory on which Plaintiffs sought summary judgment.

Plaintiffs' alternative ground for summary judgment rested on Plaintiffs' contention that Defendants made false statements and omissions in connection with the

sale of securities. (Plaintiffs' March 3, 2004 Memorandum in Support of Summary Judgment, pp. 10-11.) This theory was alleged in Plaintiffs' Complaint. (A.A. 48.)

Plaintiffs contended as a result of the violation of the Securities Act, under either theory, they were entitled to rescission of their purchase of funeral.com, inc. stock. (Plaintiffs' March 3, 2004 Memorandum in Support of Summary Judgment, p. 13.)

2. Defendants' response and motion for summary judgment.

In response, Defendants asserted that Defendants, not Plaintiffs, were entitled to judgment. There is no dispute the Plaintiffs purchased their shares in funeral.com pursuant to PPM1 and Rule 506 of Regulation D. The sales were exempt from registration when they were made. Plaintiffs' claims were barred because federal law preempts the application of Minn. Stat. § 80A.08 to this case. (A.A. 70.)

Even if state law applies, the sale of stock to Plaintiffs is exempt from Minn. Stat. § 80A.08 under Minnesota law. (A.A. 72.) Because the sales were exempt under Rule 506 of the federal securities laws, the stock sold to Plaintiffs need not be registered under Minnesota law. The offering pursuant to PPM2 was, for all intents and purposes, a nullity. No sales of the securities offered under PPM2 were ever sold and Plaintiffs have not established a securities violation by the Defendants. Moreover, because no sales were made, there could be no integration. Therefore, the second offering had no impact on the exemption used in the first offering and the exemption remains intact.

Even if it is determined that the two offerings may be integrated regardless of whether any sales were made, the application of the factors set forth in the integration rule

would not result in integration of the offerings. (Memorandum of Law in Support of Defendants' Motion for Summary Judgment, pp. 6-7.) Defendants also asserted, in a separate memorandum, that Plaintiffs are not entitled to summary judgment. (Memorandum of Law in Opposition to Plaintiffs' and Dozier and Risdalls' Motions for Summary Judgment, dated June 16, 2005.) Defendants further contended equity did not support Plaintiffs' rescission claim. (T. 6/28/05 at p. 33.)

3. Plaintiffs made admissions in reply.

In reply, Plaintiffs acknowledged they had "purchased their shares in an offering made pursuant to Rule 506 of Regulation D promulgated under the federal securities laws" and "a second and different PPM was issued on May 17, 2000." (Plaintiffs' Memorandum of Law in Opposition to Defendants' Motion for Summary Judgment, p. 3, R.A. 50.) They also have admitted no sales of securities were made to any persons who were solicited via email or websites. (*Id.* at p. 4, R.A. 51.)

C. Trial Court Grants Plaintiffs Summary Judgment.

1. Order of September 7, 2005.

By Order dated September 7, 2005, the trial court, the Honorable Steven D. Wheeler, granted Plaintiffs' motion for summary judgment against Brown and funeral.com and granted Plaintiffs the equitable remedy of rescission. (A.A. 17.) Defendants were ordered to pay $100,000 to Dozier, $70,000 to C. Risdall, and $50,000 to M. Risdall. (A.A. 19.) Interest, attorney's fees and costs and disbursements in an amount to be determined were also awarded. (*Id.*)

The trial court held its decision hinged on whether PPM1 and PPM2 were integrated so that they should be deemed to be part of the same offering. (A.A. 21.) The trial court found "Plaintiff's position is more persuasive." (A.A. 26.) The trial court concluded the sales in March and the attempted sales in May are part of a common plan to raise funds to start up funeral.com and are deemed integrated as part of the same offering. (*Id.*) The trial court held it would not "take refuge in that no sales were made" with the second offering. The trial court stated: "The prohibited conduct occurred regardless and the Court notes that the Defendants did not withdraw the offer until it was advised by the SEC that its tactics were improper." (A.A. 27.)

As a result of its finding the sales were integrated, the trial court concluded Minnesota law was not preempted. The trial court explained:

> The Defendant did not comply with federal requirements because, after the Court determined the sales were integrated, they failed to comply with Regulation D. Although the Defendant believed he was selling the shares on purported reliance of Regulation D, there was no actual compliance and as a result, the federal protections are not available.

(*Id.*) The trial court concluded:

> The court finds that the Defendants unambiguously violated federal requirements and finds there are no issues of material fact with regarding [sic] the violation.

(A.A. 28.)

As to Plaintiffs' alternative argument that Defendants committed fraud, the trial court concluded this issue was not ripe for summary judgment. (A.A. 28-31.)

The trial court also granted summary judgment as to the third-party complaints, except it held it was without sufficient information to resolve Third-Party Defendant Ted Risdall's motion for summary judgment as to Brown-Wilbert's third-party complaint against him. (*Id.*)

2. Orders of December 12, 2005.

By Order dated December 12, 2005, the trial court denied Plaintiffs' motion for summary judgment against Brown-Wilbert and granted that of Third-Party Defendant as to Brown-Wilbert's third-party complaint. (A.A. 38.) In another Order dated December 12, 2005, Defendants were ordered, pursuant to the court's rescission order, to reimburse Plaintiffs for their attorney's fees and costs in the amount of $79,984.17, plus statutory costs and interest in the amount of $47,866.67 and entered judgment. (A.A. 33-37.)

In February 2006, the trial court recognized that the Orders of September 7, 2005 and December 12, 2005 were not dispositive and the docketed judgment was ordered vacated. (R.A. 52.)

3. Order for entry of final judgment and entry of final judgment.

Subsequently, in May 2006, the trial court was advised that Plaintiffs wished to dismiss all remaining claims against Defendants with prejudice (which included their claims of fraud) and were requesting entry of final judgment. (A.A. 46.) The trial court so ordered. (*Id.*) Final judgment was entered on May 31, 2006 in the amount of $349,586.73. (A.A. 16.)

D. The Court of Appeals Reverses the Grant of Summary Judgment to Plaintiffs.

On July 3, 2007, the Court of Appeals reversed the district court's grant of summary judgment and remanded for entry of judgment in favor of Defendants. (A.A. 1.) The Court of Appeals' decision rests on two separate and independent grounds.

First, because federal courts are uniquely qualified to address issues of federal law, such as the availability of a Regulation D exemption, 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. (A.A. 9.)

Second, even if the court were to conclude there is no such preemption, the Court of Appeals would reverse the district court's grant of summary judgment because funeral.com complied with Regulation D in its sale of securities to Plaintiffs. (A.A. 10.) The Court of Appeals recognized that Plaintiffs' whole case is premised on a technical objection which has nothing to do with their investment and nothing to do with the doctrine of integration. The Court of Appeals correctly determined there could be no integration because PPM2 was a nullity as it was voluntarily withdrawn before any sales were made. As the Court of Appeals succinctly explained, "And even if [Plaintiffs'] claims under Minn. Stat. ch. 80A were not preempted by federal law, because we have determined that PPM1 and PPM2 should not be integrated, we also conclude that PPM1 was exempt under Minn. Stat. § 80A.15, subd. 2(h), from the registration requirement of Minn. Stat. § 80A.08." (A.A. 12.)

The Court of Appeals' ruling did not address Defendants' additional alternative grounds for reversal. Defendants asserted that applying the five-factor integration test to the facts of record, Plaintiffs were not entitled to summary judgment. (Defendants' Court of Appeals Brief, pp. 29-39.) The Court also did not address that rescission would not be appropriate even if the offerings are integrated. (*Id.* at pp. 39-41.)[4]

ARGUMENT

I. FEDERAL LAW PREEMPTS STATE LAW REQUIRING THE REGISTRATION OF A "COVERED SECURITY" PURPORTING TO BE EXEMPT FROM STATE REGISTRATION UNDER REGULATION D.

A. Standard of Review.

This case comes before the Court on a review of a reversal by the Court of Appeals of a grant of summary judgment in favor of Plaintiffs. On appeal from summary judgment, the Court makes two determinations: (1) whether there are any genuine issues of material fact; and (2) whether the district court erred in its application of the law. *N. States Power Co. v. Minn. Metro. Council*, 684 N.W.2d 485, 491 (Minn. 2004). Contrary to Plaintiffs' assertion, in reviewing the grant of summary judgment, this Court must view the evidence in the light most favorable to the Defendants, the parties against whom judgment was granted. *Fabio v. Bellomo*, 504 N.W.2d 758, 761 (Minn. 1993).

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[4] If this Court should reverse the Court of Appeals on both grounds, this Court must either address the other grounds asserted by Defendants for reversal or remand to the Court of Appeals. Plaintiffs, on pages 23-28 of their brief, argue the five integration factors, but do not do so by viewing the facts most favorable to Defendants. They also do not inform this Court that the Court of Appeals declined to address these factors given its rulings. Likewise, the Court of Appeals did not address whether an equity rescission could be granted here.

Interpretation of a statute is a question of law over which this Court has de novo review. *Brookfield Trade Ctr., Inc. v. County of Ramsey*, 584 N.W.2d 390, 393 (Minn. 1998). Federal preemption of state law is also a question of law which this Court reviews de novo. *Martin ex rel. Hoff v. City of Rochester*, 642 N.W.2d 1, 9 (Minn. 2002).

B. Federal Law Preempts Plaintiffs' State Law Claim.

The National Securities Markets Improvements Act (NSMIA), 15 U.S.C. § 77r, expressly preempts from state registration "covered securities." Shares issued pursuant to the exemption stated in Rule 506 of the SEC's Regulation D, 17 C.F.R. § 230.506 come within the preemption provision. The Court of Appeals rightly concluded:

> 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.

(A.A. 9.)

Contrary to Plaintiffs' and Amicus' arguments, the Court of Appeals fully understood the conflicting lines of authority on the issue of preemption. (*Id.*) The Court of Appeals correctly considered the facts of this case and determined the facts before it amply illustrated the need for preemption.[5] If there is no preemption, any issuer of a

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[5] Plaintiffs' suggestion that "[a]ctual preemption analysis is not even necessary, since Defendants did not satisfy the threshold issue of exemption eligibility." (Plaintiffs' Brief, p. 43.) Plaintiffs' and Amicus' argument is based upon their improper conclusion of law offered as fact that PPM1 and PPM 2 are integrated in spite of the fact that the Court of Appeals specifically found that they are not integrated. This error of fact is repeated throughout Plaintiffs' and Amicus' Briefs as though repeating it will make it so.

national securities offering, knowing that despite NSMIA it could be subject to liability under state unregistered securities laws for any alleged violation of the myriad of technicalities of Regulation D, would be well advised to ignore NSMIA. Issuers will then do precisely that which Congress sought to avoid with the NSMIA preemption – file duplicate, costly and redundant registrations in every state in which its securities might be offered or sold, thereby placing an undue and unnecessary burden on capital formation and markets.

Plaintiffs and Amicus argue that if the Court of Appeals ruling is allowed to stand it will result in general public solicitation in violation of Regulation D. Amicus further argues that the citizens of the State of Minnesota "may be more easily duped, the State will be stymied in its efforts to regulate, and unscrupulous issuers will have a road map to manipulate laws designed to protect the public." (Amicus Brief, p. 3.) Amicus' and Plaintiffs' arguments miss the point and ignore the very fact that federal law still applies, and that the State of Minnesota's Blue Sky Law will still exist as a deterrent to fraudulent activity.

In this case, the SEC made inquiry and Defendants responded. No enforcement action was issued. There is no reason to believe that the SEC will not continue to make inquiry and take enforcement action when warranted. Nothing that was done in the decision of the Court of Appeals has taken away from the power of the state to deal with fraudulent activity by an issuer of unregistered securities. The sky will not fall upon innocent Minnesotans if the decision of the Court of Appeals is affirmed.

A review of the relevant federal securities laws underscores Defendants' position that the Court of Appeals was correct and its decision must be affirmed.

1. The Federal securities scheme is one of preemption.

The Securities Act of 1933, 15 U.S.C. § 77a, *et seq.*, and the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a, *et seq.*, are the statutory schemes which regulate the purchase and sale of securities in the United States. The Securities Act and the Exchange Act were enacted in the early years of the Great Depression and arose under the economic woes then being faced by the nation. The architects of the Securities Act and the Exchange Act had two basic objectives: require companies to provide investors with the necessary financial and factual information to permit the investors to make informed investment decisions; and prohibit the fraudulent sale of securities. Frank A. Taylor, *The Issuance of Securities by Small and Growing Business: A Primer*, 22 Wm. Mitchell L. Rev. 1375, 1379-85 (1996); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 858 (2nd Cir. 1968).

The Securities Act of 1933, 15 U.S.C. §§ 77a-77aa, generally requires the filing of a registration statement with the Securities and Exchange Commission (the SEC) prior to the offer or sale of any security and prohibits the sale of any security prior to the effective date of the registration statement. 15 U.S.C. § 77e. To prevent the hampering of commerce that results from unnecessary registration, the 1933 Act provides a variety of exemptions from registration that relieve issuers of the cost and delay of registration. 15 U.S.C. § 77g; 15 U.S.C. § 77c(a); 15 U.S.C. § 77c(b); 15 U.S.C. § 77d(1); 15 U.S.C.

§ 77d(2). These exemptions from registration embody the policy of the 1933 Act to facilitate commerce. *See Ruefenacht v. O'Halloran*, 737 F.2d 320, 334 (3rd Cir. 1984) (commenting that in enacting the 1933 Act, which provides exemptions for certain transactions, "Congress acted with a number of rationales in mind, among them the facilitation of commerce in certain named instruments to reduce transaction costs and enhance the free flow of capital.").

Regulation D contains rules promulgated by the SEC to provide certain guidance and safe harbors for transactions exempted from the registration requirements of Section 5 of the Securities Act. 17 C.F.R. §§ 230.501-.508. Regulation D was "designed to simplify and clarify existing exemptions, to expand their availability, and to achieve uniformity between federal and state exemptions . . . ." Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales, Exchange Act Release No. 33,6389, 47 F.R. 11251-01 (March 16, 1982).

The exemptions within Regulation D combine the elements of the qualified exemptions under Section 3(b) for small issues, 15 U.S.C. § 77c(b), the exemption under Section 4(6) for offerings to "accredited investors," 15 U.S.C. § 77d(6), and the exemption provided by Section 4(2) for issuer transactions that are considered private placements. 15 U.S.C. § 77d(2). The exemptions provided by Regulation D are found within Rules 504 through 506. *See* 17 C.F.R. §§ 230.504-506. Issuers relying upon the private placement exemption of Regulation D can only offer their securities to a limited number of potential investors who are deemed to have investment sophistication and

access to information concerning the issuer and its offering. *Id.* When an issuer relies upon an exemption provided by Rule 505 or 506, Rule 502 prohibits the offer or sale of securities through a general solicitation or advertising. 17 C.F.R. § 230.502(c).

Due to their business acumen and access to information, the offerees of a private placement are deemed not to need the protection that registration affords. *See* 17 C.F.R. § 230.506. Offerees of a securities transaction that is exempt pursuant to Regulation D nevertheless receive a private placement memorandum disclosing information pertaining to the issuer and its offering. *See* SEC Rule 502, 17 C.F.R. § 230.502; SEC Rule 506, 17 C.F.R. § 230.506. Since less information is required in the private placement memorandum than in the documents of a registered offering, preparation of the private placement offering materials saves time and money for issuers relying on the exemption.

A private placement memorandum, however, still contains a significant amount of data. *See* SEC Rule 502, 17 C.F.R. § 230.502 (setting forth the information that must be provided in a private placement memorandum). Private placement offerees are substantively protected from fraudulent offerings by the disclosure contained in the private placement memorandum and by their access to information about the offering and the issuer. Under SEC Rule 502, the issuer must give purchasers of securities offered under Rule 506 "the opportunity to ask questions and receive answers concerning the terms and conditions of the offering." SEC Rule 502(b)(2)(v), 17 C.F.R. § 230.502.

There is no dispute that the Plaintiffs purchased their shares in an offering made pursuant to Rule 506 of Regulation D promulgated under the federal securities laws.

(R.A. 50.) Simply put, Defendants did not purportedly sell securities (PPM1) to Plaintiffs pursuant to Rule 506 of Regulation D – Defendants *did* sell securities (PPM1) to Plaintiffs pursuant to Rule 506 of Regulation D.

2. The plain language of NSMIA preempts plaintiffs' state law claim.

The National Securities Markets Improvements Act of 1996 (NSMIA), 15 U.S.C. § 77r, NSMIA amended Section 18(a) of the 1933 Act expressly to preempt any state Blue Sky laws requiring redundant state registration and qualification of any nationally offered and traded securities, defined by NSMIA as "covered securities." Section 18(a)(1)(A) of the 1933 Act – the NSMIA express preemption provision – specifically prohibits any state from requiring any federal "covered security" to be registered in the state:

> (a) Except as otherwise provided in this section, no law, rule, regulation, or order, or other administrative action of any state or any political subdivision thereof –
>
> (1) requiring, or with respect to, registration or qualification of securities, or registration or qualification of securities transactions, shall directly or indirectly apply to a security that –
>
> (A)is a covered security; . . . .

This preemption provision advances the primary purpose of NSMIA, to eradicate the prior system of "dual registration" under both the 1933 Act as well as state blue sky laws for nationally traded securities:

> By 1996, Congress recognized the redundancy and inefficiencies inherent in such a system and passed NSMIA to preclude states from requiring issuers to register or qualify certain securities with state authorities . . .
>
> . . .
>
> When considered in concert, SLUSA, NSMIA and PSLRA demonstrate that Congress intended to provide national, uniform standards for the securities markets and nationally marketed securities. Through these statutes, Congress erected uniform standards for registration of, and litigation concerning, a defined class of securities.

Lander v. Hartford Life & Annuity Ins. Co., 251 F.3d 101, 108-11 (2d Cir. 2001); *Lillard v. Stockton*, 267 F. Supp. 2d 1081, 1115 (N.D. Okla. 2003) ("The NSMIA drafters intended the Act to eliminate the costs and burdens of duplicative and unnecessary regulation by designating the federal government as exclusive regulator of national offerings of securities."); *Temple v. Gorman*, 201 F. Supp. 2d 1238, 1244 (S.D. Fla. 2002) ("Congress expressed its intent in NSMIA that federal regulations alone should govern the registration of national securities offerings.").

Federal district courts have therefore dismissed a plaintiff's state law unregistered securities claims, since a state's registration requirement for "covered securities" is preempted by NSMIA and unenforceable, even when a plaintiff alleges that the defendant's Rule 506 offering was defective and did not qualify for exemption.[6] *Temple*, 201 F. Supp. 2d at 1243-44; *Lillard*, 267 F. Supp. 2d at 1115; *Pinnacle Communications Int'l, Inc. v. Am. Family Mortgage Corp.*, 417 F. Supp. 2d 1073, 1087 (D. Minn. 2006).

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[6] However, the states continue to have the authority to regulate and punish fraudulent activity by issuers.

3. Plaintiffs' claims are preempted pursuant to NSMIA.

There is no dispute that the Plaintiffs purchased their shares in an offering made pursuant to Rule 506 of Regulation D. The sales to Plaintiffs were exempt from registration when made. PPM1 delivered to Plaintiffs clearly states that the sales to Plaintiffs were being made in reliance on the exemptions provided in Regulation D. (A.A. 85, 99, 100.) The subscription agreements signed by Plaintiffs established their status as accredited investors, and the Plaintiffs acknowledged therein that the shares being acquired by them had not been registered and were being offered pursuant to exemptions from registration under the 1933 Act. (R.A. 1, 7, 12, 19, 25, 31.) In this litigation, Plaintiffs acknowledge that it is undisputed that "Plaintiffs purchased their shares in an offering *made pursuant to* Rule 506 of Regulation D promulgated under the federal securities laws." (Plaintiffs' Memorandum of Law in Opposition to Defendants' Motion for Summary Judgment – Statement of Undisputed Facts, p. 3) (R.A. 50) (emphasis in original).

4. Relevant case law supports preemption.

It is Defendants' position that when an offering when made is exempt under federal Regulation D, any allegation of improper *registration* is covered exclusively by federal law. Any claim for failure to properly *register* under state law or for rescission under state law is preempted. This is exactly what the Court of Appeals held when it adopted the decision of the Minnesota federal district court holding in *Pinnacle Communications Int'l, Inc.*, 417 F. Supp. 2d at 1087.

In *Pinnacle*, the federal district court held that when a private placement of securities purports to be exempt under Rule 506, it does not matter whether the private placement actually complied with Regulation D exemptions. Any claim to a remedy under state law is preempted. *Id.* at 1087. *See also Temple*, 201 F. Supp. 2d at 1238; *Lillard*, 267 F. Supp. 2d at 1116. However, federal law remains to enforce strict compliance with registration requirements.

In *Temple*, the Florida district court reviewed the legislative history of NSMIA and determined Congress intended to preempt state law whenever securities are "offered or sold pursuant to Commission rule or regulation adopted under such section 4(2)." 201 F. Supp. 2d at 1243. When passing NSMIA, Congress stated its purpose, "to further and advance the development of national securities markets and eliminate the costs and burdens of duplicative and unnecessary regulation by, as a general rule, designating the federal government as the exclusive regulator of national offerings of securities." H.R. Rep. No. 104-622 at 16 (1996), reprinted in 1996 U.S.S.C.A.N. 3877, 3878, quoted in *Temple*, 201 F. Supp. 2d at 1243. The district court then explained why plaintiff's Florida state securities claim was preempted:

> Here, plaintiffs have alleged that defendants' private placement of securities "purported to be exempt from registration pursuant to Rule 506 of Regulation D promulgated by the SEC." Construing this allegation in plaintiffs' failure, the Court finds that the securities in this case were "offered or sold pursuant to Commission rule or regulation adopted under Section 4(2)." Regardless of whether the private placement actually complied with the substantive requirements of Regulation D or Rule 506,

> the securities sold to plaintiffs are federal "covered securities" because they were sold pursuant to those rules.

Id. at 1243-44.

Here, as Plaintiffs themselves have admitted, the securities sold to Plaintiffs are federal covered securities because they were sold pursuant to Rule 506 of Regulation D.[7] (R.A. 50.) The Court of Appeals properly decided that Plaintiffs' state law claim is preempted and Plaintiffs cannot seek or obtain redress under Minn. Stat. § 80A.23.

5. Plaintiffs' and Amicus' reliance on distinguishable case law from other jurisdictions is misplaced given the facts of this case.

Plaintiffs and Amicus argue that the Court of Appeals erroneously chose to blindly embrace the much criticized minority position on preemption in a trio of federal district decisions. (Plaintiffs' Brief, p. 34; Amicus Brief, pp. 11-12.) In other words, Plaintiffs and Amicus would have this Court ignore the reasoning of the Court of Appeals, which adopted the holding in a case issued in 2006 by the federal district court of Minnesota in *Pinnacle*, 417 F. Supp. 2d 1073, and instead rely on a factually distinguishable cases by the Sixth Circuit in *Brown v. Earthboard Sports USA, Inc.*, 481 F.3d 901 (6th Cir. 2007), a split decision by the Alabama Supreme Court in *Buist v. Time Domain Corp.*, 926 So. 2d 290 (Ala. 2005), a decision of the Arkansas federal district court, *Hamby v. Clearwater Consulting Concepts, LLLP*, 428 F. Supp. 2d 915 (E.D. Ark. 2006), and a decision of the

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[7] Amicus inexplicably presumes integration without even bothering to analyze the five-factor test to argue that the securities sold to Plaintiffs were illegal, and so the requirement that the security in question "is a covered security" subject to preemption is not met in this case. (Amicus' Brief, p. 13.)

Colorado federal district court in *Grubka v. WebAccess Int'l, Inc.*, 445 F. Supp. 2d 1259, 1270 (D. Colo. 2006).

In *Brown v. Earthboard Sports* the court hypothesized: "to hold that NSMIA preempts state regulation wherever offerings merely purport to be filed pursuant to a valid federal registration exemption, or where the parties have filed for, but fail to qualify for, an SEC registration exemption, would effectively eviscerate state registration requirements." *Earthboard*, 481 F.3d at 911. This statement, however, overlooks the Congressional purpose of enacting NSMIA ("the ultimate touchstone of preemption analysis"), which unequivocally establishes that NSMIA's entire purpose was to preempt states from regulating the registration of national securities offerings.

As the very title of the National Securities Markets Improvement Act suggests, and the text of the statute and legislative history makes perfectly clear, Congress intended to make the regulation of the registration and offering of national securities uniform by eliminating the cobbled-together state-generated patchwork quilt of regulation in this area. Thus, "eviscera[ting] state registration requirements" relating to national securities offerings was precisely what Congress intended when enacting NSMIA. *See Lander*, 251 F.3d at 108-12; *Lillard*, 267 F. Supp. 2d at 1115; *Temple*, 201 F. Supp. 2d at 1244 ("Congress expressed its intent in NSMIA that federal regulations alone should govern the registration of national securities offerings.").

Although the *Earthboard* court refused to even consider the legislative history, it nonetheless hypothesized that Congress could not have intended "such a world [in which]

state registration requirements could be avoided merely by adding spurious boilerplate language to subscription agreements suggesting that the offerings were 'covered,' or by filing bogus documents with the SEC." *Earthboard*, 481 F.3d at 911. Inexplicably, the *Earthboard* court thus engaged in conjecture and hypotheses about what Congress could not have intended, yet refused to consult the legislative history, which, next to the text of the statute, is unquestionably the best source for which to learn Congress' intent.

Plaintiffs point to the *Earthboard* court's "worst-case-scenario" hypothetical, which implies that Congress did not weigh the costs and benefits associated with preempting states from regulating the registration and offering of national securities, even in the event an issuer might fail to comply with a claimed exemption. (Plaintiffs' Brief, p. 40.) However, Congress did in fact weigh the costs and benefits of preempting state regulation of the registration and offering of national securities and determined that the costs and burdens to the capital markets imposed by allowing every state to impose and enforce its own registration and offering requirements outweighed any benefit to investors, which Congress found to be minimal in light of the duplicative oversight of the SEC and the states. *See* 15 U.S.C. § 77r; *Temple*, 201 F. Supp. 2d at 1244 ("Congress expressed its intent in NSMIA that federal regulations alone should govern the registration of national securities offerings.")

The *Earthboard* court did not present or discuss competing "hypothetical scenarios" (or not-so-hypothetical) whereby state regulators or private individuals, as in the instant case, might file state enforcement actions or rescission suits for mere

allegations of violation of state registration requirements, effectively putting companies and aspects of the securities markets out of business; and at a substantial expense require it to affirmatively prove to such individuals that the company has complied in every material respect with the federal exemption. All the while, the disgruntled investors and states might proclaim victory of "fraudulent" offerings of securities without having ever alleged, pleaded or proved any claim of fraud in the process (as the Plaintiffs and Amicus ask the Court to do in this case).

The Plaintiffs and Amicus ask this Court to reverse the Court of Appeals and do what the *Earthboard* court did when it disregarded the very scenario that prompted Congress to enact NSMIA and that it is intended to remedy – having 50 state regulatory bodies imposing and enforcing disparate registration requirements on national offerings of securities, thereby impeding the capital markets with no commensurate benefit to investors. The *Earthboard* decision exemplifies the very harm that NSMIA was designed to prevent, and if further perpetuated and followed by this Court, NSMIA's enactment was purely a wasted effort, and the capital markets will not be uniformly regulated, protected, or improved upon – rather, it will be quite the opposite.

The remaining cases cited by Plaintiffs and Amicus are also distinguishable from the facts of this case. The majority in *Buist* rejected the reasoning of *Temple* and its progeny, claiming it to be ipse dixit despite the *Temple* court's analysis and reliance on

the legislative history of the NSMIA. *Buist*, 926 So. 2d at 297.[8] Instead, the majority in *Buist* relied on a one-page ruling by the Alabama Securities Commission, *In re Cherokee Energy Co.*, which, without analysis or citation to legal authority, opined that cold calls to Alabama residents nullified any exemption under Regulation D. *Id.* at 296.

Contrary to the Alabama Supreme Court's statements, the *Temple* court recited and relied specifically upon the legislative history and congressional intent of NSMIA, and *Lillard* cited federal court authorities as additional support for *Temple*'s statutory intent foundation. *Lillard*, 267 F. Supp. 2d at 115-16; *Temple*, 201 F. Supp. 2d at 1242-44. The Minnesota federal district court followed *Temple* and *Lillard* and adopted their analysis. *Pinnacle*, 417 F. Supp. 2d at 1087. Moreover, *Buist*'s concern focused more on the law of evidence and the shifting burdens of proof on summary judgment than on the law of securities regulation for its basic proposition that the burden is on the party asserting the registration exemption to prove it. *Buist*, 926 So. 2d at 298.

6. Where there is an alleged defect in a federal exemption claim, a party can institute an action in federal court.

The Court of Appeals correctly decided that the only remedies recognized by the federal securities statutes for an alleged defect in a federal exemption claim is for an individual investor to institute an action in the federal courts or for the SEC to institute"cease and desist" proceedings. *See* 15 U.S.C. § 77l; 15 U.S.C. § 77h-1. There is

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[8] Ipse dixit, literally, "he himself said it," means "something asserted but not proved," as in the case of a bare statement that a witness is a liar without any proof. Black's Law Dictionary 833 (7th ed. 1999). Ipse dixit is thus a critique on the quality of the evidence, rather than a court's legal skills of statutory construction.

simply no federal statutory remedy providing for state courts to determine what is or is not a "covered security" by interpreting federal exemptions from state registration requirements. To adopt the Plaintiffs' and Amicus' positions would reflect a results-oriented bias which would disregard the plain language of the federal statute at issue as well as the Congressional purpose in its enactment.

7. This case does not concern a sham Rule 506/Regulation D offering.

Here, Plaintiffs concede that if there had been no PPM2, they would agree that Regulation D would be available to Defendants. (Plaintiffs' Brief, p. 21.) There is no question that when Plaintiffs purchased the stock in question, they appreciated and understood that PPM1 was made pursuant to Regulation D. (R.A. 1-2, 7-8, 13-14, 25-26, 31-32.)

As the record reflects, this case does not concern a sham Rule 506/Regulation D offering. There is no question Defendants complied with Regulation D at the time of PPM1 and this is not a case where a party is merely asserting form over content. In *Earthboard*, 481 F.3d at 913, the Sixth Circuit Court of Appeals reversed a grant of summary judgment to a defendant because it found there was a genuine issue of material fact as to whether or not the securities sold to Plaintiff were covered securities. Importantly, the *Earthboard* court found it "highly persuasive" that the SEC filed a still-pending law suit against the defendant for offering unlawfully unregistered securities for sale that did not qualify for federal exemption. *Id.* In *Buist*, the Alabama Supreme Court denied the exemption to the defendant because it submitted no evidence indicating the

sale of securities was actually made in conformity with Regulation D. *Buist*, 926 So. 2d at 297-98.

The same analysis was conducted in *Hamby v. Clearwater Consulting Concepts, LLLP*, 428 F. Supp. 2d at 915. Specifically, in *Hamby*, the defendants contended the security at issue was a "covered security" even though no Form D was ever filed and argued that a mere statement in the Partnership Agreement was enough to provide an exemption. *Id.* at 919-20. The federal court in *Hamby* concluded that the defendants had not met their burden of proof. *Id.*

In *Grubka v WebAccess Int'l, Inc* , 445 F. Supp. 2d at 1270, another case cited by Plaintiffs and Amicus, the court rejected *Temple* and asserted that a defendant cannot avoid liability under state law by declaring its alleged compliance with Regulation D. The court held, "that a defendant could avoid liability under state law simply by declaiming its alleged compliance with Regulation D is an unsavory proposition and would eviscerate the statute." *Id.* But what the federal district court ignores is that NSMIA expressly permits states to retain jurisdiction over fraudulent conduct. 15 U.S.C. § 77r(c)(1). *See also Faye L. Roth Revoc. Trust v. UBS Painewebber, Inc.*, 323 F. Supp. 2d 1279, 1299 (S.D. Fla. 2004). Accordingly, state law is not voided as the federal district court incorrectly suggests.[9]

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[9] No allegation of fraudulent conduct remains in this case as Plaintiffs dismissed with prejudice all of the fraud claims alleged in their complaint.

Lastly, Plaintiffs and Amicus erroneously argue that the holding *In re Blue Flame Energy Corp.*, 871 N.E.2d 1227 (Ohio Ct. App. 2006), also supports their position the Court of Appeals decision should be reversed; however, the facts in *Blue Flame* are readily distinguishable from the facts here. In *Blue Flame*, Ohio brought a cease and desist action against the company that made a single offering on a public web site with resulting sales. *Id.* at 1235. The defendants asserted that the offering was made pursuant to Rule 506, but that they did not actually have to comply with Rule 506. *Id.* at 1243. The court held that the defendants did not meet their burden.

This is not the case here. In this case, it is undisputed that Defendants actually complied with Regulation D as to PPM1. It also cannot be disputed that the SEC took no action against Defendants for their actions with regard to PPM2. As such, reliance on the court's holding in *Blue Flame* is misplaced.

8. This case illustrates the need for preemption.

To accept Plaintiffs' and Amicus' unreasonably restrictive interpretation of NSMIA's express preemption of "covered securities" would defeat the entire purpose of NSMIA "that federal regulations alone should govern the registration of national securities offerings." *Temple*, 201 F. Supp. 2d at 1244. This case illustrates the need for preemption. Plaintiffs and Amicus would have this Court void Plaintiffs' purchase on the basis of a little understood integration doctrine which depends on the application of a multifaceted subjective test the precise parameters of which are uncertain. The integration doctrine's availability is essentially dependent on questions of fact varying

with the facts of each situation with little precedent to guide the courts. *See Circle Creek Aquaculture V,* SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 76,665, 1993 WL 93583 (Mar. 26, 1993) (A.A. 166) (determination as to whether integration applies is very fact specific and different facts or conditions may require a different conclusion).

Any issuer of a national securities offering, knowing despite NSMIA it will be subject to liability under state unregistered securities laws for any violation of the myriad technicalities of Regulation D, would be well-advised to ignore NSMIA and do precisely that which Congress sought to avoid with the NSMIA preemption – file duplicate, costly and redundant registrations in every state in which its shares might be offered or sold, thereby placing an undue and unnecessary burden on capital formation and markets.

Plaintiffs' assertion runs contrary to the very purpose of NSMIA. The point is, PPM1 cannot be attacked standing alone, as conceded by Plaintiffs. (Plaintiffs' Brief, p. 21.) Plaintiffs made their purchase pursuant to it. Plaintiffs attack Defendants' activities after PPM2 was issued. No sales were made pursuant to PPM2; therefore, the Court of Appeals correctly held that PPM2 could not be integrated with PPM1. (A.A. 11-12.) No action was taken by the SEC and no action has been asserted by the State of Minnesota. The Court of Appeals correctly recognized that Plaintiffs' whole case is premised on a technical objection which had nothing whatsoever to do with Plaintiffs' investment. Nothing in PPM2 impinged or imperiled Plaintiffs' investment in PPM1. As such, Plaintiffs' claim is preempted.

II. EVEN IF STATE LAW APPLIES TO THE TRANSACTIONS, THEY ARE EXEMPT FROM MINN. STAT. § 80A.08 UNDER MINNESOTA LAW.

If Plaintiffs' purported claim for rescission under Minnesota state law is not preempted by federal law, their purchase of funeral.com stock is exempt from the application of Minn. Stat. § 80A.08 under the exemption provided in Minn. Stat. § 80A.15, subd. 2(h) because Defendants did actually comply with Regulation D. Plaintiffs' assertion that Defendants are not entitled to an exemption is premised solely on the argument that simply because there was an inadvertent posting on the website and a mailing of PPM2, absent any action by the SEC, the exemption for PPM1 is lost under the principles of integration.[10] The Court of Appeals correctly rejected Plaintiffs' argument. (*Id.* at 10-11.)

A. There Can Be No Integration Because There Were No Sales as a Result of PPM2.

Plaintiffs and Amicus would have this Court ignore that in order to have integration there must be sales in the offerings sought to be integrated. (Plaintiffs' Brief, pp. 28-33; Amicus' Brief, pp. 19.) Contrary to their argument, the Court of Appeals did not add a sale requirement – the sales requirement is clearly set forth in Minn. Stat.

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[10] Notably, the SEC has taken no action against Defendants. The Plaintiffs and Amicus assert and the trial court simply assumed that Defendants had lost their exemption for PPM2, without requiring proof of that by Plaintiffs. The Plaintiffs' and Amicus' entire argument is premised upon this erroneous assumption.

§ 80A.15, subd. 2(h) and subd. 2(h)(10), which incorporates 17 C.F.R. § 230.502(a).[11] Subdivision 2(h)(10) states:

> The determination of whether offers and sales made in reliance on the exemption set forth in Paragraph (h) shall be integrated with offers and sales according to other paragraphs of this subdivision shall be made according to the integration standards set forth in Rule 502 of Regulation D promulgated by the Securities and Exchange Commission, Code of Federal Regulations, title 17, Section 230.502. If not subject to integration according to that rule, offers and sales according to Paragraph (h) shall not otherwise be integrated with offers and sales according to other exemptions set forth in this subdivision.

1. Rule 502 requires sales.

Rule 502 of Regulation D of the securities laws clearly states that "[a]ll sales that are part of the same Regulation D offering must meet all of the terms and conditions of Regulation D." It further states that 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."

The five-factor test created in Non-Public Offering Exemption, Exchange Act Release No. 33-4552, 1962 WL 69540 (Nov. 6, 1962) is the sole method for evaluating whether individual offers and sales should be "integrated" for purposes of applying Regulation D and the related state exemption provisions. The Plaintiffs' Brief at page 29

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[11] Because this case was pending on August 7, 2007, the effective date of Minn. Stat. § 80A.40, it is true it is still governed by sections 80A.01 to 80A.31. However, it must be noted that the new act, codified at Minn. Stat. §§ 80A.40-90, contains no reference to integration. Therefore, any claim that would be based on integration could now only arise under federal law.

n. 17, also acknowledges that currently, the factors to be considered in determining whether offers and sales should be integrated for purposes of the Regulation D exemptions all focus on actual sales. That test looks at the following factors:

(a) Whether the *sales* are part of a single plan of financing;

(b) Whether the *sales* involve issuance of the same class of securities;

(c) Whether the *sales* have been made at or about the same time;

(d) Whether the same type of consideration is being received; and

(e) Whether the *sales* are made for the same general purpose.

17 C.F.R. § 230.502(a) (R.A. 54); SEC Release No. 33-4552, 27 Fed. Reg. 11316 (emphasis supplied).

2. The Court cannot ignore the term sales and cannot rewrite the test under the auspices of interpretation or construction.

Plaintiffs attempt to negate this significant change in the integration test by stating that the five-factor test originally used the word "offerings" rather than "sales." SEC Release No. 33-4552. In their brief, Plaintiffs cite the language of the integration test set forth in an SEC publication of proposed revisions to the Regulation D Integration Safe Harbor that incorrectly uses the word "offerings" rather than "sales" in a proposal to reduce the time allowed between offers and sales as evidence that the SEC regulation contains the word "offering" rather than "sales." *See* Plaintiffs' Brief, p. 24, *citing* SEC Release No. 33-8828 at 57 (Aug. 3, 2007) (excerpted at A.A. 133). This is misleading at best, as it is undeniable that the statute now in effect specifically uses the word "sales." 17 C.F.R. § 230.502(a) (R.A. 54). Plaintiffs also cite two cases and commentator who,

without discussion, continue to use the term offering instead of sales. These citations did not address, nor was it relevant to their discussion, that the use of the word "sales" is now contained in 17 C.F.R. § 230.502(a).

Just because certain courts have continued to use the word "offerings" in discussing the current test does not make the change from "offerings" to "sales" of "no significance," as Plaintiffs assert. The fact is that the test uses the term "sales" – a term clearly defined in the Securities Act of 1933, and a term that is consistent with the wording of Rule 502. As set forth in Section 2(a)(3) of the Act:

> The term "sale" or "sell" shall include every contract of sale or disposition of a security or interest in a security, for value.

In contrast, the term "offering" is not defined in the Securities Act or Regulation D. 17 C.F.R. § 230.502 (R.A. 54).[12]

The Court is not free to disregard the term "sales" in determining whether the integration doctrine applies to this case. The general rules of statutory construction apply to the plain language of a federal regulation. *Valley Camp of Utah, Inc. v. Babbitt*, 24 F.3d 1263, 1270 (10th Cir. 1994). The court cannot rewrite this test under the auspices of interpretation or construction. *McNeice v. City of Minneapolis*, 250 Minn. 142, 84 N.W.2d 232, 237 (1957); Minn. Stat. § 645.16. This is not one of those rare cases where

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[12] Plaintiffs' extensive discussion of how they would define "offering" illustrates why the choice was made to use the term "sales" in the integration test, a term to which there can be no ambiguity or dispute. Under Plaintiffs' definition, any conversation, no matter how preliminary, would constitute an offering even without a formal offer to purchase a security.

the court can disregard the statute's plain language. *Toth v. Arason*, 722 N.W.2d 437, 442 (Minn. 2006).

Plaintiffs assert that by the use of the word "sales" the SEC acted contrary to the legislative enactment, 15 U.S.C. § 77d(2), which uses the word "transactions." (*See* Plaintiff's Brief, p. 32.) That, of course, ignores that the word transactions is not defined in the Act nor in any administrative rule. The interpretation of the term transaction cited by Plaintiffs, as enunciated by the Second Circuit in *SEC v Chinese Consol. Benevolent Ass'n*, 120 F.2d 738, 741 (2nd Cir. 1941), falls far short of a formal definition.

A "transaction" for those in the commercial world is a business deal, which would necessarily involve a sale. As one commentator explained: "The horizontal element of the transactional exemption structure, the integration doctrine, focuses on sales of securities directly by the issuer." C. Steven Bradford, *Expanding the Non-Transactional Revolution: A New Approach to Securities Registration Exemptions*, 49 Emory L.J. 437, 455-56 (2000).

Since there were no sales under Defendants' second offering, PPM2, the integration rules do not and cannot apply.

3. 17 C.F.R. § 230.155 supports Defendants' position.

Contrary to Plaintiffs' insinuation, Rule 155, 17 C.F.R. § 230.155, supports this holding. Rule 155 was adopted January 26, 2001 and addresses a registered offering (where public solicitation is allowed) that follows an abandoned private offering, and a private offering that follows a withdrawn or abandoned registered offering. As noted, in

both situations addressed by Rule 155, an abandoned offering is involved. A Rule 506 offering is included with the definition of a "private offering."

Rule 155 provides a private offering of securities will not be considered part of an offering for which the issuer later files a registration statement if, among other things, no securities were sold in the private offering. Rule 155 further provides an offering for which the issuer filed a registration statement will not be considered part of a later commenced private offering if, among other things, no securities were sold in the registered offering. It is clear it is the "sales" and not "offers" that are important in determining whether two offerings should be integrated and treated as one.

Plaintiffs correctly note that the Commission explicitly stated that the adoption of Rule 155 was not intended to "affect traditional integration analyses." The five-factor test used in determining whether integration should apply refers to "sales" in the various factors. Rule 155 would not have an adverse impact on traditional integration analyses because it, too, focuses on "sales."

4. No support is supplied for integration without sales.

Plaintiffs have provided the Court with no case, and Defendants assert there is none, where the doctrine of integration has been applied to an offering where there were no sales. The Plaintiffs cite an SEC No-Action letter as proof to asset that "the SEC has expressly indicated that two "offers" could be integrated where no sales occurred under one of the offers." *See Circle Creek Aquaculture V,* SEC No-Action letter, Fed. Sec. L.

Rep. (CCH) ¶ 76,665, 1993 WL 93583 (A.A. 166). However, this is a gross distortion of what the SEC advisory letter actually said.

In the letter, the SEC was responding to Silver Creek's request for an advisory opinion, because it had done a public offering that did not raise needed capital. *Id.* Silver Creek had taken the step of refunding the purchase price, plus interest to all purchases of the public offering. *Id.* As such, there is no question that a "sale" of securities has occurred. Silver Creek wanted to do a private offering without the fear of integration and requested SEC advisory opinion before undertaking the private offering. *Id.* The SEC simply stated that under the facts before it, it could not "concur in your view that the prior registered offering would not constitute a 'general solicitation' for purposes of Rule 502(c) of Regulation D." *Id.* Importantly, the SEC also wrote that "different facts or conditions might require a different conclusion." *Id.*

Here, the SEC was informed all references to the private placement had been removed from websites. (A.A. 113.) No subscriptions would be accepted from anyone who requested a PPM through the websites. Funeral.com informed the SEC that "the Company will make every effort to ensure that its offering efforts remain limited and focused and that investors are not sought or identified through any form of general solicitation." (A.A. 114.) No sales were ever made to anyone pursuant to PPM2. As such, Plaintiffs attempt to equate the facts of *Silver Creek* with the facts of this case is completely without merit.

5. Plaintiffs' argument ignores and is contrary to the purpose of integration.

The purpose of a registration requirement "is to protect investors by promoting full disclosure of information thought necessary to inform investment decisions." *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953). Plaintiffs admit that they are accredited investors and were given access to full and complete information regarding funeral.com. (R.A. 1, 7, 12, 19, 25, 31.)

Integration is used as a regulatory device to prevent issuers from splitting sales which might not meet the dollar requirements or number of purchase requirements of a Regulation D exemption into two or more sales in order to avoid registration. Darryl B. Deaktor, *Integration of Securities Offerings*, 31 Fla. L. Rev. 465, 492-93 (1979). Plaintiffs cite *Donohoe v. Consol. Operating Prods. Corp.*, 982 F.2d 1130 (7th Cir. 1992). *Donohoe* acknowledges this purpose. The integration doctrine was developed to address the situation where a seller breaks an offering into small pieces in order to avoid the requirements of Section 5. Andre Douglas Pond Cummings, *The Integration Conundrum. Debilitating Failures of the Securities and Exchange Commission Must Be Addressed as U.S. Corporate Malfeasance Is "Getting Serious, So Serious,"* 48 Wayne L. Rev. 1305, 1322 (2003).

These Plaintiff investors do not require the protection of the integration doctrine under these circumstances. There has been no abuse of the exemption requirements. There is no threat here to the investing public. There was no dilution of Plaintiffs' investment because of PPM2 because no sales were made. The rationale of the

sophisticated offeree exemption is that certain offerees, because of sophistication, bargaining power or access to information, do not sufficiently benefit from any additional protection registration provides. Plaintiffs admit they are in that category. (R.A. 1, 12, 25.) Plaintiffs nonetheless want this Court to remove the integration concept from its moorings so that they can evade what they now view as a bad investment decision. The law does not so support.

III. EVEN IF THE COURT DETERMINES ALL DEFENDANTS' OFFERINGS MAY BE INTEGRATED REGARDLESS OF WHETHER SALES WERE MADE, THE FACTS DO NOT SUPPORT INTEGRATION.

Although not addressed by the Court of Appeals given its rulings, Defendants also asserted that even if the Court were to determine that the two offerings may be integrated regardless of whether any sales were made in PPM2, the application of the factors set forth in the integration rule does not result in integration of PPM1 and the following offerings as a matter of law. (Appellants/Defendants' Brief to Court of Appeals, pp. 29-39.) Although Plaintiffs now argue the five-factor integration test, they fail to inform this Court that, given the Court of Appeals' rulings, the trial court's analysis of the five factors was not addressed by the Court of Appeals.

A. The Basic Premise Is That Financial Offerings Are Separable, Not Integrated.

As previously stated, Plaintiffs' claim for lack of compliance with Regulation D can be made only if the Court accepts Plaintiffs' theory the doctrine of integration applies and PPM1's Regulation D status can be voided nunc pro tunc. In presenting their argument, Plaintiffs ignore that a basic concept running throughout the Securities Act of

1933 is that the financial dealings of an issuer are separable. 15 U.S.C. § 77a, *et seq.* Plaintiffs instead leave the Court with the incorrect impression that financial dealings of an issuer are generally to be viewed as integrated rather than separable.

That financial dealings of an issuer are separable is reflected in the provisions of Section 4 of the 1933 Act, which exempts certain transactions from the registration requirements of the 1933 Act. In addition, certain of the securities exemptions contained in Sections 3 and 4 of the 1933 Act are in fact administered by the SEC as transactional exemptions. For example, Section 4(2) of the 1933 Act exempts from the registration and prospectus delivery requirements of the 1933 Act "transactions by an issuer not involving any public offering." Section 3(a)(11) of the 1933 Act exempts from the registration and prospectus delivery requirements of the 1933 Act "[a]ny security which is part of an issue offered and sold only to persons resident in a single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory." Section 3(b) of the 1933 Act uses the word "issue" and "small amount involved or the limited character of the public offering."

B. Sparse Precedent Exists on the Application of the Doctrine of Integration.

Because the integration doctrine depends on the facts and circumstances of each situation, sparse precedent exists. Cheryl L. Wade, *The Integration of Securities Offerings: A Proposed Formula That Fosters the Policies of Securities Regulation*, 25 Loy. U. Chi. L.J. 199, 220-21 (1994); Kathryn Taylor Frame, Note, *Securities Regulation:*

Integration of Securities Offerings, 34 Okla. L. Rev. 864, 870 (1981). One commentator has explained:

> Case law interpreting the five-factor test outlined by the SEC has been relatively sparse. The opinions contain limited analysis of the integration issue and frequently involve determinative factors unrelated to the integration issue (such as fraud).

Bryn Vaaler, *Financing a Small Business in Mississippi: The Practitioner's Guide to Federal and State Securities Exemptions, Part 1*, 63 Miss. L.J. 129, 196 (Fall 1993).

The integration doctrine and its five-factor test "has been plagued by confusion, ambiguity and indiscernible interpretation over the past quarter century." Cummings, 48 Wayne L. Rev. at 1320. One scholar, referring to the five-factor test, wrote:

> Everyone seems to agree that these criteria are nearly impossible to apply, principally because neither the Commission nor the courts have ever adequately articulated how these factors are to be weighed or how many factors must be present in order for integration to occur.

Cummings, 48 Wayne L. Rev. at 1344-45, *quoting* Rutheford B. Campbell, Jr., *The Plight of Small Issuers (and Others) Under Regulation D: Those Nagging Problems That Need Attention*, 74 Ky. L.J. 127, 164 (1985-86).

Another commentator reached the conclusion that in essence, the SEC, in deciding whether to take action, has looked at whether protection of investors required integration under the circumstances. If not, no action has been taken. Deaktor, 31 Fla. L. Rev. at 542.

The trial court, with citation to no authority, found integration on summary judgment simply because it "finds that Plaintiff's position is more persuasive." (A.A. 26.)

The trial court so finds even though the record stands undisputed that Defendants' second offering – PPM2 – was not an attempt to avoid registration. At most, Defendants made an inadvertent error, corrected it immediately when it learned of the error, and caused no harm to anyone. The SEC has accepted Defendants' explanation. Plaintiffs, who did not assert integration as an issue in their Complaint, are merely using this doctrine to save themselves in hindsight from what they now view as an error in business judgment on their part in the purchase of stock. The use that Plaintiffs are making of the integration doctrine bears no resemblance to its purpose.

C. Applying the Facts in a Light Most Favorable to Defendants, There Is No Integration as a Matter of Law.

As previously stated, the trial court, with citation to no authority, finds integration on summary judgment simply because it "finds that Plaintiff's position is more persuasive." (A.A. 26.) This is error. If the same facts can support integration or nonintegration, the trial court is not free on summary judgment to find integration and grant summary judgment against Defendants. For example, one of the factors is whether the sales proposed to be integrated are made for the same general purpose. If the general purpose is viewed as the enrichment of a common sponsor, then any sale of securities will be deemed to have been made for the same general purpose. On the other hand, if the proceeds for one sale are to be used for a distinct purpose such as to repay a promissory note, the sales should not be viewed as being made for the same general purpose.

The same is true in considering whether the differing sales are part of a single plan of financing. This can be viewed as a restatement of the question whether the sales are

being made for the same general purpose. If this factor is interpreted as being whether the sales have as their common plan the furtherance of the sponsor's financial well-being, then any sale of securities will meet this test. To adopt Plaintiffs' theory of integration would result in all sales being integrated, which is contrary to the general principle that financial dealings of an issuer are separable. Applying the five factors to the facts of record viewed in a light most favorable to Defendants requires reversal.

1. The sales are not part of a single plan of financing and were not made for the same general purpose.

a. Sales were not part of a single plan of financing.

Several offerings are not part of a single plan of financing if at the time of the first offering the issuer did not intend to make subsequent offerings. *See Livens v. William D. Witter, Inc.*, 374 F. Supp. 1104, 1107 (D. Mass. 1974) (holding that although six offerings were made for the same general purpose, because the issuer had hoped that the first financing would be sufficient and expected each successive financing to be the last, the offerings did not involve a single plan of financing and "the integrated offering doctrine is clearly inapplicable."); *see also Barrett v. Triangle Mining Corp.* [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH), ¶ 95,438, 1976 WL 760 (S.D.N.Y. 1976) (R.A. 58) (federal district court denies integration in the absence of an apparent plan of financing).

The question is whether PPM1, PPM2 and PPM3 were spawned from one idea, then split into stages to avoid the need to register, or came about piecemeal, in response to changing business needs. In finding one single plan of financing here, the trial court

ignored the undisputed facts of record. (A.A. 26.) As Brown testified, which testimony stands undisputed:

> [E]ach funeral.com offering was separate. In March of 2000, we believed the initial offering was the only one we would ever need. Unfortunately, the offering was disappointing. Unfortunately, as time passed, funeral.com's cash needs were always increasing. For example, we were told in May of 2000 that Corio, a major website developer at the time, needed millions of dollars to develop the funeral.com site.

(A.A. 121.)

In direct contravention of the federal district court's analysis in *Livens* and *Barrett*, Plaintiffs would have this Court disregard the undisputed facts of record that at the time of PPM1, Defendants believed PPM1 was the only stock offering they would need. Like Livens, Defendants hoped and expected PPM1 would be the one and only offering. Following *Livens* and *Barrett*, there should be no integration. Given this evidence of record and the standard of review requiring the court to view the facts in a light most favorable to Defendants, the trial court cannot find "[t]he funds were (a) part of a single plan of financing: to start Funeral.com . . . ." (A.A. 26.)

b. The sales were not made for the same general purpose.

Another integration factor is whether the sales are made for the same general purpose. The trial court finds "the sales involved the same purpose: to start up Funeral.com." (A.A. 27.) In so ruling, the trial court again ignored the facts of record.

In PPM1, the offeree was informed that if a minimum number of shares were sold, $375,000 of proceeds would be used to repay a promissory note held by Brown. (A.A.

80, 85.) The minimum shares were sold and PPM1 raised $760,006. (A.A. 124.) Accordingly, 50% of PPM1 was used for this sole purpose, which was not the purpose of PPM2 or PPM3. Payment of the note to Brown had nothing to do with PPM2 and PPM3, and PPM1, PPM2 and PPM3 were not made for the same purpose.

Moreover, and contrary to Plaintiffs' position, on summary judgment the trial court is not free to infer that repaying a note to Brown is for the same general purpose as providing funds to funeral.com and therefore integration applies. If the purpose is a factual question, it cannot be decided in Plaintiffs' favor on summary judgment.

In addition, Brown testified that PPM2 was necessitated because in May, Corio, a major website developer, needed millions of dollars to develop the funeral.com site. (A.A. 121.) What the record presents is not a single financing scheme for the same general purpose but different financing attempts for different purposes born out of desperation.

2. The sales do not involve the same class of securities.

Another factor which the SEC and the courts look to in determining whether multiple securities sales should be integrated is whether the sales involve the same class of securities. The trial court reasoned:

> The funds . . . (b) involved the same class of stock: common shares were sold on three offering memoranda. Although preferred shares were also sold, they were sold under different terms to insiders and Plaintiffs do not contend the different class of shares were part of the integration . . . .

(A.A. 26-27.) But the trial court was not free to ignore the facts. And Plaintiffs are not entitled to self-servingly assert that the preferred shares are not part of the integration and that the trial court should therefore eliminate that fact from the analysis. (*Id.*) As Loss and Seligman explain in their *Fundamentals of Securities Regulation*, at page 361:

> When different classes of securities, such as common stock and preferred stock, are offered, the courts and the Commission generally have not integrated.

Loss and Seligman, *Fundamentals of Securities Regulation* 361 (2004).

Moreover, Loss and Seligman also recognize that "slight differences between two securities have nonetheless been held to justify nonintegration." *Id.* They offer the following example:

> For example, in *SEC v. Dunfee*, the court refused to integrate 6 percent notes payable in 20 monthly installments with 7 percent notes issued eight months later and payable in 36 months.

Id.

When two or more securities are only slightly different, the SEC staff and courts have refrained from integrating offerings or have found that offerings do not involve the same class of securities. *See SEC v. Dunfee* [1966-67 Transfer Binder], Fed. Sec. L. Rep. (CCH), ¶ 91,970 at 96,302 (W.D. Mo. 1967) (R.A. 63) (concluding that an offering of notes with an interest rate of 6% and a separate offering of notes with an interest rate of 7% by the same issuer eight months later did not require integration).

A consideration is the identity of the offerees. If the offerings are not directed at the same pool of potential investors, this is supportive of the position that the classes of

securities are different. Deaktor, 31 Fla. L. Rev. at 532-33. Accordingly, the SEC has looked at the offerings' disparity in price and the amount required for a minimum investment. *Id.* at n. 392.

Here, PPM1, PPM2 and PPM3 contained offers of stock at vastly different prices – i.e., $6.00, $3.00 and $1.50 per share respectively. (A.A. 76, 108, 116.) More importantly, the minimum investment is vastly different between PPM1 and PPM2. PPM1 required a minimum investment of $50,000. (A.A. 76.) In contrast, the minimum for PPM2 was $10,000 and $9,000 for PPM3. (A.A. 108, 116.) Given the disparity in price and minimum investment, the pool of potential investors which Defendants looked to in PPM2 is vastly different than PPM1. The district court was not free to state that the difference in price for PPM1, PPM2 and PPM3 is "irrelevant." (A.A. 27.)

3. That cash was consideration is not determinative.

Whether the securities are offered in exchange for the same consideration is not a determining factor. Here, cash consideration was paid in all sales. The same consideration factor poses a problem because cash is most often the consideration sought in securities offerings. *See* Deaktor, 31 Fla. L. Rev. at 535. Because cash is so commonly sought as the consideration for a security, this factor does not provide an accurate and reliable indication that an issuer has artificially divided its sales to avoid the Act's registration requirements. Wade, 25 Loy. U. Chi. L.J. at 216. Loss and Seligman, in their treatise *Fundamentals of Securities Regulation*, explain:

> "[S]ame types of consideration," has rarely been of much significance in resolving whether two or more issues should be

> integrated for the simple reason that cash is the normal consideration in both integrable and nonintegrable offers.

Id. at 362.

4. Timing is not determinative.

The SEC will also examine whether the sales were made at or about the same time. One commentator has noted that "proximity in time . . . has seldom been determinative; even if simultaneous, one or more of the other integration factors often will be viewed as more important." Deaktor, 31 Fla. L. Rev. at 534. Timing has been viewed as the least significant of all five factors. *See, e.g.*, *Wellington Fund, Inc.*, SEC No-Action Letter, 1976 WL 12640 at ¶ 6 (August 23, 1996) (R.A. 65). Here, the trial court finds "the sales of shares took place over five months," which the trial court states it "believes is 'at or about the same time . . . .'" (A.A. 27.)

In contrast to the trial court's "belief," rulings by the SEC are contrary to the trial court's holding. As one commentator explained:

> [Whether the offerings are made at or about the same time] is a factor, but it never appears to determine the issue of integration. In *Delta* [*Delta Nat'l Gas Co.*, 1977 SEC No-Action Letters (CCH), Fiche 57, Frame C21], a no-action letter was issued although offerings were made at the same time. In *Martin Exploration* [1976 Fed. Sec. Law Rptr. (CCH) ¶ 80,794], two offerings of limited partnership interests were made by the same general partner within one six-month period and a no-action letter was issued. *Oklahoma Oil & Gas* [1978 SEC No Action Letters, Fi che 52, Frame L5] offered preformation limited partnership interests in August 1978 and had proposed a second offering of preformation limited partnership interest to begin in October or November in 1978, but a no-action letter was issued by the SEC.

Frame, 34 Okla. L. Rev. at 875; *see also In re Board of Directors of Multicanal S.A.*, 340 B.R. 154, 178 (S.D.N.Y. 2006) (*quoting* Wade, 25 Loy. U. Chi. L.J. at 220, that timing of offerings "is perhaps the least significant of all five factors"). Unfortunately, the trial court does not explain how its "belief" supports integration.

In summary, because the trial court's findings are not in accord with the record viewed in a light most favorable to Defendants, on that ground also the trial court must be reversed.

IV. REGARDLESS OF WHETHER THE OFFERINGS ARE DEEMED INTEGRATED, UNDER THE FACTS OF THIS CASE, PLAINTIFFS ARE NOT ENTITLED TO RESCIND THEIR TRANSACTION.

Rescission under Minn. Stat. § 80A.23, subd. 1 is an equitable remedy. Minn. Stat. § 80A.23(1); *Logan v. Panuska*, 293 N.W.2d 359, 363 (Minn. 1980). Plaintiffs are not entitled to rescind the transaction because rescission would not further the policies underlying the statute. *Adams v. Resolution Trust Corp.*, 731 F. Supp. 352 (D. Minn. 1990), *aff'd*, 927 F.2d 348 (8th Cir. 1991), *cert. denied*, 502 U.S. 815 (1991).

As recognized in *Adams*, rescission under Minn. Stat. § 80A.23 serves a dual function: "It protects innocent purchasers and compels sellers to comply with the securities regulations by depriving them of ill-gotten gains." Plaintiffs, however, cannot use Minnesota's Blue Sky law to save themselves from errors in business judgment; "equity will not allow blind protection of purchasers." *Id.* at 357 n. 9, *citing Logan*, 293 N.W.2d at 363. As this Court declared in *Logan*:

> We [do not] believe the Blue Sky Law was meant to be used to protect the investor from all of his errors of business judgment no matter how unrelated to, or distant from, the sale of unregistered securities.

293 N.W.2d at 363; *see also Clapp v. Peterson*, 327 N.W.2d 585, 587 (Minn. 1982) (securities law designed to protect the investing public from deceitful practices by requiring sellers to fully disclose relevant investment information to prospective buyers). *Wingsco Energy One v. Vanguard Groups Res. 1984, Inc.*, 699 F. Supp. 1232, 1240 (S.D. Tex. 1988) (holding rescission "as a remedy for violations of securities laws requires proof that the investor's loss was proximately caused by the defendant's conduct." *Id.* at 1240-41, *citing Rousseff v. E.F. Hutton Co.*, 843 F.2d 1326, 1328-29 (11th Cir. 1988)).

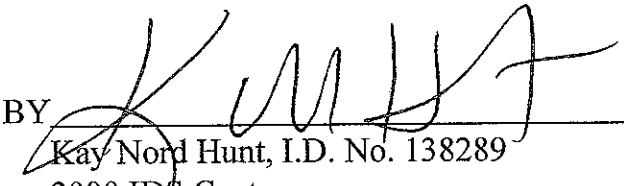
Simply put, the application of rescission here does not serve the interests of Minnesota's Blue Sky law. No purported offense by Defendants caused any harm to Plaintiffs. This is not a case of ill gotten gains. It is a case where Plaintiffs clearly purchased exempt securities. They then argue a subsequent inadvertent error by Defendants, which has nothing to do with their purchase and which was committed after their purchase, can be used by them to protect themselves from their business judgment. To grant Plaintiffs a remedy under the Blue Sky law is inappropriate and Plaintiffs are certainly not entitled to recover in "equity." PPM2 simply had no relationship to or bearing on Plaintiffs' purchase of stock, which had been purchased months prior to the PPM2 offering.

CONCLUSION

Defendants respectfully request that the decision of the Court of Appeals be affirmed and this action ordered dismissed. In the alternative, if the Court should reverse on the grounds addressed by the Court of Appeals, the Court should nonetheless reverse the trial court's determination that the facts support integration.

LOMMEN, ABDO, COLE, KING & STAGEBERG, P.A.

Dated: December 3, 2007

BY 

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CERTIFICATION OF BRIEF LENGTH

I hereby certify that this brief conforms to the requirements of Minn. R. Civ. App. P. 132.01, subds. 1 and 3, for a brief produced with a proportional font. The length of this brief is 13,912 words. This brief was prepared using Word Perfect 10.

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