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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

v.

LOUIS V. SCHOOLER and FIRST
FINANCIAL PLANNING
CORPORATION, dba Western
Financial Planning Corporation,

Defendants.

Case No. 3:12-cv-2164-GPC-JMA

**ORDER DENYING
DEFENDANTS’ MOTION TO
DISMISS**

[Dkt No. 43]

INTRODUCTION

Before the Court is Defendants Louis V. Schooler and First Financial Planning Corporation d/b/a Western Financial Planning Corporation’s (collectively “Defendants”) Motion to Dismiss.¹ (Dkt No. 43.) Defendants seek dismissal under Federal Rule of Civil Procedure 12(b)(6) on the basis that the Securities and Exchange Commission (“SEC”) has failed to state a claim upon which relief can be granted because the interests offered and sold by Defendants in general partnerships are not securities. As such, Defendants contend the SEC does not have statutory authority to

¹ The parties’ Joint Motion for Extension of Time to File a Responsive Pleading, (Dkt No. 41), is GRANTED.

1 bring its claims against Defendants. Having considered the parties' submissions and
2 for the reasons set forth below, the Court hereby **DENIES** Defendants' Motion
3 to Dismiss.

4 BACKGROUND

5 On September 4, 2012, the SEC filed a complaint against Defendants, alleging
6 Defendants have violated and continue to violate the anti-fraud and registration
7 provisions of the federal securities laws. (Dkt No. 1, Compl. at 1, 16-19.) The same
8 day, the SEC also filed an ex parte application for a temporary restraining order
9 ("TRO") and, among other requests, orders freezing assets and appointing a temporary
10 receiver. (Dkt No. 3.) Judge Burns granted all relief sought by the SEC. (Dkt No. 10.)

11 The SEC Complaint alleges, inter alia, that since 2007, Defendants defrauded
12 thousands of investors by offering and selling approximately \$50 million worth of
13 general partnership units ("GP units")—i.e., interests in general partnerships organized
14 by Defendants—without disclosing material facts regarding the true value of the
15 underlying land, the mortgages encumbering the properties, and when ownership of the
16 underlying land was transferred from Defendants to the general partnerships ("GPs").
17 (Compl. at 10.) Specifically, the SEC contends Defendants have violated and continue
18 to violate Sections 5(a), 5(c), and 17(a) of the Securities Act, 15 U.S.C. §§ 77e(a),
19 77e(c), 77(q)(a); Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b); and Rule 10b-
20 5, 17 C.F.R. § 240,10b-5. (*Id.* at 19.)

21 On September 11, 2012, Defendants filed a motion to dissolve or modify the
22 TRO, which was denied on September 13, 2012. (Dkt Nos. 14, 18, 22.) Judge Burns
23 held a hearing on September 17, 2012, on his order to show cause re converting the
24 TRO into a preliminary injunction. (*See* Dkt No. 30.) Defendants' primary argument
25 in opposing the preliminary injunction was that the interests in the GPs organized by
26 Defendants are not securities, and therefore the SEC lacks enforcement authority to
27 bring this action. (Dkt No. 21, Resp. to TRO Mot. at 9-22.) After briefing by the
28 parties and oral argument, Judge Burns converted the TRO into a preliminary

1 injunction on October 5, 2012. (Dkt No. 44, “PI Order.”) Based on his finding that the
2 GP units sold by Defendants are securities, Judge Burns concluded the SEC had met
3 its burden of establishing a prima facie case that Defendants have violated and continue
4 to violate securities laws. (*Id.* at 21-22.)

5 Also on October 5, 2012, Defendants filed the instant Motion to Dismiss on the
6 basis that the GP interests at issue in this case are not securities. (Dkt No. 43 at 1.) The
7 SEC responded that, having satisfied the more stringent standard for issuance of a
8 preliminary injunction, the SEC’s allegations, taken as true, clearly withstand
9 Defendants’ Rule 12(b)(6) motion. (Dkt No. 55, Resp. to Mot. Dism. at 1.)

10 LEGAL STANDARD

11 A motion to dismiss under Federal Rule of Civil Procedure 12(b)(6) tests the
12 sufficiency of a complaint. *Navarro v. Block*, 250 F.3d 729, 732 (9th Cir. 2001).
13 Dismissal is warranted under Rule 12(b)(6) where the complaint lacks a cognizable
14 legal theory. *Robertson v. Dean Witter Reynolds, Inc.*, 749 F.2d 530, 534 (9th Cir.
15 1984); *see Neitzke v. Williams*, 490 U.S. 319, 326 (1989) (“Rule 12(b)(6) authorizes a
16 court to dismiss a claim on the basis of a dispositive issue of law.”). Alternatively, a
17 complaint may be dismissed where it presents a cognizable legal theory yet fails to
18 plead essential facts under that theory. *Robertson*, 749 F.2d at 534. While a plaintiff
19 need not give “detailed factual allegations,” a plaintiff must plead sufficient facts that,
20 if true, “raise a right to relief above the speculative level.” *Bell Atlantic Corp. v.*
21 *Twombly*, 550 U.S. 544, 545 (2007).

22 “To survive a motion to dismiss, a complaint must contain sufficient factual
23 matter, accepted as true, to ‘state a claim to relief that is plausible on its face.’”
24 *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009) (quoting *Twombly*, 550 U.S. at 547).
25 A claim is facially plausible when the factual allegations permit “the court to draw the
26 reasonable inference that the defendant is liable for the misconduct alleged.” *Id.* In
27 other words, “the non-conclusory ‘factual content,’ and reasonable inferences from that
28 content, must be plausibly suggestive of a claim entitling the plaintiff to relief.” *Moss*

1 v. *U.S. Secret Service*, 572 F.3d 962, 969 (9th Cir. 2009). “Determining whether a
2 complaint states a plausible claim for relief will . . . be a context-specific task that
3 requires the reviewing court to draw on its judicial experience and common sense.”
4 *Iqbal*, 129 S. Ct. at 1950.

5 In reviewing a motion to dismiss under Rule 12(b)(6), the court must assume the
6 truth of all factual allegations and must construe all inferences from them in the light
7 most favorable to the nonmoving party. *Thompson v. Davis*, 295 F.3d 890, 895
8 (9th Cir. 2002); *Cahill v. Liberty Mut. Ins. Co.*, 80 F.3d 336, 337-38 (9th Cir. 1996).
9 Legal conclusions, however, need not be taken as true merely because they are cast in
10 the form of factual allegations. *Ileto v. Glock, Inc.*, 349 F.3d 1191, 1200 (9th
11 Cir. 2003); *W. Mining Council v. Watt*, 643 F.2d 618, 624 (9th Cir. 1981). When ruling
12 on a motion to dismiss, a court may consider the facts alleged in the complaint,
13 documents attached to the complaint, documents relied upon but not attached to the
14 complaint when authenticity is not contested, and matters of which the court takes
15 judicial notice. *Lee v. Los Angeles*, 250 F.3d 668, 688-89 (9th Cir. 2001).

16 DISCUSSION

17 Sections 2(a)(1) of the Securities Act and 3(a)(10) of the Exchange Act include
18 investment contracts in their definitions of a “security.” 15 U.S.C. §§ 77b(a)(1) &
19 78c(a)(10). An investment contract is “a contract, transaction, or scheme whereby a
20 person invests his money in a common enterprise and is led to expect profits solely
21 from the efforts of the promoter or a third party.” *SEC v. W.J. Howey Co.*, 328 U.S.
22 293, 298-99 (1946). The requirement that profits be expected “solely” from the efforts
23 of a promoter has been liberally construed; the Ninth Circuit has even done away with
24 the term “solely” altogether for the purpose of determining whether an investment is
25 a security contract. *See Burnett v. Rowzee*, 2007 WL 2809769, at *4 (C.D. Cal.
26 Sept. 26, 2007) (citing *Hocking v. Dubois*, 885 F.2d 1449, 1455 (9th Cir. 1989)).
27 Rather, the question is “whether the efforts made by those other than the investor are
28 the undeniably significant ones, those essential managerial efforts which effect the

1 failure or success of the enterprise.” *SEC v. Glenn W. Turner Enters., Inc.* 474 F.2d
2 476, 484 (9th Cir. 1973).

3 The Supreme Court has emphasized that “economic reality is to govern over
4 form and that the definitions of the various types of securities should not hinge on
5 exact and literal tests.” *Williamson v. Tucker*, 645 F.2d 404, 418 (5th Cir. 1981) (citing
6 *Int’l Brotherhood of Teamsters, Chauffeurs, Warehousemen & Helpers of America v.*
7 *Daniel*, 439 U.S. 551, 558 (1979); *United Housing Foundation, Inc. v. Forman*, 421
8 U.S. 837, 848 (1975); *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967)). While there
9 is a general presumption that GPs are not securities, “the mere fact that an investment
10 takes the form of a general partnership or joint venture does not inevitably insulate it
11 from the reach of the federal securities laws.” *Williamson*, 645 F.2d at 422.

12 A GP is an investment contract—and thus a security—if one of the following
13 factors is present: (1) the general partnership agreement leaves so little in the hands of
14 the partners that the arrangement in fact distributes power as would a limited
15 partnership; (2) the partners are so inexperienced and unknowledgeable in the general
16 partnership business affairs that they are incapable of intelligently exercising their
17 partnership powers; or (3) the partners are so dependent on some unique
18 entrepreneurial or managerial ability of the promoter or manager that they cannot
19 replace the manager of the enterprise or otherwise exercise meaningful partnership or
20 venture powers. *Id.* at 422-24; *see also Koch*, 928 F.2d at 1477-78 (expressly adopting
21 the *Williamson* test for investment contracts); *Hocking*, 885 F.2d at 1460. To
22 determine whether investors expected profits solely from efforts of a promoter or third
23 party and whether investments in GPs are investment contracts, courts can look to
24 promotional materials, oral representations by promoters at the time of investment, and
25 the practical possibility of investors exercising powers pursuant to partnership
26 agreements. *Koch v. Hankins*, 928 F.2d 1471, 1476 (9th Cir. 1991)

27 The Court finds the SEC has met its burden of pleading sufficient factual matter,
28 accepted as true and in light most favorable to the nonmoving party, to “state a claim

1 that is plausible on its face.” *Iqbal*, 129 S. Ct. at 1949. Furthermore, having already
2 obtained a preliminary injunction, the SEC has presumptively met its burden under
3 Rule 12(b)(6). *See, e.g., Motorola, Inc. v. Pick*, 2004 WL 5472092, at *3 (C.D. Cal.
4 June 22, 2004) (denying motion to dismiss following a grant of preliminary injunction
5 on the basis that plaintiff “easily met the less stringent burden of Rule 12(b)(6) having
6 met its burden on a motion for preliminary injunction”). Although the presence of any
7 one factor under *Williamson* renders a GP interest an investment contract, the Court
8 concludes the SEC has pled sufficient facts to establish the second and third factors.

9 **I. Allocation of Power**

10 The Court concludes the SEC’s claims do not meet the first *Williamson* factor
11 because the SEC does not sufficiently allege the GP agreements “leave so little power
12 in the hands of the partners” as to render the GPs limited partnerships. *Williamson*,
13 645 F.2d at 422-24. The first factor addresses “the legal powers afforded the investor
14 by the formal documents without regard to the practical impossibility of the investors
15 invoking them.” *Koch*, 928 F.2d at 1478.

16 Here, although partners may, in reality, lack any real power over the partnerships
17 due to the size and structure of the GPs, the partnership agreements clearly afford the
18 partners significant legal power. The SEC acknowledges the GP agreements purport
19 to give general partners control over the partnerships by, for example, disallowing
20 Defendants from voting and assigning Signatory Partners to sign documents or to take
21 necessary actions on behalf of the partnership. (Compl. ¶¶ 24-25.) Therefore, the
22 Court finds the GP agreements provide investors with sufficient legal authority to
23 exercise power over the partnerships and “access to important information and
24 protection against dependence on others.” *Koch*, 928 F.2d at 1479. As such, the SEC’s
25 allegations are insufficient to satisfy the first *Williamson* factor.

26 **II. Experience and Knowledge of Partners**

27 The Court finds the SEC has pled sufficient facts to satisfy the second
28 *Williamson* factor. The relevant inquiry under the second factor is “whether the

1 partners are inexperienced or unknowledgeable ‘in business affairs’ generally, not
2 whether they are experienced and sophisticated in the particular industry or area in
3 which the partnership engages.” *Holden*, 978 F.2d at 1121; *Koch*, 928 F.2d at 1479.
4 Whether investors lack business expertise and what effect any lack of expertise has on
5 investors’ ability to exercise their partnership powers intelligently are questions of fact
6 to be resolved by the fact finder. *Koch*, 928 F.2d at 1479.

7 The SEC alleges GP investors were often unsophisticated in business affairs.
8 (Compl. ¶ 26.) Investors included a water filter salesman, a retired school teacher, and
9 a pharmacist. (*Id.*) The SEC further alleges that even signatory partners—who legally
10 assumed significant responsibilities on behalf of the GPs—were often unsophisticated
11 in business affairs and unaware they had signed material documents on behalf of the
12 GPs, such as GP formation paperwork, bank signature cards, and purchase agreements
13 between Western and their respective GPs. (*Id.*) Although Defendants may prove to
14 the contrary at a later stage in these proceedings, the Court finds the SEC has alleged
15 sufficient facts to satisfy the second *Williamson* factor.

16 **III. Dependence on Managerial Ability**

17 The SEC’s allegations also sufficiently establish the third *Williamson* factor. A
18 GP interest is an investment contract if the partners are so dependent on some unique
19 entrepreneurial or managerial ability of the promoter or manager that they cannot
20 replace the manager of the enterprise or otherwise exercise meaningful partnership or
21 venture powers. *Williamson*, 645 F.2d at 423-24. A dependency relationship may exist
22 where investors rely “on the managing partner’s unusual experience and ability in
23 running [a] particular business.” *Id.* at 423. It is insufficient that “partners in fact rely
24 on others for the management of their investment; a partnership can be an investment
25 contract only when the partners are so dependent on a particular manager that they
26 cannot replace him or otherwise exercise ultimate control.” *Id.* at 424. However,
27 “[e]ven the most knowledgeable partner may be left with no meaningful option when
28 there is no reasonable replacement for the investment’s manager.” *Id.*

1 Defendants contend that partners were not so dependent on Defendants'
2 managerial and entrepreneurial skills such that partners could not replace Defendants
3 or otherwise exercise any meaningful partnership powers because Defendants merely
4 performed administrative duties and because returns on the GPs' investments were
5 solely a function of market appreciation. (Dkt No. 43-1 at 10.) Defendants argue that
6 the SEC has failed to plead facts supporting a finding that there is no reasonable
7 replacement for Defendants. (*Id.* at 11.) The Court concludes, however, that the SEC
8 has alleged sufficient facts suggesting that investors are so dependent on Defendants
9 such that investors did not, and do not, have any meaningful alternatives other than to
10 rely on Defendants.

11 **A. Fractional Ownership of Land**

12 The SEC alleges that, because Schooler divided the properties he selected and
13 purchased among several GPs, individual investors could only exercise control over
14 their fractional portion of the parcel, forcing them to depend upon Defendants. *See*
15 *Koch*, 928 F.2d at 1480 (holding that because each individual partnership had only a
16 fractional interest in a jojoba plantation, "it would be difficult if not impossible for an
17 investor to affect the management of the plantation as a whole"). The SEC pleads
18 sufficient facts supporting a finding that a similar situation exists in this case. The SEC
19 alleges Defendants formed more than 100 GPs and that each land deal involved
20 multiple GP offerings. (Compl. ¶¶ 18, 23.) For example, the Complaint alleges that
21 four separate GPs hold the Borda property, two GPs hold the Pyramid Highway
22 property, and four GPs will hold the Stead property once all of the offerings close.
23 (Dkt No. 1, ¶¶ 45, 53, 61.) This suggests that, as a practical matter, investors were, and
24 are, dependent on Defendants because each partner may only "exercise general partner
25 control and decisionmaking *within* each partnership" but not over the entire property
26 belonging to several GPs. *See Koch*, 928 F.2d at 1480. As such, the pleaded facts,
27 taken as true, sufficiently establish that investors were ultimately dependent on
28 Western to sell their respective properties because the consent of all partnerships

1 invested in those respective properties was required.

2 **B. Defendants' Unique Expertise**

3 In determining whether investors depend on the unique expertise of the
4 promoter, courts may consider “the representations and promises made by promoters
5 or others to induce reliance upon their entrepreneurial abilities.” *Gordon v. Terry*, 684
6 F.2d 736, 742 (11th Cir. 1982) (finding that the third *Williamson* factor was met where
7 promoter of land syndications represented to investors that, because of his expertise
8 and experience with the central Florida real estate market, he could realize a substantial
9 profit for investors by buying and reselling undeveloped land); *see also SEC v.*
10 *Merchant Capital, LLC*, 483 F.3d 747, 756 (11th Cir. 1982) (reviewing representations
11 made by the promoter and not just the legal agreements underling the sale of interests
12 in determining investors' expectations of control); *Koch*, 928 F.2d at 1478 (considering
13 representations made to investors in determining whether a transaction is a security);
14 *Hocking v. Dubois*, 885 F.2d 1449, 1457 (9th Cir. 1989) (noting that in attempting to
15 determine whether a scheme involves a security, inquiry is not limited to contracts but
16 should include a thorough examination of Defendants' representations to induce
17 investment).

18 The SEC pleads sufficient facts in support of its allegation that investors were
19 induced to purchase GP units based on representations regarding Defendants' unique
20 expertise. The SEC alleges, inter alia, that Western represented to investors that the
21 firm had decades of experience putting together real estate syndications involving
22 undeveloped land in California, Nevada, and Arizona and that Western had an
23 impressive track record. (Compl. ¶ 30.) The SEC further alleges that Western's sales
24 managers told a Western salesman during training that Schooler used his extensive
25 experience in the industry to buy land at a very steep discount, and that Western was
26 able to pass this discount on to investors. (*Id.* at 16, ¶ 65.) These allegations are
27 sufficient to demonstrate that Defendants' representations regarding their expertise
28 with the types of real estate transactions involved here induced investors' reliance on

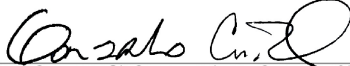
1 Defendants' unique entrepreneurial abilities, and investors thereafter relied on and
2 were dependent on Defendants' unique entrepreneurial abilities.

3 In sum, the Court concludes the SEC has sufficiently pled violations of Sections
4 5(a), 5(c), and 17(a) of the Securities Act, 15 U.S.C. §§ 77e(a), 77e(c), 77(q)(a);
5 Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b); and Rule 10b-5, 17 C.F.R.
6 § 240.10b-5.

7 **CONCLUSION**

8 For the reasons set forth above, **IT IS HEREBY ORDERED** that Defendants'
9 Motion to Dismiss is **DENIED**.

10 DATED: July 1, 2013

11 
12 HON. GONZALO P. CURIEL
13 United States District Judge
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