NO. 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.

RESPONDENTS' SUPPLEMENTAL BRIEF AND APPENDIX

Kay Nord Hunt (#138289)
LOMMEN, NELSON, COLE & STAGEBERG, P.A.
2000 IDS Center
80 South Eighth Street
Minneapolis, MN 55402
(612) 339-8131

George E. Antrim, III, Esq. (#120534)
GEORGE E. ANTRIM III PLLC
201 Ridgewood Avenue
Minneapolis, MN 55403
(612) 872-1313

Attorneys for Appellants

Scott D. Hillstrom (#15524X)
GUARDIAN LAW GROUP, LLC
527 Marquette Avenue
Suite 1800
Minneapolis, MN 55402
(612) 332-8063

Peter A. Koller (#150459)
MOSS & BARNETT, P.A.
4800 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402
(612) 877-5302

Daniel J. Morrissey
GONZAGA UNIVERSITY
SCHOOL OF LAW
Box 3528
Spokane, WA 99220-3528
(509) 323-3693

Attorneys for Respondents

2008 – BACHMAN LEGAL PRINTING – FAX (612) 337-8053 – PHONE (612) 339-9518 or 1-800-715-3582

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INTRODUCTION

Plaintiffs Charles Risdall, Len Dozier and John Risdall ("Plaintiffs") submit this Supplemental Brief pursuant to the Court's Order dated August 14, 2008. The sole issue for determination at this time is whether the district court properly granted summary judgment to Plaintiffs under the five-factor integration test endorsed by the Minnesota Supreme Court in this case.

Faced with the parties' cross-motions for summary judgment, the district court held, as a matter of law, that Defendants Christopher C. Brown and funeral.com, Inc. ("Defendants") were liable for selling unregistered securities to Plaintiffs because (a) it is undisputed that Defendants sold unregistered securities to Plaintiffs and (b) Defendants failed to introduce facts sufficient to carry their burden of proof as to their claimed registration exemption. Whether Defendants are entitled to that exemption turns on whether Defendants' offers and sales of securities using offering materials dated March 2, 2000 (PPM1) are "integrated" with Defendants' illegal offers of securities using offering materials dated May 17, 2000 (PPM2). As the supreme court succinctly explained, "[I]f integration occurs, then [Defendants] are not entitled to the state exemption provided in Minn. Stat. § 80A.15, subd. 2(h)." *Risdall v. Brown-Wilbert, Inc.*, 753 N.W.2d 723, 731 (Minn. 2008).[1]

[1] For purposes of this case, it is relevant only that purported offerings PPM1 and PPM2 are integrated. They are either integrated or not as of the time the illegal act occurred; whether the subsequent PPM3 offering is integrated or not does not affect the result.

ARGUMENT

I. DEFENDANTS CARRY A SUBSTANTIAL BURDEN OF PROOF.

The opinion issued by the supreme court lays out the procedural history of this case and the relevant facts. 753 N.W.2d at 725-27. Those facts are set forth with specific citations to the record at pages 4-7 of Plaintiffs' initial brief to this Court. Resp. Supp. App. ("R.S.A.") 2-5.[2] The basic summary judgment standard applicable to this case is also set forth in Plaintiffs' initial brief. R.S.A. 6. That statement of the summary judgment standard should be supplemented by the Minnesota Supreme Court's statement that, when faced with a motion for summary judgment, a court "must view the evidence presented through <u>the prism of the substantive evidentiary burden</u>." *Richie v. Paramount Pictures Corp.*, 544 N.W.2d 21, 26 (Minn. 1996) (quoting *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 254 (1986)) (emphasis added).

Here, it is <u>Defendants</u> who have the burden of proving that they are entitled to exemption from registration. *See SEC v. Ralston Purina*, 346 U.S. 119, 136 (1953) (holding that issuer of unregistered securities has the burden to prove compliance with the private placement exemption). Moreover, to carry that burden, Defendants must present proof that is "explicit, exact, and not built on [their own] conclusory statements." *See Johnston v. Bumba*, 764 F. Supp. 1263, 1273 (N.D. Ill. 1991) (quoting *SEC v. Continental Tobacco Co.*, 463 F.2d 137, 156 (5th Cir. 1972)). Because Defendants failed

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[2] For the Court's convenience, relevant portions of Respondents' Brief are copied in the appendix to this Supplemental Brief.

to produce such "explicit," "exact" and non-conclusory evidence, the district court properly granted summary judgment to Plaintiffs.

II. THE INTEGRATION DOCTRINE SEEKS TO PREVENT ISSUERS FROM AVOIDING ENFORCEMENT OF THE REGISTRATION STATUTES.

All sales of unregistered securities are *strictly* prohibited by federal and state statutes. *See* 15 U.S.C. § 77l(a)(1); Minn. Stat. § 80A.23. Parties who offer and sell unregistered securities are held *strictly liable* to purchasers, unless they can prove that the securities offering qualifies for exemption from the registration requirements. In this case, the exemption claimed by Defendants is not available because Defendants violated a requirement of the exemption by conducting advertising and general solicitations.

Defendants cite no law that would excuse what they claim was an inadvertent violation of the requirements for exemption under Regulation D, because there is no such law. Rather, Defendants can only carry their burden of establishing an exemption from registration if they are permitted to separate their offering of funeral.com common stock using PPM1 and PPM2 into two different offerings. As the supreme court noted in this very case, however, the Integration Doctrine is intended to prevent such a result:

> The SEC has explained that "[t]he integration doctrine seeks to prevent an issuer from improperly avoiding registration by artificially dividing a single offering into multiple offerings such that Securities Act exemptions would apply to the multiple offerings that would not be available for the combined offering." Securities Act Release No. 8828, Investment Company Act Release No. 27,922, 72 Fed. Reg. 45,116, 45,129 (proposed Aug. 10, 2007).

Risdall, 753 N.W.2d at 731 (emphasis added).

III. ALL FIVE INTEGRATION FACTORS NEED NOT BE PRESENT.

As explained at pages 19-27 of Plaintiff's initial brief (R.S.A. 10-18), the SEC has established a five-factor test for determining whether purportedly separate offerings are really a single, integrated offering. Contrary to Defendants' implied assertion, this Court may affirm the summary judgment ruling of the district court even if undisputed facts do not conclusively establish each of the five integration factors. *See SEC v. Murphy*, 626 F.2d 633, 646 (9th Cir. 1980); *see also S EC v. Cavanagh*, 1 F. Supp. 2d 337, 364 (S.D.N.Y. 1998). In *Murphy*, the Ninth Circuit affirmed a summary judgment ruling that multiple purportedly separate offerings were integrated, even though the court concluded that only four of five integration factors had been established. 626 F.2d at 646. Indeed, the *Murphy* court concluded that one of the factors suggested that the various transactions were not integrated, but that that factor was "heavily outweighed" by the other factors. *Id.* Similarly, the court in *Cavanagh* expressly stated "[n]ot all of these factors need to be established to justify a finding that transactions claimed to be separate were in fact one integrated transaction." 1 F. Supp. 2d at 364.[3]

Since all of the factors are not needed to trigger integration, the existence of a fact dispute concerning a particular factor or factors is not sufficiently "material" to defeat summary judgment if the other factors definitively favor integrating purportedly separate transactions. Accordingly, this Court should affirm the decision of the district court so long as enough of the factors have been established trigger integration. That said, as set

[3] The *Ishopnomarkup.com* case cited by Defendants does not hold differently. *See SEC v. Ishopnomarkup.com, Inc.*, 2007 WL 2782748 (E.D.N.Y.) (copied at A.S.A. 1).

forth at pages 20-27 of Plaintiffs' initial brief (*see* R.S.A. 11-18) and in the following sections of this brief, undisputed evidence establishes <u>each</u> of the factors.

IV. DEFENDANTS SHOULD NOT BE ALLOWED TO CONTRADICT THE STATEMENTS THEY CHOSE TO PUT IN PPM1 AND PPM2.

All of the necessary factual grounds for integration are plainly established by Defendants themselves (in Defendant Brown's sworn affidavits) or within the four corners of the securities offering documents (PPM1 and PPM2) that Defendants used to offer and sell securities to Plaintiffs and many other investors. These facts are outlined in the following section of this brief and can be fully examined in the PPMs and affidavits contained in Appellants' Appendix. Obviously, Defendants do not dispute their own sworn statements. Meanwhile, all of the investor representations contained in the PPMs were made under a strict legal duty not "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." Securities Exchange Act Rule 10b-5, 17 C.F.R. 240.10b-5, promulgated under Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b); Minn. Stat. 80A.01 (a) and (b). The statements made in the PPMs should, therefore, be taken as facts that cannot be disputed.

For Defendants to dispute statements contained in the PPMS -- like Defendant Brown has done with his self-serving statement that he did not plan to do more than one offering (A. 62), even though PPM1 explicitly states Defendants expected to need to raise more capital than the amount raised using PPM1 (A. 87) -- is tantamount to, if not the equivalent of, the very fraudulent conduct that the above-cited statutes were adopted to prevent. Furthermore, such an attempt to create a fact issue is the functional equivalent of introducing a "self-serving" affidavit to contradict prior damaging deposition testimony -- a practice that this Court has previously held to be insufficient to defeat a properly supported motion for summary judgment. *See Banbury v. Omnitrition Int'l, Inc.*, 533 N.W.2d 876, 881 (Minn. Ct. App. 1995) ("A self-serving affidavit that contradicts earlier damaging deposition testimony is not sufficient to create a genuine issue of material fact."). For those reasons, this Court should disregard those portions of Defendants' self-serving affidavits that attempt to contradict the statements contained in PPM1 and PPM2.

V. THE DISTRICT COURT REACHED THE PROPER RESULT UNDER THE FIVE-FACTOR TEST.[4]

There was a single plan of financing. According to the plain language of PPM1 and PPM2, both purported offerings are part of a single plan to raise millions of dollars over a period of time to finance the start-up costs and operations of Defendant funeral.com. The offering began with PPM1 and Defendants continued to raise financing for all the same purposes using PPM2 and PPM3. The cover page of PPM1 states that Defendant funeral.com sought to raise a minimum of $700,000 and a maximum of $3,600,000 (A.A. 78), reflecting a need for the maximum and a readiness to close escrow as soon as the minimum was reached. Furthermore, the "Use of Proceeds" section of PPM1 states, "We will likely need to raise additional capital *immediately* in order to fund

[4] All five of factors of the integration test are discussed in detail at pages 20-27 of Plaintiffs' initial brief to this Court. R.S.A. 11-18. The following discussion highlights and supplements elements of that earlier discussion.

our expansion, to develop new or enhanced existing services or products, to respond to competitive pressures or to acquire complementary products, businesses or technologies." A.A. 87 (emphasis added).

As foreseen, more money was needed, much more. Sales using PPM1 totaled only $760,006 (A.A. 66), a result that Brown described as "disappointing" in one of the two affidavits that he filed in connection with the cross-motions for summary judgment (A.A. 62). Notwithstanding his self-serving statement that a single offering was all that was ever intended, even Brown concedes that the "disappointing" returns under PPM1 made PPM2 necessary. *Id.*

Defendants issued PPM2, only three weeks after funeral.com made the last sale to one of Plaintiffs using PPM1. A.A. 109. The offer of common stock under PPM2 reflects a desire to raise the funds that Defendants had planned but failed to raise using PPM1 or, in the alternative, an implementation of Defendants' stated plan to raise more money "immediately" after PPM1 was completed. In either event, the offers using PPM2 were plainly part of the same plan of financing as the offers and sales to Plaintiffs using PPM1.

Later, Defendants started using PPM3, planning to sell exactly twice as many shares of common stock as PPM2 at half the price to raise the exact same amount of money. A.A. 117. Though the PPM3 offering is not relevant to the integration of the preceding two offerings, it shows the continuation of the same plan of financing that was described in both PPM1 and PPM2. Indeed, between the three purported offerings, Defendants raised only $931,006 dollars of the $3,600,000 they planned to raise when they issued PPM1. Thus, it is clear from Defendants' own PPMs that the PPMs were all part of one single plan of financing.

This is not a case, as Defendants contend, where the issuer encountered unanticipated expenses forcing it to sell shares it had not previously planned to sell. Rather, funeral.com was a typical start-up business that had only a rough idea of how much money it would need and that attempted to raise money as-needed to fund the start-up. Defendant Brown's claim that he expected each offering to be the last -- that there was no plan to conduct more than the first offering -- in his sworn affidavit (A.A. 63) is disingenuous at best and is belied by the plain language of the PPMs that he provided to investors in which he said more money would be raised after raising money using PPM1.

The same class of securities was offered. Both PPM1 and PPM2 offered only common stock for sale. Consistent with Minn. Stat. § 302A.401, all of the shares of common stock offered had the same rights and privileges.

The purportedly separate offerings were made at or about the same time. The purported offerings were conducted virtually back-to-back, reflecting the execution of one continuous offering from start to finish. Only 19 days separated the date of the last sale to a Plaintiff -- April 28 -- from the date on which Defendants started using PPM2 -- May 17. A.A. 148 and 109. Rule 502(a) creates a safe harbor ensuring that sales that occur more than six months before an initial offering or more than six months after an offering period ends will not be integrated. *See* 17 CFR 230.502(a). Only three weeks passed between the last sale to Plaintiffs and the release of PPM2.

The purportedly separate offerings involved the same type of consideration. The same type of consideration -- *i.e.*, cash -- was sought in each purported offering. Whether the price differs for the sale of the same securities is not relevant. The Integration Doctrine asks only whether the "type" of consideration was the same. Here, the consideration required and received for all offers and sale of the common shares was U.S. Dollars paid in cash.

The purportedly separate offerings were for the same general purpose. Both PPM1 and PPM2 state that the offering proceeds would be used to pay for "marketing and promotional expenses, web-site development, [equipment], salaries and general working capital." A.A. 82 and 110. Indeed, the "Use of Proceeds" language in the two PPMs is identical, except that PPM1 uses the words "purchase equipment" while PPM2 uses the words "equipment purchases." *Id.*

Contrary to Defendants' arguments, the fact that a portion of the proceeds raised from PPM1 were used to reimburse Defendant Brown for start up expenses he had already paid does not mean that the purportedly separate offerings did not share the same general purpose. The proceeds paid to Brown from PPM1 repaid him for previous payments of the very same types of expenses that the rest of the proceeds were used to pay --"the development of the site design, maintenance of the site and associated costs." A.A. 82. Defendants argue that, because some proceeds paid for expenses retrospectively by reimbursing Brown while other proceeds were used to pay the same expenses prospectively from offering proceeds, the offering made by PPM1 was not for the same general purposes as the offering made by PPM2. In fact, all proceeds of both offerings were used for the same purposes, whether those purposes were fulfilled by paying the same expenses by means of reimbursement or directly from proceeds.

The objective facts speak clearly and loudly for themselves.[5] *All five factors are strongly supported by those facts. Accordingly, the district court properly concluded that the purportedly separate offerings are integrated.*

VI. VARIOUS AUTHORITES CITED BY DEFENDANTS DO NOT PERSUASIVELY SUPPORT DEFENDANTS' POSITION.

A. *SEC v. Ishopnotmarkup.com* Supports the District Court's Decision in the Present Case.

Defendants cite *SEC v. Ishopnomarkup.com* in their supplemental brief as authority for why integration should not apply. 2007 WL 2782748 (E.D.N.Y.) (copied at A.S.A. 1). This is curious, because that case actually provides strong support for the district court's summary judgment ruling in the present case.

Applying the five-factor integration test, the court in *Ishopnomarkup.com* held (in the context of a summary judgment motion) that three purportedly separate offerings were all one, integrated offering. *Id.* at *5. That is significant, because a comparison of the facts of *Ishopnomarkup.com* to the facts of the present case reveals that the five-factor

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5 Defendants wrongly imply that the key to integration is the issuer's subjective intent -- *i.e.*, whether, at the outset, the issuer made a conscious decision to use multiple purported offerings to try to avoid federal and/or state registration requirements. The fact is, the only time the Integration Doctrine ever can be applied is after the fact, when an issuer attempts to avoid legal liability by raising a "separate offerings" defense. In reviewing this defense, all five integration factors concern only objective facts and, consistent with the underlying rule of strict liability for issuers of unregistered securities, none of them concern subjective intent or inadvertent error. There would be an absurd futility to the Integration Doctrine if an issuer could defeat integration by simply claiming that he or she did not subjectively "intend" to do multiple offerings.

test is met even more squarely in the present case than it was in *Ishopnomarkup.com*. Both funeral.com and Ishopnomarkup.com were formed around the year 2000 to conduct internet commerce, and both tried to raise capital in what they purported were three separate exempt offerings. In both situations it was undisputed that the defendants did not file a registration statement, and the defendants in each case therefore bore the burden to prove the applicability of the claimed exemption.

As to the five factors, both Ishopnomarkup.com and funeral.com conducted their purportedly separate offerings as part of a single, continuous plan to provide financing for their start-up companies, although Ishopnomarkup.com had considerably more fundraising success than did funeral.com. Unlike funeral.com, which had a "disappointing" return under PPM1 and never got close to raising the maximum amounts identified in its various offering materials, Ishopnomarkup.com sold out its initial purported offering and sold hundreds of thousands of shares using subsequent materials. They both sold the same class of securities in each purportedly separate offering -- common stock. The time period spanned by the combined offering in the present case was considerably shorter than the eleven-month period in *Ishopnomarkup.com*, however. In addition, while the same consideration, cash, was received at all times in both cases, the *Ishopnomarkup.com* case appears to have involved a greater variety in the use of the proceeds (web-site development, consulting, marketing, and working capital) than exists in the present case (paying for start up costs and web-site development).

Looking at all of the five factors, it would seem that Ishopnomarkup.com had a stronger argument under the integration test than Defendants have. Nevertheless, the court in *Ishopnomarkup.com* concluded, as a matter of law, that the purportedly separate offerings of Ishopnomarkup.com were integrated. This Court should follow the lead of the *Ishopnomarkup.com* court by affirming the summary judgment in favor of Plaintiffs.

B. <u>Other Authorities Cited by Defendants Are Not Persuasive.</u>

As Plaintiffs have explained in their first brief to this Court at pp. 20-22, the situation here is quite different from two other cases where Courts held that a single plan of financing was not present. *Livens v. William D. Witter, Inc.*, 374 F. Supp. 1104 (D. Mass. 1974) involved six separate offerings -- involving different classes of securities -- over the course of nearly three years. There, unlike here, the issuer made a credible showing that it was confronted with a series of unpredictable problems in its business. That case is a far cry from the instant case, where all of Defendants' money-raising occurred over just a few months and all involved common stock. Even more importantly, in the instant matter the company itself acknowledged in its first money-raising memorandum that there would be a need for ongoing funding to get the business going.

A showing of unanticipated problems similar to the *Livens* case was also made in *Barrett v. Triangle Mining Corp.*, 1976 U.S. Dist Lexis 16883, Fed. Sec. L. rep. (CCH) ¶ 95,438 (S.D.N.Y. 1976). The court in that case called the problems "totally unforeseen difficulties." That is, once again, quite different from the current situation where funeral.com experienced an anticipated short-fall in its first capital raising effort and turned right around to begin another one.

Defendants also note that the common shares were sold for different prices in those situations. Such concerns, however, are irrelevant for the integration analysis. The second factor only requires the same *class* of securities and says nothing of the price. Thus, the different purported offerings in the *Ishopnomarkup.com* were found to be part of a single, integrated offering, even though the per-share price charged during the last purported offering in that case was more than five times higher than the per-share price charged in the initial purported offering. 2007 WL 2782748 at *1.

This is furthermore not a situation like *SEC v. Dunfee*, [1966-67 Transfer Binder] Fed. Sec L. Rep. (CCH) ¶ 91,970 (W.D. Mo. 1966), where there were offerings of promissory notes with different interest rates and maturity dates. As previously noted, all the common stock of PPM1 and PPM2 had the same rights and preferences under Minn. Stat. § 302A.401.

Finally, Defendants' citation to the ABA position paper on integration is similarly off the mark. The warning against the overuse of the integration doctrine in that paper was principally in reference to situations where ". . . sales by seemingly separate issuers . . . can be integrated." *See* American Bar Association, *Integration of Securities Offerings: Report of the Task Force on Integration by the Committee on Federal Regulation of Securities* 41. Bus. Law. 595, 596. (1986). Here, the private placement memoranda at issue (PPM1 and PPM2) were designed to fund one company, not separate entities with separate books and records that are doing separate projects. Separate enterprises could rise or fall independent of each other and, therefore, their funding efforts would not be a single plan of financing or for the same general purpose. That is obviously not the case with a situation like funeral.com, where the same corporation made purportedly separate offerings to fund its ongoing operations.

CONCLUSION

It is not disputed that Defendants sold unregistered stock to Plaintiffs. Since this is strictly prohibited by both federal and state statute, Defendants are liable to Plaintiffs unless Defendants carry the burden to prove that the offering in which they made the sales to Plaintiffs (which, if separated, is exempt) is not part of the same offering in which they conducted illegal advertising and general solicitations (which is not exempt). The SEC's five-factor integration analysis must be used to determine whether the two purported offerings are actually parts of the same offering.

Not every factor needs to favor integration for two purportedly separate offerings to be integrated. Accordingly, even if a fact dispute existed with regard to one or more factors, integration may still be found as a matter of law if there are no disputes as to other factors sufficient to sustain integration.

For purposes of their motion for summary judgment, Plaintiffs have rested their case entirely upon facts represented by Defendants in affidavits and in the PPMs that Defendants used to sell securities to Plaintiffs and to various other investors. Because Defendants made the representations in the PPMs while under a legal duty under both federal and state securities laws to make only truthful representations, those representations are the equivalent of sworn statements and should not be subject to impeachment by the self-serving affidavits submitted by Defendants.

Taking all of this into consideration, Defendants have failed to carry their burden of production as to their claimed registration exemption defense. Each factor of the five-factor integration analysis is established in this case by undisputed evidence. Therefore, as a matter of law, the offers and sales to Plaintiffs are part of the same offering in which Defendants engaged in advertising and general solicitations, and the registration exemption claimed by Defendants for that offering is not available.

For all of these reasons, the Court should affirm the judgment of the district court.

Respectfully submitted,

MOSS & BARNETT
A Professional Association

Dated: October 3, 2008.

By Peter A. Koller

Peter A. Koller (#150459)
4800 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402-4129
Telephone: (612) 877-5300
Facsimile: (612) 877-5999

and

Scott D. Hillstrom (#15524X)
GUARDIAN LAW GROUP, LLC
527 Marquette Avenue, Suite 1800
Minneapolis, MN 55402
Telephone: (612) 332-8063

and

Daniel J. Morrissey
Professor of Law
Gonzaga University School of Law
721 N. Cincinnati St., Box 3528
Spokane, WA 99220-3528
Telephone: (509) 313-3693

1247158v1

Attorneys for Plaintiffs/Respondents