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9

10 UNITED STATES DISTRICT COURT  
11 SOUTHERN DISTRICT OF CALIFORNIA

12 SECURITIES AND EXCHANGE  
13 COMMISSION,

14 Plaintiff,

15 v.

16 LOUIS V. SCHOOLER and FIRST  
FINANCIAL PLANNING  
17 CORPORATION d/b/a WESTERN  
FINANCIAL PLANNING  
18 CORPORATION,

19 Defendants.  
20

) Case No. 12 CV 2164 LAB JMA

) **MEMORANDUM OF POINTS AND**  
) **AUTHORITIES IN SUPPORT OF**  
) **MOTION TO DISMISS FOR FAILURE**  
) **TO STATE A CLAIM UPON WHICH**  
) **RELIEF CAN BE GRANTED**  
) **(FRCP 12(b)(6))**

) Date: November 26, 2012

) Time: 11:30 a.m.

) Courtroom: 9

) Judge: Hon. Larry Alan Burns  
)

21  
22 Defendants LOUIS V. SCHOOLER and FIRST FINANCIAL PLANNING  
23 CORPORATION (collectively "Defendants") submit the following Memorandum of Points  
24 and Authorities in Support of their Motion to Dismiss for Failure to State a Claim Upon  
25 Which Relief Can Be Granted.

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I.

INTRODUCTION

This is a case about general partnerships that do nothing more than hold raw land in anticipation of selling that land sometime in the future for a profit (the “GPs”). The GPs’ business operations are simple. In essence, the GPs pay real property taxes and insurance on the vacant land, they issue K-1s to the partners, and the partners vote on whether to accept or reject any offer on the land.

Plaintiff Securities and Exchange Commission (the “Commission”) has brought its Complaint against Defendants on its flawed conclusion that these GPs are “securities.” In purported support of this flawed conclusion, the Commission asserts solely conclusory allegations in its Complaint, wholly failing to sufficiently plead this most important, threshold element to its action against Defendants.

Just because the Commission states that these GPs are securities, does not make them so. The Commission’s conclusory allegations, unsupported by any real factual allegations, can be and must be rejected by this Court.

In fact, *this Court must first presume that general partnerships are not securities.* The *limited* exceptions to this rule are simply not applicable in this case.

This is so because the general partners are vested with *all of the rights and powers of a general partner, including the power to direct and protect their investments.* While awaiting an offer on the raw land, minimal management of the GPs is required (e.g., paying taxes and insurance, issuing K-1s). The GPs’ business operations involve no extraordinary skill or unique ability such that the general partners are *incapable* of intelligently exercising their powers or are wholly reliant on Defendants. Again, the GP’s business is just holding raw land to sell sometime in the future.

In sum, the GPs are not the exception to the rule. *The GPs are not securities.*

The Commission is without right or power to bring and maintain this action. Accordingly, the Commission has failed to state a claim upon which relief can be granted. Defendants respectfully request that this Court, therefore, grant their motion, dismissing

1 the Commission's Complaint, without leave to amend.

2 **II.**

3 **THE COMMISSION CANNOT STATE A CLAIM UPON WHICH RELIEF CAN**  
4 **BE GRANTED BECAUSE THE GPs ARE NOT SECURITIES**

5 Federal Rule of Civil Procedure 12(b)(6) allows the court to dismiss a complaint  
6 due to a Plaintiff's failure to state a claim upon which relief can be granted. The purpose  
7 of the motion to dismiss is to test the sufficiency of a complaint, not to decide its merits.  
8 (*Moore v Bd. of Educ. of Chi.* (2004, ND Ill) 300 F Supp 2d 641.)

9 In its review of a Rule 12(b)(6) motion to dismiss, the court may consider only  
10 facts alleged in the complaint, documents attached as exhibits or incorporated by  
11 reference in the complaint, and matters of which judicial notice may be taken. (*Pouliot v*  
12 *Paul Arpin Van Lines, Inc.* (2004, DC Conn) 303 F Supp 2d 135.)

13 A complaint cannot survive a Rule 12(b)(6) motion to dismiss merely by setting  
14 forth all of the elements of the causes of action pled, since Rule 12(b)(6) was designed to  
15 screen out claims of which plaintiff was without right or power to assert and for which no  
16 relief could possibly be granted. (*Port Auth. v Arcadian Corp* (1999, CA3 NJ) 189 F3d  
17 305.)

18 In this case, the Commission has failed to state a claim against Defendants in  
19 which relief can be granted as the Commission is without right or power to assert its  
20 claims against Defendants. Each and every claim the Commission has asserted against  
21 Defendants is based on the mistaken notion that the GPs are securities. The GPs are *not*  
22 securities.

23 **A. THE SECURITIES ANALYSIS BEGINS WITH THIS COURT**  
24 **PRESUMING THAT THE GPs ARE NOT SECURITIES**

25 The term "security" means any note, stock, treasury stock, bond, debenture,  
26 evidence of indebtedness, . . . investment contract . . . or, in general, any interest or  
27 instrument commonly known as a "security. . . ." (15 U.S.C. § 77(b)(1)(§ 2(1) of the  
28 Securities Act of 1933.) General partnership interests are not included among the

1 enumerated types of securities. Therefore, the test is whether the GPs are “investment  
2 contracts.”

3 An “investment contract” has long been held to be “a contract, transaction, or  
4 scheme whereby a person invests his money in a common enterprise and is led to expect  
5 profits solely from the efforts of the promoter or third party.” (*SEC v. W.J. Howey Co.*,  
6 328 U.S. 293, 298-99 (1946) (emphasis added).)

7 The starting point for the analysis is that the law *presumes* that a general  
8 partnership is *not a security*; “*A general partnership interest is presumed not to be an*  
9 *investment contract.*” (*SEC v. Merchant Capital, LLC*, 483 F.3d 747, 755 (11th Cir. Ga.  
10 2007) (emphasis added).) Likewise, “*investments in land solely for the purpose of*  
11 *profits from appreciation on resale cannot be securities.*” (*Gordon v. Terry*, 684 F.2d  
12 736, 740 n.4 (11<sup>th</sup> Cir. 1982).)

13 The investments in question in this case are exactly both of those things  
14 combined, i.e., a general partnership formed to invest in raw land solely for the purpose  
15 of profits from appreciation on resale. Accordingly, the presumption is that the GPs at  
16 issue *are not investment contracts and, thus, not securities.*

17 **B. THE LIMITED EXCEPTIONS TO THIS PRESUMPTION ARE WHOLLY**  
18 **INAPPLICABLE**

19 Courts have recognized *limited* exceptions to the presumption that general  
20 partnerships are not investment contracts. In particular, the court will find that a general  
21 partnership is an investment contract only if one or more of the following factors are  
22 present: (1) the general partnership agreement among the parties must leave so little  
23 power in the hands of the partner that the arrangement, in fact, distributes powers as  
24 would a limited partnership; (2) the partner is so inexperienced and unknowledgeable in  
25 the general partnerships business affairs that he or she is incapable of intelligently  
26 exercising his or her partnership powers; or (3) the partner is so dependent on some  
27 unique entrepreneurial or managerial ability of the promoter or manager that he cannot  
28 replace the manager of the enterprise or otherwise exercise meaningful powers.

1 (*Williamson v. Tucker*, 645 F.2d 404, 422 (5<sup>th</sup> Cir. 1981).) In this case, none of the  
2 factors exist.

3 **1. The First *Williamson* Factor is Not Met**

4 The first exception to the rule is applied when the general partnership agreement  
5 among the parties leaves so little power in the hands of the partner that the arrangement,  
6 in fact, distributes powers as would a limited partnership. (*Williamson v. Tucker*, supra,  
7 645 F.2d 404, 422.)

8 The partnership agreements at issue in this case are standard general partnership  
9 agreements. There is no plausible reading of the general partnership agreement which  
10 would transmute the partnerships into limited partnerships. (See. Declaration of Louis  
11 Schooler filed herewith, Exhibit 1 thereto (hereinafter “GP Agreement”); See also *Branch*  
12 *v. Tunnell* (9th Cir. 1994) 14 F3d 449, 454 - a defendant may attach to a Rule 12(b)(6)  
13 motion the documents referred to in the complaint to show that they do not support  
14 plaintiff's claim.)

15 As detailed in the partnership agreements, there are no limited partners. All  
16 partners are general partners with one vote for every unit they own. (GP Agreement.)

17 To the extent Defendants purchase any units in the GPs, the general partnership  
18 agreement specifically provides that Defendants, and any and all persons and parties  
19 affiliated with Defendants, are **unable** to vote on **any** general partnership decisions **ever**.  
20 Defendant are non-voting members only. (GP Agreement, ¶ 5.1.3.)

21 The agreements provide the partners with access to the partnerships records and to  
22 information about its day-to-day business affairs. (GP Agreement, ¶ 2.6.) All partners  
23 (with the exception of Defendants) have the ability to engage and direct the partnership in  
24 whatever direction they desire. (GP Agreement, ¶ 5.) The partners are provided all  
25 contact information for one another to facilitate communication. (GP Agreement, ¶ 5.4.)

26 Any partner may initiate a ballot for a partnership vote on any matter by simply  
27 submitting a request to the partnership administrator/secretary. (GP Agreement, ¶ 5.2.)  
28 The secretary has no discretion regarding any ballot request. The secretary simply serves

1 as a messenger coordinating the efficient distribution of a ballot to all partners on any  
2 matter any partner desires to be addressed by the partnership. (GP Agreement, ¶ 5.2.)

3 The partnerships, like any general partnerships, can take any action they want with  
4 a proper vote of the partners and cannot take any action not duly authorized by a vote of  
5 the partners or set forth in the terms of the partnership agreement. (GP Agreement, ¶  
6 5.1.2.)

7 The partnership agreement provides that a “signatory partner” can sign official  
8 documents on behalf of the partnership, with proper authorization from the GPs. This  
9 signatory partner exists so that the GPs can efficiently carry out their decisions and  
10 business activities. The signatory partner has no other significant role or responsibility.  
11 (GP Agreement, ¶ 10.)

12 The Commission’s contention that Defendants “retained control over each entity  
13 through the use of so-called ‘Signatory Partners’” and ‘Secretaries’” is a mere conclusion  
14 that is explicitly contradicted by the partnership agreements. (Complaint, Pg. 6, ¶ 24.)

15 As detailed in the partnership agreement, the partners, *with the exception of*  
16 *Defendants*, vote on any action they want the GPs to take. Per the partnership agreement,  
17 the majority vote dictates whether the action is taken, *not Defendants*. (GP Agreement, ¶  
18 5.)

19 In *Koch v. Hankins*, 928 F.2d 1471 (9<sup>th</sup> Cir. 1991), the Ninth Circuit analyzed the  
20 *Williamson* factors to an investment structure that involved 160 investors across 35  
21 different partnerships that invested in an active, operating 2700 acre jojoba plantation.  
22 The Ninth Circuit held that the investment did *not* meet the first prong of *Williamson*.  
23 (*Koch v. Hankins*, supra, 928 F.2d 1471.)

24 The Ninth Circuit noted that the general partnership agreements at issue in that  
25 action gave actual exercisable authority to the partners to make decisions and exert  
26 control of the partnerships. The Ninth Circuit opined that “Even though each investor’s  
27 absolute control is reduced by the voting structure, the general partners as a legal matter  
28 ‘do have the sort of influence which generally provides them with the access to important

1 information and protection against dependence on others.” (*Koch v. Hankins*, supra, at  
2 1479, fn.12.)

3 In other words, the *Koch v. Hankins* court found that the general partnership  
4 agreement provided the partners with *sufficient opportunity* to exercise their authority  
5 such that the investment did not satisfy the first prong of *Williamson*. (Compare, *SEC v.*  
6 *W.J. Howey Co.*, 328 U.S. 293, 299 (1946) - the orange grove investment gave the  
7 management company a leasehold interest and full and complete possession of the  
8 acreage, along with full discretion and authority over the cultivation, harvest and  
9 marketing of the crops such that investors had no right of entry to market the crop without  
10 the consent of the company.)

11 The partnership agreements in this case, like the agreements in *Koch v. Hankins*,  
12 provide the partners with sufficient power and ability to exercise their powers and protect  
13 their investment. (GP Agreements.) Furthermore, the Commission has not and cannot  
14 viably contend that partners were prevented from exercising their powers under the  
15 agreements.

16 In order to fall under the first exception to the rule and find that the GPs are  
17 investment contracts, the *general partnership agreement must leave so little power in*  
18 *the hands of the partner that the arrangement, in fact, distributes powers as would a*  
19 *limited partnership*. (See, *Williamson v. Tucker*, supra, 645 F.2d 404, 422.)

20 In reviewing the general partnership agreements at issue in this case, the only  
21 conclusion this court can reach is that the partnership agreements provide the partners  
22 with all of the rights and powers of a general partner, including the power to protect their  
23 investments and, therefore, the first *Williamson* factor does not apply.

## 24 **2. The Second Williamson Factor is Not Met**

25 The second exception to the rule is applied when a partner is so inexperienced and  
26 unknowledgeable in the general partnerships business affairs that he or she is incapable of  
27 intelligently exercising his or her partnership powers. (*Williamson v. Tucker*, supra, 645  
28 F.2d 404, 422.)

1 The Commission contends that the partners in this case “come from all walks of  
2 life... and are often unsophisticated investors;” “Many of the investors were not capable  
3 of intelligently exercising their partnership powers because they were so inexperienced and  
4 unknowledgeable about business affairs and the particulars of the land deals.”  
5 (Complaint, Pg. 6, ¶ 23; Pg. 7, ¶ 28.)

6 The Commission’s minimal, conclusory contentions do not subject the GPs to the  
7 second exception. (*Ashcroft v. Iqbal* 556 U.S. 662, 679 (U.S. 2009) - courts are not  
8 bound to accept as true allegations that are legal conclusions.) The Complaint is  
9 completely devoid of any factual allegations that, in fact, these partners lack general  
10 business experience or are unknowledgeable about business generally. (*Holden v.*  
11 *Hagopian*, 978 F.2d 1115, 1123 (9th Cir. Cal. 1992).)

12 Furthermore, the business affairs of the general partnership are relatively simple  
13 and straightforward. These partnerships are formed to hold raw land and later sell that  
14 land for a profit. (Complaint, Pg. 1, ¶ 2; GP Agreement, ¶ 1.3.) In connection therewith,  
15 the partnerships have to pay property taxes, insurance and other costs of holding the raw  
16 land. (e.g., GP Agreement, ¶ 7.)

17 There simply are no complicated day-to-day, hour-by-hour management decisions  
18 that must be made. The partnership makes its tax, insurance and other payments, issues  
19 K-1s to the partners, and waits for an opportunity to sell the raw land at some future date  
20 to make a profit.

21 When an offer is made on the raw land, the general partners vote to accept or reject  
22 the offer. (GP Agreement, ¶ 5.) When the partners make a decision, the signatory  
23 partners have the ability, with the proper authorization from the partnership, to execute  
24 documents on behalf of the partnership that reflect the decisions made by the partners.  
25 (GP Agreement, ¶ 10.)

26 The Commission contends that these signatory partners, which include “a water  
27 filter salesman, a retired school teacher, and a pharmacist,” are all incapable of  
28 comprehending such tasks. (Complaint, Pg. 6, ¶ 26.) To bolster its conclusory allegation,

1 the Commission contends that certain signatory partners informed the Commission that  
2 they were not aware of their powers or what they had signed years ago. (Complaint, Pg.  
3 6, ¶ 26.)

4 Yet, this contention is insufficient. Moreover, this contention is directly  
5 contradicted by the Commission's statement that the signatory partners are "investors who  
6 typically have invested in *multiple offerings*," i.e., that the signatory partners are, in fact,  
7 experienced in these particular types of general partnerships. (Complaint, Pg. 6, ¶ 25  
8 (emphasis added).)

9 Moreover, in analyzing this second *Williamson* exemption, the question is whether  
10 the partners, including the signatory partners, are *incapable* of intelligently exercising  
11 their partnership powers. (*Williamson v. Tucker*, supra, 645 F.2d 404, 422.) As detailed  
12 above, the partnership's business and the partners' roles and powers in connection  
13 therewith are not so complex that these partners, including the signatory partners, are  
14 *incapable* of understanding the same. (See, GP Agreement.)

15 These partners can read the partnership agreements, which detail the business and  
16 the partners' roles and powers. The Commission has failed to allege why it is that these  
17 partners were incapable of reading and/or incapable of understanding what they were  
18 reading and signing. Again, the general partnerships' business is just holding raw land for  
19 future sale.

20 As such, in reality, the partners were and are capable of understanding this basic  
21 business operation such that they could and can intelligently exercise their powers. The  
22 second exception to the rule is, therefore, inapplicable.

### 23 **3. The Third *Williamson* Factor is Not Met**

24 The third exception to the rule is applied when a partner is so dependent on some  
25 unique entrepreneurial or managerial ability of the promoter or manager that he or she  
26 cannot replace the manager of the enterprise or otherwise exercise meaningful powers.  
27 (*Williamson v. Tucker*, supra, 645 F.2d 404, 422.)

28 ///

1 In this case, the partners were and are not so dependent on Defendants'  
2 entrepreneurial and managerial skills such that the partners could not replace Defendants  
3 or otherwise exercise any meaningful partnership powers. It is simply impossible for any  
4 one person to have any impact at all on the GPs' return on the investment, even if they  
5 wanted to.

6 The return on the investment is solely a function of market appreciation. There is  
7 no management or entrepreneurial skill that could ever have an impact on the return of  
8 investment for the GPs. It is a function of many different macro-economic forces,  
9 including everything from zoning to tax rates to local, regional, and national economies,  
10 transportation and infrastructure projects, the pace of growth in a specific area, decisions  
11 by different businesses and industries to locate or relocate, and many other factors that no  
12 one can control.

13 One of the reasons the case law is so consistent in finding investments in raw land  
14 held solely for appreciation to not be a security is that unlike residential or commercial  
15 real estate, there is no management of raw land that is going to affect the eventual  
16 appreciation.

17 The only management necessary is paying the property taxes and insurance and  
18 making sure the partnerships K-1's are filed. None of these tasks have any impact on the  
19 pace at which the property appreciates in value or when a developer might eventually  
20 become interested in the property.

21 The Commission's conclusory contention that "the investors could not replace the  
22 Defendants as the true managers of the GP enterprises or otherwise exercise any  
23 meaningful partnership powers over the GPs" is simply quoting the standard and is  
24 insufficient to survive this motion to dismiss. (See, Complaint, Pg. 7, ¶ 28.)

25 The Commission has failed to explain in its Complaint why it is that the partners  
26 are incapable of ensuring that the taxes, insurance and other costs associated with  
27 maintaining the property are paid, why they are incapable of ensuring K1's are issued, and  
28 why they are incapable of deciding whether to accept or reject any offer that is presented.



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**III.**

**CONCLUSION**

The GPs are not investment contracts and, thus, not securities. Just because the Commission says they are, does not make them so. The Commission has failed to set forth facts sufficient to support its conclusory allegations that the GPs are securities. In fact, the Commission cannot do so.

The partnership agreements provide the partners with the power to protect their investment. The partnership's business of holding raw land for future sale at a profit is not so complex such that the partners are incapable of intelligently exercising their powers. The partnership's business also requires no unique ability such that the partners cannot meaningfully exercise their powers as relatively few tasks are required, i.e., payment of taxes and insurance, issuance of K1's and voting to accept or reject an offer.

In sum, the limited exceptions to the rule that GPs are not investment contracts are wholly inapplicable. The GPs are, thus, not securities. Accordingly, Defendants respectfully request that this Court grant their motion and dismiss this action in its entirety, without leave to amend.

Respectfully Submitted,

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