A06-1233

State of Minnesota
In Court of Appeals

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

Respondents,

v.

Christopher C. Brown and funeral.com, inc.

Appellants.

BRIEF OF APPELLANTS
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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 MINN. STAT. § 80A.23 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 trial court granted Respondents summary judgment, holding as a matter of law that Minnesota law was not preempted and that the exemption from registration was lost under the principles of integration, entitling Respondents to rescind their purchase of stock and ordering payment by Appellants to Respondents of the purchase price of the stock, costs, interest and attorney's fees.

15 U.S.C. § 77r

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

17 C.F.R. § 230.506

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

STATEMENT OF FACTS

The trial court, the Honorable Steven D. Wheeler, granted summary judgment to Respondents/Plaintiffs Charles Risdall (C. Risdall), Len Dozier (Dozier) and John Risdall, in his capacity as personal representative of the Estate of Mary Risdall (M. Risdall), holding that Plaintiffs were entitled to rescind their purchase of Appellant funeral.com stock.[1] (A. 4.) Appellants/Defendants Christopher C. Brown (Brown) and funeral.com, inc. (funeral.com) were ordered to pay Plaintiffs the purchase price of their stock, interest, costs and attorney's fees, resulting in a judgment of $349,586.73. (A. 1.) Defendants challenge that ruling on appeal. The material facts are as follows.

A. March 2000 Confidential Private Placement Offering Memorandum (PPM1).

Funeral.com was incorporated in the fall of 1999. Brown is its chief executive officer. (A. 62, 66.) Brown is also the President of Brown-Wilbert, Inc., a burial vault manufacturer. (A. 94.) 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. 81.)

1. 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. 78.) In PPM1, funeral.com's stock was offered at a price of $6.00 per share and required a minimum

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[1] When referred to jointly, Respondents will be referenced as Plaintiffs and Appellants will be referenced as Defendants.

investment of $50,000. (A. 78.) 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." (A. 78.) The offeree was also 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. 82.) 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." (A. 82.)

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. 102.)

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. 87.)

2. Purchase of stock by Plaintiffs.

The initial private placement memorandum raised a total of $760,006.00. (A. 66.) Of the $760,006 raised, $220,000 was as a result of Plaintiffs' purchase of stock. (*Id.*)

On March 13, 2000, Dozier signed two subscription agreements to purchase 25,000 shares of funeral.com for $100,000. (A. 121, 127.) On that same day, C. Risdall signed two subscription agreements to purchase 20,000 shares of funeral.com for $70,000. (A. 132, 139.) And on April 28, 2000, M. Risdall signed two subscription agreements to purchase 16,677 shares of funeral.com for $50,000. (A. 145, 151.)

Ted Risdall served on funeral.com's Board of Directors from January 2000 to February 2001. (A. 164.) C. Risdall is Ted Risdall's uncle and M. Risdall is his grandmother. (A. 175-76.) Dozier is a friend of Ted Risdall. (A. 174.) In 2000, Ted Risdall was excited about funeral.com and thought it was a good business opportunity. (A. 172.) Ted Risdall gave to Brown the addresses of Dozier and C. Risdall. All received a copy of PPM1 before making their investment. (A. 177, 180.)

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

In their executed subscription agreements Plaintiffs acknowledged receipt of PPM1. (A. 121, 127, 132, 139, 145, 151.) They 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 understand that the Company's reliance on such exemptions is predicated in part on my representations to the Company contained herein.

- 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 am experienced and knowledgeable in financial and business matters, capable of evaluating the merits and risks of investing in the Shares, and do not need or desire the assistance of a knowledgeable representative to aid in the evaluation of such risks (or, in the alternative, I have used a knowledgeable representative in connection with my decision to purchase the Shares).

- I understand that investment in the Shares is highly speculative and involves a high degree of risk. I believe the investment is suitable for me based on my investment objectives and financial needs. I have adequate means for providing for my current financial needs and personal contingencies and have no need for liquidity of investment with respect to the Shares. 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.

(A. 121-22, 127-28, 133-34, 145-46, 151-52.) All acknowledged they were accredited investors. (A. 123, 135, 147.)

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. 63.) There was never any intent by Defendants to avoid the securities laws by splitting a single plan of financing into several different offers. (A. 62.)

Subsequent stock offerings were necessitated based on the different needs of funeral.com at the time the decisions to make offerings were made. (A. 62.) In May 2000, funeral.com was told that Corio, a major website developer, needed millions of dollars to develop the funeral.com site. (A. 63.) This need made a second stock offering necessary. (*Id.*)

B. 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. 110.) 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.*) 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. 111.) Funeral.com also stated that its "actual uses and allocation of the proceeds may vary . . . ." (*Id.*)

In May 2000, funeral.com posted the private placement memorandum on the vfinance.com website. (A. 67.) 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). When Ted Risdall on May 31, 2000 learned of the web posting, he personally called the webmaster and directed him to remove the offending material from the website immediately. (A. 165.) He explained to Brown and the other directors of funeral.com that such solicitation was not permissible. (A. 165.) The May 17, 2000 PPM2 was withdrawn and no sales were made under PPM2. (A. 63.)

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

Subsequently, a Series A Preferred Stock offering as well as a July 20, 2000 common stock offering (PPM3) were made. (A. 117, 120.) The stock was offered at $1.50 a share. The minimum investment was $9,000. (A. 118.) 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. 119.)

D. SEC Inquiry.

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. 112.) On August 10, 2000, funeral.com, inc.'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. 114.) A formal response was offered to the SEC by funeral.com's counsel on August 14, 2000. (A. 115.) 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. 116.) The SEC has not responded and no action has been taken by the SEC.

STATEMENT OF THE CASE

A. Allegations of Plaintiffs' Complaint.

Almost three years later, in March 2003, Plaintiffs brought this action against Defendant Brown-Wilbert, Inc., Brown and funeral.com in Ramsey County District Court. (A. 35.) 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.*)

In their Complaint, Plaintiffs alleged that PPM1 presented representations that

- Brown was a reputable trustworthy businessperson;
- He had invested $375,000 of his own money;
- He had not defrauded Brown-Wilbert;
- He would honor the restriction to keep sales proceeds in a segregated account;
- He was not under pressure to remit hundreds of thousands of dollars to Brown-Wilbert.

(A. 39-40.) Plaintiffs alleged that these representations were false, that they were induced to invest in funeral.com by these representations, and had they known the truth about Brown and the role Brown-Wilbert played behind the scenes, Plaintiffs would not have invested in funeral.com. (A. 41.) Based on these assertions, Plaintiffs contended Defendants "violated the securities laws of the State of Minnesota, including Minn. Stat. sec. 80A.01" and "[b]y reason of such violation, Plaintiffs have been damaged." Plaintiffs then realleged the same factual premise for their rescission claim. (A. 43.)

Based on the assertions of Plaintiffs, various third-party claims were asserted.[2] Brown-Wilbert, Inc. brought a third-party action against Marge Johnson and Ted Risdall, directors of funeral.com. (A. 16-17, 94.) Marge Johnson, in turn, brought a third-party action against John Risdall individually, Ted Risdall individually, and Risdall-Lenihan d/b/a Risdall-Lenihan Advertising n/k/a Risdall Advertising. (A. 17.)

B. Parties' Motions for Summary Judgment.

1. Plaintiffs' motion for summary judgment.

In March 2004, Plaintiffs sought summary judgment on two grounds. (A. 69.) Plaintiffs asserted that Defendants engaged in the sale of unregistered securities in violation of the Minnesota securities laws. Plaintiffs acknowledge that they purchased their shares in PPM1 offering and that PPM1 offering was made pursuant to Rule 506 of Regulation D. Even though their sales were made pursuant to PPM1, Plaintiffs assert that

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

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 that 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.)[3]

Plaintiffs' alternative ground for summary judgment rested on Plaintiffs' contention that Defendants made false statements and omissions in connection with the sale of securities. (*Id.* at pp. 10-11.) It was this theory alone that was alleged in Plaintiffs' Complaint. (A. 41.)

Plaintiffs contended that 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. They asserted entitlement to restitution of the amount paid for the stock, interest from the date of payment, costs and reasonable attorney's fees. (*Id.* at p. 13.)

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[3] Integration is the doctrine (first enunciated in SEC Reg. No. 33-97 (1933)), where two or more apparently separate offerings are constructively combined into a single offering, often resulting in the loss or unavailability of an exemption from registration for the combined offering. The doctrine is used to prevent issuers from avoiding the registration requirements of the Securities Act by dividing what would otherwise be a nonexempt offering into two or more exempt offerings. Wade, *The Integration of Securities Offerings: A Proposed Formula That Fosters the Policies of Securities Regulation*, 25 Loy. U. Chi. L.J. 199, 209 (1994).

2. Defendants' response and motion for summary judgment.

In response to Plaintiffs' motion for summary judgment, Defendants asserted that Defendants, not Plaintiffs, were entitled to judgment. There is no dispute that the Plaintiffs purchased their shares in funeral.com pursuant to PPM1 and Rule 506 of Regulation D of the federal securities laws. The sales were exempt from registration when they were made. Defendants asserted Plaintiffs' claims were barred because federal law preempts the application of Minn. Stat. § 80A.08 to this case. (A. 72.)

Even if state law applies, the sale of stock to Plaintiffs is exempt from Minn. Stat. § 80A.08 under Minnesota law. (A. 73.) 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. (Defendants' Memorandum in Support of Summary Judgment, pp. 6-7.) Defendants also asserted, in a separate memorandum, that Plaintiffs are not entitled to summary judgment. (Defendants' Memorandum of Law in Opposition to Plaintiffs' Motion for Summary Judgment dated June 16, 2005.)

Defendants further contended at oral argument that equity did not support Plaintiffs' rescission claim. (T. 7/28/05 at p. 33.)

3. Plaintiffs' admissions in reply.

In reply, Plaintiffs acknowledged that 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, A. 197). They also have admitted no sales of securities were made to any persons who were solicited via email or websites. (*Id.* at p. 4, A. 198.)

C. Trial Court Grants Plaintiffs Summary Judgment.

1. Order of September 7, 2005.

By Order dated September 7, 2005, the trial court granted Plaintiffs' motion for summary judgment against Brown and funeral.com and granted Plaintiffs the equitable remedy of rescission. (A. 4.) Defendants were ordered to pay $100,000 to Dozier, $70,000 to C. Risdall, and $50,000 to M. Risdall. (*Id.*) It was further ordered that Plaintiffs' counsel was to submit detailed proposals with respect to the amount of interest, attorney's fees and costs and disbursements. (*Id.*)

In granting summary judgment to Plaintiffs, the trial court held the case hinged on whether PPM1 and PPM2 were integrated so that they should be deemed to be part of the same offering. (A. 6.) The trial court found "Plaintiff's position is more persuasive." (A. 11.) The trial court concluded that 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 that it would not "take refuge in that no sales were made" with the second offering. The trial court states: "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. 12.)

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

> 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.

(A. 12.) The trial court concludes:

> 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. 13.)

As to Plaintiffs' alternative argument that Defendants made false and misleading statements in the sale of the securities, the trial court concluded this issue was not ripe for summary judgment. (A. 13-16.)

The trial court also granted summary judgment to Third-Party Defendant Ted Risdall and Third-Party Defendants John Risdall, Ted Risdall and Risdall Advertising Agency's motion for summary judgment against Marge Johnson. (A. 4) The trial court held that 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. (A. 4)

2. Orders of December 12, 2005.

By Order dated December 12, 2005, the 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. 26.) In another Order dated December 12, 2005, the trial court ordered that Defendants were to reimburse Plaintiffs for their attorney's fees and costs in the amount of $79,984.17, as well as $200.00 in statutory costs plus statutory interest in the amount of $47,666.67. (A. 21-22.) The district court administrator notified the parties that a judgment was entered and docketed on December 28, 2005.

That judgment, however, was not a final judgment. The trial court had not resolved the issue of Brown-Wilbert's liability to the Plaintiffs nor that of the third-party complaint of Brown-Wilbert against Third-Party Defendant Ted Risdall. In February 2006, the court recognized that the Orders of September 7, 2005 and December 12, 2005 were not dispositive of the case and there should have been no docketing of a money judgment. The docketed judgment was ordered vacated pursuant to Rule 60.01. (A. 33.)

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 Brown, funeral.com and Brown-Wilbert with prejudice and were requesting entry of final judgment based on the trial court's orders granting them summary judgment and attorney's fees. (A. 31.) The trial court then ordered:

> All claims by Plaintiffs against Defendants Christopher C. Brown and funeral.com, inc., not already resolved by prior Court Order, including any outstanding fraud claims, are dismissed with prejudice.
>
> All claims against Brown-Wilbert, Inc. are dismissed with prejudice.
>
> The Orders issued by this Court on September 7, 2005 and December 12, 2005 are now final . . . .

(A. 32.) Final judgment was entered on May 31, 2006 in the amount of $349,586.73. (A. 1.)

ARGUMENT

PLAINTIFFS ARE NOT ENTITLED TO RESCIND THEIR PURCHASE OF FUNERAL.COM STOCK.

A. Standard of Review.

This case comes before the Court on 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). 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). To withstand summary judgment, "a party need not show substantial evidence." Instead, summary judgment is inappropriate if the non-moving party has the burden of proof on an issue and presents sufficient evidence to permit reasonable persons to draw different conclusions." *Schroeder v. St. Louis County*, 708 N.W.2d 497, 507 (Minn. 2006).

Interpretation of a statute is a question of law over which this Court has de novo review. *Nash v. Wollan*, 656 N.W.2d 585, 589 (Minn. Ct. App. 2003), *rev. denied.* 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 the Application of Minn. Stat. Chapter 80A and This Action Must Be Dismissed.

Plaintiffs sought and the trial court granted rescission of their purchase of funeral.com shares under Minn. Stat. § 80A.08 and 80A.23. Minn. Stat. § 80A.08 makes it unlawful to offer or sell a security in Minnesota unless the security is registered, the security or transaction is exempted or the security is a federal security. Minn. Stat. § 80A.23, subd. 1 provides the remedies for violations of Minn. Stat. § 80A.08. It is Defendants' position that federal law preempts the application of Minn. Stat. Chapter 80A to this case.

1. Federal securities scheme.

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. Taylor, *The Issuance of Securities by Small and Growing Business: A Primer*, 22 Wm. Mitchell L. Rev. 1375, 1379-85 (1996); *Securities and Exchange Comm'n 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. 6,863 (March 8, 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 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. (A. 197.)

2. Enactment of NSMIA, 15 U.S.C. § 77r.

In 1996, Congress enacted the National Securities Markets Improvements Act (NSMIA), 15 U.S.C. § 77r. It expressly preempts from state registration "covered securities" and provides preemption whereby such covered securities need not register their stock sale transactions with any state agency. *Lander v. Hartford Life & Annuity Ins. Co.*, 251 F.3d 101, 108 (2nd Cir. 2001) (primary purpose of NSMIA to preempt state "Blue Sky" laws). 15 U.S.C. § 77r(a) states:

> [N]o law, rule, regulation, or order or other administrative action of any State or any political local division 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; . . . (3) shall directly or indirectly prohibit, limit, or impose conditions, based on the merits of such offering or issuer, upon the offer or sale of any [covered security].

15 U.S.C. § 77r(a) (1997 & Supp. 2001), *quoted in Temple v. Gorman*, 201 F. Supp. 2d 1238, 1243 (S.D. Fla. 2002). Among the covered securities contemplated in NSMIA are those described in 15 U.S.C. § 77r(b)(4)(D), which provides "a security is a covered security with respect to a transaction that is exempt from registration under this subchapter pursuant to . . . Commission rules or regulations issued under Section 77d(2) of this title . . . ." Shares issued pursuant to the exemption stated in Rule 506 of the

SEC's Regulation D, 17 C.F.R. § 230.506, comes within the preemption provision of 15 U.S.C. § 77r(b)(4)(d).

NSMIA changed Section 18 of the Securities Act of 1933 that had preserved the jurisdiction of the states prior to the 1996 Act. Under the Securities Act, as amended by the 1996 Act, the states are prohibited from requiring registration or from regulating four classes of covered securities. 15 U.S.C. § 77r. In response to the 1996 Act, in 1997, Minn. Stat. § 80A.08 was amended to exclude federal covered securities from being subject to Minn. Stat. § 80A.08.

3. Plaintiffs' claims are preempted.

In this case, there is no dispute that the Plaintiffs purchased their shares in an offering made pursuant to Rule 506 of Regulation D. The sales were exempt from registration when they were made. The initial private offering memorandum delivered to Plaintiffs clearly indicated that the sales to Plaintiffs were being made in reliance on the exemptions provided in Regulation D. 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. 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 law." (Plaintiffs' Memorandum of Law in Opposition to Defendants' Motion for Summary Judgment – Statement of Undisputed Facts, p. 3, A. 197) (emphasis in original).

a. 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 federal district court recently held in *Pinnacle Communications Int'l, Inc. v. American Family Mortgage Corp.*, 417 F. Supp. 2d 1073, 1087 (D. Minn. 2006).

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 v. Gorman*, 201 F. Supp. 2d 1238 (S.D. Fla. 2002); *Lillard v. Stockton*, 267 F. Supp. 2d 1081, 1116 (N.D. Okla. 2003).

In *Temple*, the Florida district court reviewed the legislative history of NSMIA and determined that 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 and 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. (A. 197.) Plaintiffs' state law claim is preempted and Plaintiffs cannot seek or obtain redress under Minn. Stat. § 80A.23.

b. Trial court's analysis must be rejected.

The trial court, with citation to no authority, has ruled that Minnesota law is not preempted. (A. 12.) Under the trial court's analysis, exemption and preemption are equivalent. According to the trial court, the only way to assert federal preemption is to first show an exemption from federal registration actually applies.[4] (*Id.*) The trial court then denies preemption because it finds the exception actually does not apply because it views PPM1 and PPM2 as integrated sales and that the placement of PPM2 on the websites removes the exemption. According to the trial court, "[t]he Defendant did not comply with federal requirements because, after the Court determined the sales were integrated, they failed to comply with Regulation D." (A. 12.) But that ignores Plaintiffs' admission that PPM1, which is the offering pursuant to which they made their stock purchases, was made in conformity with Regulation D.

In accord with the federal district court's decision in *Pinnacle*, Plaintiffs' claims are preempted and the trial court must be reversed and this action ordered dismissed.

C. 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 on

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[4] Although not cited by the trial court, *Buist v. Time Domain Corp.*, 926 So. 2d 290, 296 (Ala. 2005), and *Hamby v. Clearwater Consulting Concepts, LLLP*, 428 F. Supp. 2d 915 (E.D. Ark. 2006), reject the analysis of *Temple* and *Pinnacle*. In *Buist*, the Alabama Supreme Court denied the exemption to defendant because it submitted no evidence indicating the sale of securities were actually made in conformity with Regulation D. *Id.* at 297-98. This same analysis was conducted in *Hamby*, 428 F. Supp. 2d at 921. Neither case involves the issue of integration. Plaintiffs have admitted that the securities were sold to them pursuant to Rule 506 of Regulation D. (A. 197.)

Plaintiffs' assertion that because there was an inadvertent posting on the website and a mailing of PPM2, the exemption for PPM1 is lost under the principles of integration.[5] The trial court agreed, and Defendants challenge that ruling on appeal. (A. 12.)

1. Minnesota law exempts sales made in reliance on Regulation D.

Minn. Stat. § 80A.15, subd. 2(h) exempts sales made "in reliance on the exemptions provided by Rule 505 or 506 of Regulation D promulgated by the Securities and Exchange Commission . . ." if the offer and sale also satisfies the conditions and limitations in clauses (1) to (10). Subsection (10) incorporates the integration standards of Rule 502 of Regulation D. It 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.

Minn. Stat. § 80A.15, subd. 2(h)(10). Rule 502 of Regulation D, 17 C.F.R. § 230.502, which sets out the integration standard, in turn, states:

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[5] Notably, the SEC has taken no action against Defendants. The trial court simply assumed that Defendants had lost their exemption for PPM2, without requiring proof of that by Plaintiffs.

> a) Integration. All <u>sales</u> 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 made more than six months after completion of a Regulation D offering will not be considered part of the 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 similar class as those offered or sold under Regulation D . . . .
>
> 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 Section 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 . . .
>
> The following factors should be considered in determining whether offers and sales should be integrated for purposes of the exemptions under Regulation D:
>
> (a) whether the <u>sales</u> are part of a single plan of financing;
> (b) whether the <u>sales</u> involve issuance of the same class of securities;
> (c) whether the <u>sales</u> have been made at or about the same time;
> (d) whether the same type of consideration is being received; and
> (e) whether the <u>sales</u> are made for the same general purposes.

(Emphasis added.)

While the term offering is not defined in the Act or Regulation D, Section 2(3) of the 1933 Act defines "sale" and "offer." A "sale" includes "every contract of sale or disposition of a security or interest in a security for value." 15 U.S.C. § 77b(a)(3). An "offer" includes "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." *Id.*[6]

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

In order to have integration, there must be sales in the offerings sought to be integrated. Rule 502(a) unequivocally states: "All sales that are part of the same Regulation D offering must meet all the terms and conditions of Regulation D." (Emphasis added.) 17 C.F.R. § 230.502.

In addition to the language of Rule 502(a), Rule 155, which was released February 5, 2001, reaffirms the SEC's emphasis on the need for actual completed sales before integration is even an issue. 17 C.F.R. § 230.155. Rule 155 specifically states that it does not modify or rescind the five-factor test in determining whether securities offerings should be integrated. Rule 155 then addresses a registered offering (where public solicitation is allowed) that follows an abandoned private offering, or a private offering that follows a withdrawn registered offering. *Id.* at subd. (a) and (b). Rule 155 now provides that 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. *Id.*

[6] Minn. Stat. § 80A.14, subd. 17(1) and (2) provides the same definition. The term offering is also defined in Minnesota's statute. In addition, Minn. Stat. § 80A.15, subd. 2(h) refers to "offers and sales" in the conjunctive. Accordingly, both are necessary in order to apply the integration rule.

Rule 155 further provides that 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. Rule 155 clearly shows that it is the "sales" that are important in determining whether two offerings should be integrated and treated as one.

The trial court was in error when it stated that

> [I]t is inconsequential that the second offering was withdrawn before any sales, as the entire offering was tainted. It has been established that the Defendant conducted general solicitations of unregistered securities. The Court does not take refuge in that no sales were made.

(A. 12.) The fact that there were no sales as a result of PPM2 is both relevant and determinative.

The offering pursuant to PPM2 was, for all intents and purposes, a nullity. No sales were ever made under PPM2. Therefore, as a matter of law, PPM2 had no impact on the exemption used in PPM1. Because no sales were ever made under PPM2, there can be no integration with PPM1. PPM1 remains exempt under Rule 506 of the federal securities laws. Because of the federal exemption, the state securities laws are preempted and there can be no violation of Minn. Stat. Chapter 80A.

The trial court, in its ruling, also "notes that the Defendants did not withdraw the offer until it was advised by the SEC that its tactics were improper." (A. 12.) That is factually incorrect. According to Ted Risdall, as soon as he learned on May 31, 2000 that there had been a posting of PPM2 and the subscription agreement on the website, he called the webmaster and directed their removal. (A. 165.) Mr. Risdall goes on to incorrectly state that it was at the May 31, 2000 meeting that the directors were informed of a letter by the SEC complaining about the general solicitation of securities. (A. 165.) In fact, the SEC's letter is dated August 3, 2000 and was discussed at the August 10, 2000 funeral.com board meeting. (A. 112, 114.) The trial court was obligated to view the facts in a light most favorable to Defendants, which it did not do. The record does not support the trial court's statement that "the Defendants did not withdraw the offer until it was advised by the SEC that its tactics were improper." (A. 12.)

E. Applying the Facts of Record in a Light Most Favorable to Defendants, There Is No Integration.

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 does not result in integration of PPM1 and the following offerings.

1. Purpose of integration doctrine.

Integration operates to identify the scope of a particular offering by considering the relationship between multiple transactions. The SEC developed the concept of integration shortly after the passage of the 1933 Act to prevent issuers from circumventing the Act's registration requirements. *See* Darryl B. Deaktor, *Integration of Securities Offerings*, 31 U. Fla. L. Rev. 465, 492-93 (1979). The integration doctrine, conceptually, was to protect investors from unscrupulous issuers. 17 C.F.R. § 230.155.

To evade the Act's registration requirements and the accompanying expense and delay where there is no legitimately available exemption, many issuers divided what is essentially one offering, for which no exemption is available, into two or more separate offerings that each satisfy exemption requirements. *See* Kathryn Taylor Frame, *Note, Securities Regulation: Integration of Securities Offerings*, 34 Okla. L. Rev. 864, 866 (1981). Because the boundaries of the Act's exemptions have been carefully drawn, the division of single offerings for the sole purpose of avoiding registration frustrates the Act's registration requirement and the Act's goal of investor protection through full and fair disclosure. The doctrine of integration attempts to prevent the misuse of the Act's exemptions by combining offerings that have been purposefully separated into a single integrated offering for which there may be no exemption from registration. *Donohue v. Consolidated Operating & Production Corp.*, 982 F.2d 1130, 1140 (7th Cir. 1992) ("the doctrine of integration prevents issuers of securities from avoiding the requirements of section 5 by breaking offerings into small pieces"). *See* ABA Committee on Federal Regulation of Securities, *Integration of Securities Offerings: Report of the Task Force on Integration*, 41 Bus. Law 595 (1986); Wade, 25 Loy. U. Chi. L.J. at 209.

Integration is most often used as a regulatory device to prevent issuers from splitting offerings which might not meet the dollar requirements or number of purchase requirements of a Regulation D exemption to two or more offerings in order to thwart the scheme and avoid registration. Offerings are integrated and registration is required when issuers have abused the Act's exemptions. 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 (Winter 2003).

2. Integration doctrine is confusing and ambiguous.

Because the integration doctrine depends on the facts and circumstances of each situation, sparse precedent exists. *See* Wade, 25 Loy. U. Chi. L.J. at 220-21; Frame, 34 Okla. L.J. at 870. 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). Furthermore, because of the factual nature of integration determination, the SEC adopted a policy in 1979 not to give interpretive advice on the topic. In 1985, the SEC discontinued this policy. Since then, the SEC has taken a number of significant interpretive positions, but elucidation of the five-factor test has been extremely limited, and the whole area remains very murky.

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. As a result, the area remains confusing and dangerous.

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).

Perhaps the most maligned component of the five-factor test is the ambiguity resulting from the SEC's refusal to give weight to the five factors or to describe in any comprehensible detail the relevance of each factor when compared against the others. Cummings, 48 Wayne L. Rev. at 1340 and 1345, *quoting* C. Steven Bradford, *Expanding the Non-Transactional Revolution: A New Approach to Securities Registration Exemptions*, 49 Emory L.J. 437, 462 (2000). "The first and fifth factors, which appear to have some overlap in meaning, have been said to be more important than the other factors." Vaaler, 63 Miss. L.J. at 197. 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 U. Fla. L. Rev. at 542.

3. The trial court's application of the test is in error.

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. 11.) 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. It is Defendants' position that, viewing the facts of record in a light most favorable to Defendants, requires reversal of the trial court's integration determination.

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

One of the components of the SEC's formula for integration involves determining whether the sales are a single plan of financing. The SEC staff and the courts have frequently cited the single plan of financing factor in deciding whether multiple securities offerings should be integrated. *See*, *e.g.*, *SEC v. Murphy*, 626 F.2d 633, 645-46 (9th Cir. 1980); *Walker v. Montclaire Housing Partners*, 736 F. Supp. 1358, 1364-65 (M.D.N.C. 1990). In fact, a single plan of financing was found in every case where integration was mandated. Frame, 34 Okla. L. Rev. at 870-71.

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 (S.D.N.Y. 1976) (A. 181) (federal district court denies integration in the absence of an apparent plan of financing).

The question is whether the offerings 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. As Brown testified, which testimony stands undisputed, "each 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. 63.) Despite this evidence of record and the standard of review, the trial court finds "[t]he funds were (a) part of a single plan of financing: to start Funeral.com . . . ." (A. 11.) This is error.

b. Sales were not made for the same general purpose.

Another factor[7] 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. 12.) 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. 82.)

[7] This is actually the fifth factor, but has been viewed to be more important than the other factors, other than factor one – whether there was a single plan of financing. Vaaler, 63 Miss. L.J. at 197.

The minimum shares were sold and PPM1 raised $760,006. (A. 66, 78.) Accordingly, 50% of PPM1 was used for this sole purpose, which was not the purpose of PPM2 or PPM3. It has been suggested that when the offer shows that more than 25% of the securities offered are to be used for one purpose, the offering should be deemed to have been for that purpose. ABA Task Force on Integration, 41 Bus. Law at 636. Here, the purpose of PPM1 was to repay Brown. Payment of the note to Brown had nothing to do with the subsequent offerings and those offerings were not made for the same purpose.

In addition, Brown testified that the PPM2 was necessitated because in May, Corio, a major website developer, needed millions of dollars to develop the funeral.com site. (A. 63.) 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.

c. The offerings do not all involve the same class of securities.

Another factor which the SEC and the courts look to in determining whether multiple securities offerings should be integrated is whether the offerings 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. 11-12.)

The cases and no action letters offer little guidance as to the weight to be given the same class of securities factor in the integration analysis. Cummings, 48 Wayne L. Rev. at 1347-48. Offerings involving classes of securities that have not been clearly and conclusively distinguished have nonetheless been found to be non-integrable. In fact, when two or more securities are only slightly different, the SEC staff and courts have refrained from integrating offerings or have found that offerings did not involve the same class of securities. *See SEC v. Dunfee* [1966-67 Transfer Binder], Fed. Sec. L. Rptr. (CCH), ¶ 91,970 at 96,302 (W.D. Mo. 1967) (A. 186) (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 U. 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. *1Id.* and 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. More importantly, the minimum investment is vastly different between PPM1 and PPM2. PPM1 required a minimum investment of $50,000. (A. 78.) In contrast, the minimum for PPM2 was $10,000 and $9,000 for PPM3. (A. 110, 118.) Clearly, given the disparity in price and minimum investment, the pool of potential investors which Defendants looked to in PPM2 is vastly different than PPM1.

Also offered was funeral.com preferred stock. The trial court did find the same class of stock was offered by Defendants by accepting Plaintiffs' argument that the preferred shares offering should not be considered in the integration analysis. (A. 11-12.) But such a holding contradicts the trial court's finding that Defendants engaged in a single plan of financing. (A. 11.) Integrating sales combines artificially divided offerings into one – if Defendants had a single plan of financing, the integration of PPM1, PPM2, the preferred offering and PPM3 would be required.

On summary judgment, the trial court is obligated to view the facts in a light most favorable to Defendants. The undisputed fact is that offerings do not all involve the same class of securities.

d. Consideration is not a determinating factor.

Another factor in the SEC's formula to determine whether separate securities offerings should be integrated is whether the securities are offered in exchange for the same consideration. Here, cash consideration was paid in all sales. (A. 12.) The same consideration factor poses a problem because cash is most often the consideration sought in securities offerings. *See* Deaktor, 31 U. 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 offerings to avoid the Act's registration requirements. Wade, 25 Loy. U. Chi. L.J. at 216.

e. Timing does not support integration.

Another factor the SEC and courts will examine when determining if two or more securities offerings should be integrated is whether they 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 U. Fla. L. Rev. at 534. The timing of the offerings 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) (A. 193) (concluding that the mere fact that the mutual fund was continuously offered does not necessarily lead to the conclusion that the continuous offering should be integrated and subject to registration). 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. 12.)

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, Fiche 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, the trial court must be reversed. The record does not support integration.

F. Regardless of Whether the Offerings Are Deemed Integrated, Under the Facts of This Case, Plaintiffs Are Not Entitled to Rescind Their Transaction.

Plaintiffs were granted rescission under Minn. Stat. § 80A.23. Equitable principles apply in a purchaser's action for rescission. Minn. Stat. § 80A.23(1); *Logan v. Panuska* 293 N.W.2d 359, 363 (Minn. 1980). It is Defendants' position that 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 the federal district court 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. *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). In *Wingsco Energy One v. Vanguard Groups Resources 1984, Inc.*, 699 F. Supp. 1232, 1240 (S.D. Tex. 1988), the federal district court denied plaintiffs rescission, finding 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).

Defendants argued to the trial court that under *Logan* the court must examine the equities before granting rescission. (T. 7/28/05 at p. 33.) The trial court, while recognizing that such an argument was before it, failed to address it. (A. 11.)

Here, the trial court has allowed rescission, ignoring that its application of rescission 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. To apply Minn. Stat. § 80A.23 as the trial court has done here leads "to harsh and unfair results where no actual fraud is present."

Clapp, 327 N.W.2d at 587. Here, there is no claim of fraud, Plaintiffs having voluntarily dismissed such unfounded assertions. (A. 31-32.) The grant of rescission should be reversed.

CONCLUSION

Appellants respectfully request that the trial court be reversed and this action ordered dismissed. In the alternative, if the Court finds a material issue of fact, the judgment must be reversed and the case remanded for further proceedings.

Dated: August 25, 2006

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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 10,103 words. This brief was prepared using Word Perfect 10.

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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) (with amendments effective July 1, 2007).