

IN BRIEFSM

Coordinate Your Beneficiary Decisions *By Douglas J. Dehn*



Did you realize that having a Will or a Trust does not complete your estate planning work? Almost everyone has a life insurance policy, an IRA, a 401(k) or similar company retirement plan, a bank account or a stock or mutual fund portfolio. Beneficiaries can be named for all of these assets.

The beneficiaries you name in a Will or a Trust may or may not be the same beneficiaries you want to name with these other types of assets. I bet that 90% of my clients do not have copies of plan documents that name their beneficiaries.

Company beneficiary forms come in all shapes and sizes. Some do not easily allow alternate (contingent) beneficiaries. Most companies want simple designations that can be easily computerized. Qualified retirement plans (plans where you obtained a tax deduction) are governed by the federal ERISA law. Special written spousal consent forms may be needed. In general, company beneficiary formats may not allow detailed or complex contingent beneficiary provisions.

In some cases, the owner's estate or testamentary trust or living trust should be named the contingent beneficiary. This would allow the person's estate or trust to use these funds in a plan for (1) a child's

education; (2) a plan to delay distribution to a child later than age 18; or (3) a tax saving disclaimer plan. Important income tax issues arise, however, where an owner desires to control qualified retirement plan funds to fund these customized plans. A balance must be struck between the loss of the advantage of the extended payout rules available to "individual" child beneficiaries and control over distributions. Naming a child or grandchild directly as an alternate beneficiary in a qualified plan allows the beneficiary to withdraw the funds out of that IRA or 401(k) type asset, usually at lower tax rates over the life of the beneficiary. A lump sum distribution to an estate or trust would usually result in a higher overall income tax, assuming that the beneficiary would not elect to take a lump sum anyway.

Plans and policies may have "default" provisions that you do not want, passing your funds to someone other than whom you really wanted. Beneficiaries or contingent beneficiaries may predecease you or die in an unusual order. Would you want an ex-spouse to remain as a beneficiary? If the default provisions are not acceptable to you, you must keep your beneficiary provisions updated!

Remember that no asset can be distributed directly to a minor child. Most companies require that a guardian or conservator be appointed for a minor child (even if there is a surviving parent) before funds are distributed. Naming a Trust as a beneficiary may

avoid a guardianship or a conservatorship, at least for the distribution of funds from that plan.

Careful thought should be given to beneficiary designations. Just because you can name a beneficiary doesn't necessarily mean it is an easy decision. You should create a file system identifying each plan and what benefits are payable under that plan. You should always know who the beneficiaries and alternates of each plan are. Obtain a copy of those designations from the company. Determine if your current designations are proper and still desired. Think through what you want done if there are or could be minor beneficiaries or a family disaster. This organization will help your chosen loved one deal with your affairs after you are gone.

An advisor's help is often useful in the important coordination of beneficiaries between your Will or Trust and your "non-probate/beneficiary driven" assets. Barna, Guzy & Steffen has helped its clients with these matters for over 70 years. Give us a call when you are ready to deal with these issues.

Doug is a shareholder in Estate & Tax Planning, Probate & Trust Administration. For more information or questions regarding this article, please contact Doug directly at 763-783-5128 or ddehn@bgs.com.

Don't Run Afoul Of The SEC *By Bradley A. Kletscher*



You're the Financial Controller for a subsidiary of a United States publicly held company. The company has done layoffs. You are short staffed. You don't have all the time you need to review your staff's work. You have to rely on your staff. You sign certifications indicating your financials are accurate based on what your staff tells you. Later the economy turns around. You add some staff to get things back under control and learn that one of the staff members you relied on didn't keep up with the reconciliations and made some

mistakes. Now you need to file restated financial statements. The next thing you know the company has fired you and the Securities Exchange Commission (SEC) is suing you alleging you engaged in Securities Fraud. Hopefully, the company had officer and director insurance coverage because you need a defense.

WHAT DOES THE LAW PROVIDE?

There are several different claims the SEC might make against a Financial Controller to seek to bar the Financial Controller from ever working for a United States publicly held company, or serving as an officer or Director of a United States publicly held company.

The first claim is a claim for securities fraud under Section 10(b) of the Exchange Act. Section 10(b) prohibits fraudulent conduct in the sale and purchase of securities. 15 U.S.C. § 78j(b). In order to prove a 10(b) claim, the SEC must show: (1) misrepresentations of material fact that operated as a fraud in violation of the rule; (2) scienter on the part of defendants; and (3) causation, often analyzed in terms of materiality and reliance. SEC v. Kluesher, 834 F.2d 1438, 1439 (8th Cir. 1987); SEC v. Guenther, 395 F.Supp.2d 835, 844 (D. Neb. 2005); McConville v. SEC, 465 F.3d 780, 786 (7th Cir. 2006). The misstatement must be made "in connection with" the purchase or sale of securities. *(continued on next page...)*

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Don't Run Afoul Of The SEC (cont.)

17 C.F.R. § 240.10b-5. City Nat. Bank of Fort Smith, Ark. v. Vanderboom, 422 F.2d 221, 229 (8th Cir. 1970)(stating that "a device must be of a sort that would cause reasonable investors to rely thereon, and . . . cause them to purchase or sell a corporation's security" to satisfy "in connection with" requirement).

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"[S]cienter means 'a mental state embracing intent to deceive, manipulate, or defraud.'" SEC v. Lowy, F.Supp.2d 225, 242 (E.D.N.Y. 2003); Ferris, Baker Watts, Inc. v. Ernst & Young, LLP, 395 F.3d 851, 854 (8th Cir. 2005). Severe recklessness can constitute scienter. Guenther, 395 F.Supp.2d at 844. Severe recklessness is "limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it. . . ." Guenther, 395 F.Supp.2d at 844. "Mere negligence does not violate Rule 10b-5." Guenther, 395 F.Supp.2d at 844. The SEC must prove that the defendant acted intentionally or recklessly, not just that he should have known something or should have done something differently. In re Ceridian Corporation Securities Litigation, 542 F.3d 240, 249 (8th Cir. 2008). That is negligence, not scienter. Id.

"A misrepresentation is considered 'material,' if it has been established that there is a substantial likelihood that the misrepresentation would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." Guenther, 395 F.Supp.2d at 846. Materiality "may be decided as a matter of law in an appropriate case upon a showing that 'a reasonable investor could not have been swayed by an alleged misrepresentation' or omission." Guenther, 395 F.Supp.2d at 846; Parnes v. Gateway 2000, Inc., 122 F.3d 539, 546 (8th Cir. 1992).

A second claim that the SEC may assert is a claim for violation of Section 13(b). Section 13(b)(5) provides as follows:

No person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account described in paragraph (2).

15 U.S.C. § 78m(b)(5). "The text of the statute contemplates three different ways in which it may be violated: (i) a defendant knowingly circumvents an

existing system of accounting controls; (ii) a defendant knowingly fails to implement a system of accounting controls; or (iii) a defendant knowingly falsifies a relevant corporate book or record." SEC v. Nacchio, 438 F.Supp.2d 1266, 1283 (D. Colo. 2006). A 13(b)(5) claim requires knowledge. SEC v. Cohen, 2007 WL 1192438, at *18 (E.D. Mo. Apr. 19, 2007) (stating that the SEC "needs to show that defendant acted knowingly for an alleged violation under § 13(b)(5).")

The SEC rule that follows along with Section 13(b) is Rule 13b2-1. This rule provides as follows: No person shall directly or indirectly, falsify or cause to be falsified, any book, record or account subject to section 13(b)(2)(A) of the Securities Exchange Act.

17 C.F.R. 240.13b2-1. Liability is predicated on a reasonableness standard. Espuelas, 579 F.Supp.2d at 486. To show unreasonable conduct, the SEC must show recklessness. Espuelas, 579 F.Supp.2d at 486-87 (citing SEC v. Lowy, 396 F.Supp.2d 225, 249-51 (E.D.N.Y. 2003)).

A third basis the SEC could seek the permanent injunction against a financial controller is for aiding and abetting the actions of his or her staff. In order to establish an aiding and abetting violation, the SEC must prove the following three factors: (1) a securities law violation by the primary party (as opposed to the aiding and abetting party); (2) "knowledge" of the violation on the part of the aider and abettor; and (3) "substantial assistance" by the aider and abettor in the achievement of the primary violation. Camp v. Dema, 948 F.2d 455, 459 (8th Cir. 1991). The same factors are applied in determining violations under 13(a) and 13(b)(2)(A). SEC v. Espuelas, 579 F.Supp.2d 461, 471 (S.D.N.Y. 2008); SEC v. Cedric Kushner Promotions, Inc., 417 F.Supp.2d 326, 336-37 (S.D.N.Y. 2006); Ponce v. SEC, 345 F.3d 722, 737 (9th Cir. 2003)("Although there is apparently no circuit law articulating the requirements for aider and abettor liability for Section 13 violations, we are guided by cases finding aider and abettor liability of other securities law violations.") The second and third factors are to be considered relative to one another. Metge v. Baehler, 762 F.2d 621, 624 (8th Cir. 1985).

The "knowledge" requirement requires "knowledge of a wrongful purpose." Camp, 948 F.2d at 459. As to whether recklessness satisfies the "knowledge" element, recent post-Section 20(e) amendment case law suggests that recklessness is not sufficient. Espuelas, 579 F.Supp.2d at 470 ("[B]ased on a thorough analysis of the PSLRA's text, structure and legislative history, Judge Cote has held that 'knowingly' refers only to 'actual knowledge,' rather than to recklessness as well.") Specifically, the more recent case law cites to legislative history that suggests that the "Senate considered and rejected an amendment that would have added recklessness to the standard, and that it is unlikely that the Congress intended to codify the existing scienter

standards for aiding and abetting, given its awareness of divergent approaches among the Circuits." Espuelas, 579 F.Supp.2d at 471. "Negligence . . . is never sufficient" to satisfy the knowledge requirement. Camp, 948 F.2d at 459.

To show "substantial assistance," the SEC must show that "the aider and abettor's conduct was a substantial causal factor in the perpetuation of the underlying violation." Espuelas, 579 F.Supp.2d at 471; Cedric Kushner Promotions, Inc., 417 F.Supp.2d at 335 ("A defendant substantially assists a primary violation of Rule 10b-5 if his conduct is a substantial causal factor in the perpetuation of the underlying fraud.") The SEC must also show there is "culpable conduct" on behalf of the aider and abettor, which means "conduct that has some element of blameworthiness." Camp, 948 F.2d at 460.

WHAT CAN YOU DO TO PROTECT YOURSELF?

If you find yourself in this situation, you should ask in writing for additional staff and explain the reasons you need that staff to properly do your work. You also should not cut corners on the financials themselves. If some work has to go undone, make it be budgeting and forecasting, not the financial statements. Have that work double checked at all costs. Relying on your staff may not be good enough. Even if you think your staff is doing a good job, you should make sure that someone is assigned to double check the financial entries being made to ensure that one person's accounting errors can't be used against you later. Even though you eventually may prevail in a lawsuit that is brought, the time and energy you spend defending the suit will be substantially more than the preventative measures you can take on the front end to protect yourself.

CONCLUSION:

The SEC is funded by the Federal Government. It has virtually unlimited resources to expend in pursuing its claims against you. Protect yourself against potential SEC action by: (1) making sure there is insurance coverage to pay for a defense of you if any claim is made; (2) documenting concerns you have to those above you whether it be the CEO or the Board of Directors; and (3) put control measures in place to make sure two people are checking all work on financial statements.

If you do get sued by the SEC, find legal counsel immediately, and seek to defend your actions.

Brad Kletscher is a shareholder practicing Employment Law. He has a broad background in representing clients in business and employment matters. Brad is also experienced in appeals, writs and petitions. For questions about this article please contact Brad at 763-783-5113 or bkletscher@bgs.com.

BGS PEOPLE



Douglas G. Sauter

2010 Best Lawyer Award
BGS attorney Douglas G. Sauter was named a 2010 "Best Lawyer" in the area of Family Law by *Minnesota Monthly Magazine*. Winning attorneys are chosen through a rigorous peer review process and the list is published biennially. *Minnesota Monthly*

will publish the new list of Minnesota's Best Lawyers in their May 2010 issue. Doug has been a shareholder with BGS since 2006 and focuses his practice on Family Law and Criminal Defense. He has more than 30 years of experience and is known for his litigation and financial expertise.



Thomas J. Kettleon

Minnesota Lawyer has named Thomas J. Kettleon one of their 2010 Up & Coming Attorneys
Tom is an associate in our real estate department, focusing his practice on all aspects of commercial real estate, including acquisitions and sales, commercial lending and

workouts, development and leasing. The honor recognizes 25 attorneys who are in their first 10 years of practice and highlights some of the best of the new generation of lawyers around the state. Out of the thousands of Minnesota attorneys admitted to the bar during the last decade, less than half of 1 percent are selected as Up & Coming attorneys. Tom will be featured in the May 2010 issue of *Minnesota Lawyer* and will be honored at an upcoming awards luncheon hosted by the magazine.



Joan M. Quade

Litigation Attorney Now Licensed in Wisconsin
BGS attorney Joan M. Quade has recently been licensed to practice Employment and Litigation law in the state of Wisconsin (in addition to her practice in Minnesota). Joan is a shareholder with the firm and also the practice group leader for the Employment law/Litigation group at BGS.

Rising Star

Personal Injury/Criminal Law associate attorney Adriel B. Villarreal has been named a 2010 Rising Star by *Minnesota Law and Politics Magazine*.



Adriel B. Villarreal

In 1998, the publishers of *Law & Politics* and *Super Lawyers* launched Rising Stars in Minnesota to recognize the top up-and-coming attorneys in the state – those who are 40 years or younger, or who have been practicing for 10 years or less. Adriel joined Barna, Guzy & Steffen in 2004 as a Law Clerk. He became an attorney with the firm following his graduation from St. Thomas School of Law and admission to the bar in 2006. Adriel is bilingual and able to assist both English and Spanish speaking clients.

Beware of the Franchise

By Kip R. Peterson and Daniel D. Ganter, Jr.



Kip R. Peterson



Daniel D. Ganter, Jr.

Believe it or not, your business could be a FRANCHISE. If so, failure to comply with applicable laws and regulations could result in serious consequences. Ignorance of these laws and regulations is no defense.

When most people think of a franchise, they think of fast-food restaurants, fitness chains, and hotels. However, Minnesota law broadly defines the term "franchise," potentially expanding the reach of the franchise laws and regulations to include legal arrangements such as license agreements, consulting agreements, and distribution agreements. It is important to note that it doesn't matter what the parties call their relationship. If the elements of a franchise are met, the parties must comply with the franchise laws and regulations.

Minnesota law defines a "franchise" as a contract or agreement between two or more persons which satisfies the following elements: (1) a franchisee is granted the right to engage in the business of offering or distributing goods or services using the franchisor's trade name, trademark, service mark, logo, or other commercial symbol or characteristics; (2) the franchisor and franchisee have a "community of interest" in the marketing of goods or services; and (3) the franchisee pays a franchise fee.

Two of the three elements of a franchise are relatively straightforward. With respect to the trademark element, if one party sells goods or services using the other party's trade name or trademark, the element is met. Even if the agreement does not require use of a particular trade name or trademark, permissive use of a mark is enough. With respect to the franchise fee element, a "franchise fee" includes any fee or charge required to be paid "for the right to enter into a business or to continue a business under a franchise agreement." While there are various exceptions, most advance payments, as well as many ongoing payments (e.g., royalties or license fees), qualify as franchise fees. The third element, requiring a "community of interest," is somewhat less definite. However, in Minnesota, courts have found that whenever two parties share in the revenues from a common

product or service, this element is satisfied.

If you are contemplating entering into a business relationship in which another party will pay you money for the right to sell goods or services using your trade name or trademark, it is imperative that you determine whether or not the arrangement is subject to Minnesota franchise law. If the elements of a franchise are met, the franchisor is required to file and maintain a registration with the State of Minnesota. Failure to file a registration statement and to otherwise comply with the applicable laws and regulations can result in both civil and **criminal** penalties. Furthermore, the franchisee may be entitled to "rescind" the agreement, requiring the franchisor to refund all of the fees and other amounts paid by the franchisee.

As always, the experienced business attorneys at Barna, Guzy & Steffen stand ready to assist you. If you have questions about Minnesota franchise law, or about any other business issue, please do not hesitate to contact us.

Daniel D. Ganter, Jr. is a shareholder practicing in Corporate Law. Kip R. Peterson is an associate in Corporate Law. If you have questions regarding this article please contact Dan at 763-783-5127, dganter@bgs.com or Kip at 763-783-5179, kpeter@bgs.com.