

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22

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:

**(1) DENYING DEFENDANTS’
MOTION FOR PARTIAL
SUMMARY JUDGMENT, (ECF
NO. 542);**

**(2) DENYING PLAINTIFF’S
MOTION TO DEFER
CONSIDERATION OF
DEFENDANTS’ MOTION FOR
PARTIAL SUMMARY
JUDGMENT, (ECF NO. 553);**

**(2) GRANTING IN PART AND
DENYING IN PART
PLAINTIFF’S MOTION FOR
PARTIAL SUMMARY
JUDGMENT, (ECF NO. 563)**

INTRODUCTION

This is a civil enforcement action initiated by the Securities and Exchange Commission (“SEC”), in which the SEC alleges defendants Louis V. Schooler (“Schooler”) and First Financial Planning Corporation d/b/a Western Financial Planning Corporation (“Western”) defrauded investors through the sale of unregistered securities tied to interests in real property.

1 The Court has entered a preliminary injunction and appointed Thomas C.
2 Hebrank (“Receiver”) as permanent receiver to operate and manage the affairs of
3 Western, its subsidiaries, and the several general partnerships that Western formed in
4 connection with the sale of the aforementioned interests in real property.

5 On August 16, 2013, the Court entered an order to remove the GPs from the
6 receivership once certain conditions were satisfied. (ECF No. 470.) Among those
7 conditions, Defendants disagreed with the condition that Western’s interests in the GPs
8 be liquidated so that Western would have no further ties to the GPs. (ECF No. 474.)
9 The Court rejected Defendants’ argument that this was an inappropriate condition,
10 (ECF No. 494), and Defendants appealed to the Ninth Circuit, (ECF No. 499).
11 Thereafter, Defendants asked the Court to release the GPs from the receivership, but
12 to put a hold on the condition that Western’s interests in the GPs be liquidated. (ECF
13 No. 495.) On November 14, 2013, the Court decided to put a hold on releasing the GPs
14 from the receivership until the Ninth Circuit has a chance to decide whether this
15 Court’s conditions for releasing the GPs from the receivership are appropriate. (ECF
16 No. 513.)

17 On November 15, 2013, the SEC filed its own appeal of this Court’s order that
18 the GPs should be released upon satisfaction of certain conditions. (ECF No. 514.)

19 Now before the Court are the following three motions: **(1)** Defendants’ Motion
20 for Partial Summary Judgment (“Defendants’ MSJ”), (ECF No. 542), which has been
21 fully briefed, (ECF Nos. 552, 556¹); **(2)** the SEC’s Motion to Defer Consideration of
22 Defendant’s MSJ (“SEC’s Motion to Defer”), (ECF No. 553), which has been fully
23 briefed, (ECF Nos. 557, 564); and **(3)** the SEC’s cross Motion for Partial Summary
24 Judgment (“SEC’s MSJ”), (ECF No. 563), which has been fully briefed, (ECF Nos.

25
26 ¹ Having considered it, the Court will **GRANT** Defendants’ Request for Leave to Exceed Page
27 Limit, (ECF No. 556-3). Defendants are advised, however, that leave to exceed a page limit must be
28 granted before a document that exceeds the page limit is filed. See CivLR 7.1.h. In that vein, it is not
well taken that Defendants submitted their request as an attachment to their over-length reply brief in
lieu of filing the request as a separate motion as is the practice in this district and as Defendants
themselves have done in the past. (See ECF No. 406.)

1 571, 575). The Court finds the foregoing motions suitable for disposition without oral
2 argument. See CivLR 7.1.d.1.

3 Having considered the parties' submissions, the record in this matter, and the
4 applicable law, and for the reasons that follow, the Court will **DENY** the SEC's Motion
5 to Defer,² **DENY** Defendants' MSJ, and **GRANT IN PART** and **DENY IN PART** the
6 SEC's MSJ.

7 **BACKGROUND**³

8 **I. Solicitation**

9 When offering to sell GP units, Defendants solicited investors throughout the
10 country without regard to the investors' level of sophistication in business affairs or
11 real estate investments. Defendants, for example, engaged in cold-calling programs to
12 market the GP units to investors. Defendants also hosted real estate investing
13 workshops, which they advertised through mass mailings sent to targeted zip codes,
14 and they participated in benefits fairs to solicit new investors. Defendants also met
15 prospective investors through networking groups and other contacts. Many Western
16 salespeople also acted as financial advisors, in which role they encouraged their clients
17 to not only invest in GP units, but to also invest in real estate investment trusts
18 ("REITs"), which interests are generally categorized as securities. When acting as
19 financial advisors, these salespeople were technically working for non-party WFP
20 Securities, Inc.—a company in which Schooler owns an interest, but in which Schooler
21 asserts he is otherwise uninvolved.

22 These broad solicitation efforts attracted investors throughout the United States.
23 And, given the scope of these solicitation efforts, many investors did not meet with or
24 even know other investors in their GPs. Their only contact, at least initially, was with
25 Defendants and their representatives.

27 ² Given the SEC's statement that it "seeks to defer only to the extent that the Court is inclined
28 to grant the defendants' motion," the Court finds denial of the SEC's Motion to Defer appropriate.

³ The following facts are undisputed unless otherwise indicated.

1 Western and its salespeople gave investors and prospective investors marketing
2 materials that highlighted Western's and Schooler's expertise in real estate investment.
3 One slide show prepared by a Western salesperson explained that Western's role in the
4 GPs was to "Find the Right Investments," "Bring Investors Together," "Take Care of
5 All Paperwork Details," and "Make Sure You Get the Best Value for Your Investment"
6 and that Western performed "Rigorous Due Diligence Process" and delivered
7 "Impressive, Consistent Returns." While Defendants do not dispute that a Western
8 salesperson prepared and presented this information to investors, Schooler asserts he
9 neither saw nor approved the information for dissemination to investors. Further,
10 Western salespeople were trained to tell investors Schooler "had great expertise in . .
11 . making decisions about the best times to buy and sell land," and "Western would
12 decide when to sell the land, find a buyer, and negotiate a sales price" before sending
13 ballots to investors." At least one individual invested his IRA account with Western
14 based on representations by Western salespeople "that when Western believed the time
15 was right to sell the land, it would approach potential buyers and negotiate a sales
16 price, then come back to its investors for final approval."⁴

17 **II. GP Formation**

18 Upon investing—i.e., at the time investors gave Western cash or a promissory
19 note for their GP units—investors were generally required to sign, among others, two
20 key documents. Defendants created both documents. Investors did not negotiate the
21 terms of the documents.

22 The first document is entitled, "Statement and Agreement of Partnership"
23 ("Partnership Agreement"). Once effective, the document provides that: (1) investors
24 have the right to access, inspect, and copy GP records; (2) investors have the right to
25

26
27
28 ⁴ Defendants assert these statements are inadmissible hearsay. The Court disagrees. These statements are excluded from the definition of hearsay as statements offered against an opposing party. See Fed. R. Evid. 801(d)(2).

1 select and remove signatory partners and partnership administrators;⁵ (3) investors
2 “shall participate in the control, management, and direction of the business”; (4)
3 investors shall make decisions affecting the GP in accordance with a vote of the
4 partners holding a majority of the capital contributed to the GP who are entitled to vote;
5 (5) Schooler, Western, and others are non-voting members; and (6) any investor,
6 whether voting or non-voting, may initiate a matter for a vote by submitting a written
7 request to the partnership administrator, who “will” prepare and distribute ballots to
8 other investors.

9 The second document is entitled, “Partner Representations.” Among other
10 representations, it includes a statement that investors “have sufficient experience,
11 knowledge, and understanding of real estate and financial matters such that [they are]
12 capable of evaluating the merits and risks of [their] investment.”

13 At least two, but typically four, GPs would end up owning the undeveloped real
14 estate that Defendants selected and bought. In one instance, eleven GPs owned various
15 parcels of one large stretch of real estate.⁶ Generally, each GP held an undivided
16 fractional interest in a parcel. Schooler determined the number of GPs that would co-
17 own a parcel, the price each GP would pay for its interest, and the price of GP units
18 offered to the public.

19 Once Schooler decided the structure and terms of the offerings, Western
20 conducted the GP offerings serially—i.e., one at a time—at prices that increased from one
21 GP offering to the next, so investors had an incentive to invest early. Many GPs had
22 100 or more investors each, and some had as many as 275 investors. Once a GP was,
23 in essence, filled with investors, the offering for that GP would be “closed,” the GP

24
25 ⁵ Signatory partners were authorized to sign documents, write checks, hire
26 employees/contractors, and take other necessary actions on behalf of the GPs. Signatory partners could
27 also delegate an agent to undertake these tasks on the signatory partner’s behalf. Partnership
administrators were authorized to maintain the books and records of the GP, collect from investors
who borrowed money from Western to buy their GP units, administer the GP bank accounts,
coordinate action among GPs, and retain third-party services providers on behalf of the GPs.

28 ⁶ Unlike most parcels that were divided up between two or four GPs, two of these parcels were
each owned by only one GP.

1 would be formally organized, and Western would transfer an interest in land to the GP.
2 It was only at that time that investors were provided with a list of names and contact
3 information for the other investors in their GP. And while investors bore some
4 responsibility for keeping their partnership administrators updated with their current
5 contact information, these lists were sometimes incomplete and outdated.

6 Returning to the Partnership Agreement that investors signed at the time they
7 invested, the SEC notes each agreement states in the first paragraph that, “The General
8 Partnership Agreement is effective as of _____,” and each signature page stated that
9 the agreement was “executed as of the day and year first above written.” The effective
10 date was only filled in once a GP offering closed. For example, the Night Hawk
11 Partners offering began in May 2008, and Western continued to receive investor money
12 through August 2009 for that GP. The final Partnership Agreement for this GP
13 provides an effective date of September 9, 2009. Thus, more than a year and three
14 months passed between the initial offering and the date that this Partnership
15 Agreement, by its terms, became effective. This is one to two-year period between
16 initial offering and GP closing was typical.

17 Further, because of the above scheme, at the time most investors paid for their
18 interests, the GPs in which they were investing did not formally exist. This is because
19 a GP offering would be closed before required formation paperwork was filed with the
20 State of California. Nonetheless, bank accounts were opened in the names of
21 prospective GPs upon an initial investment. Investors did not control these bank
22 accounts until the Partnership Agreements, which provided for the appointment of
23 signatory partners, became effective. Generally, 93% of investor funds were
24 transferred from the GPs to Western during this period. 7% of investor funds would
25 remain in the GP accounts to cover operational expenses.

26 **III. Investor Dependence**

27 One of Western’s selling points was that it would take care of everything, and
28 many investors purchased GP units, in part, because they expected Western to manage

1 all partnership business for them and advise them when to sell their land.

2 While the Partnership Agreement provided that investors should make decisions
3 by majority vote, no votes were taken to decide who would act as signatory partners.
4 Neither were any votes taken as to who would act as partnership administrators.
5 Rather, two individuals who worked under or with Schooler in Western's offices—
6 Beverly Schuler ("Schuler") and Alice Jacobson ("Jacobson") (together, "Partnership
7 Administrators")—selected the signatory partners and appointed themselves
8 partnership administrators for each GP. The extent of Schooler's oversight and
9 direction of Schuler and Jacobson is disputed.

10 Until a GP offering closed, Schuler and Jacobson were generally the only
11 individuals with signatory authority on the bank accounts opened in the name of
12 prospective GPs. And, while a signatory partner was added to the account after a GP
13 offering closed, signatory partners never exercised their right to sign checks. Rather,
14 Schuler and Jacobson—without express authorization by any signatory
15 partner—continued to sign checks on behalf of the GPs. Schuler and Jacobson also
16 ensured that formation documents for each GP were filed with the State of California
17 and coordinated the transfer of real estate from Western to the GPs—again, all without
18 express authorization by any signatory partner.

19 Some investors believed they were "silent partners," and thus relied on Schooler
20 to manage the partnership, decide when to sell, and negotiate sales prices. Defendants'
21 representations at the time of investment led some investors to believe they could sit
22 back and wait for a check to come in. The SEC asserts Schooler retained control over
23 any sales of real estate GPs, in that he was responsible for receiving offers to purchase
24 GP properties and for transmitting such offers to the GPs for consideration.
25 Defendants, on the other hand, provide evidence indicating that, while written offers
26 were mailed to the same office in which Western was located, the offers were typically
27 addressed to the GPs and opened by the Partnership Administrators. Defendants assert
28 that, thereafter, the Partnership Administrators would communicate with Schooler

1 about the offers because of his expertise in real estate matters. Schooler might then
2 respond to the offer directly (e.g., when the offeror asked whether a GP might consider
3 a certain offer) or prepare a letter to investors explaining the offer. When an offer was
4 accepted, Western often acted as the real estate broker between the GP and the buyer,
5 taking a commission on the sale.

6 Some investors assert were not aware of actions they could have taken in
7 connection with their GP. Some investors assert they were not even aware they had
8 invested in a general partnership. Some signatory partners who had signed several GP-
9 related documents assert they did not understand what they had signed or what their
10 powers were. And at least one signatory partner does not even know the name of the GP
11 for which he is the signatory partner. One investor asserts he attempted to contact
12 between forty and fifty other investors in his GP, but was only able to reach one person
13 because the contact list provided to him by one of the Partnership Administrators
14 included incorrect or outdated information. This investor does not, however, state
15 whether he informed the Partnership Administrators of his inability to contact other
16 investors and, if so, what action was taken, if any.

17 Defendants in this action have argued strenuously on behalf of the GPs despite
18 Defendants' insistence that they are completely separate entities from the GPs.
19 Defendants did so until this Court ordered Defendants to stop. Schooler has sent letters
20 to investors explaining this litigation and advising them as to what action they might
21 take. Hundreds of investors have sent the Court letters in support of Defendants'
22 arguments. Most of these letters are of the same form and include the same
23 misinformation (e.g., an implication that the Receiver has acted unilaterally without
24 court approval). Some letters, however, support the SEC's position that investors do
25 in fact rely on Defendants to manage their partnership affairs. One letter states, "I have
26 faith that Schooler will eventually advise us to sell the properties at a good price."
27 Another letter asks

28 . . . could you actually believe that the best interests of the partners are
being served by removing the only individual who had such a lifetime of

1 experience and expertise and replacing them with a ‘court appointed
2 receiver,’ who has undoubtedly nowhere near the same level of expertise
in working with these types of investments?

3 (Emphasis added.)

4 When all the offerings related to a master parcel were closed, the GPs were
5 organized into co-tenancies under an agreement signed by the signatory partner of each
6 GP. Defendants set up this co-tenancy structure. Indeed, the Partnership Agreements
7 that Defendants drafted provide that each GP will hold an undivided fraction of the
8 master parcel pursuant to a co-tenancy agreement that the GPs “will enter into” to
9 “facilitate the orderly maintenance of the Master Parcel and any future disposition
10 thereof.”

11 Most co-tenancy agreements required that all decisions about a property be made
12 by unanimous consent of all co-tenant GPs. This structure made it effectively
13 impossible for any single investor or GP to exercise any power over the GP’s main
14 asset—land. Investors were limited to requesting that a ballot be sent to other investors
15 in their GP as to whether some action should be taken with regard to the co-tenancy as
16 a whole (e.g., voting to sell the land).⁷ Even if a single investor could contact the 100-
17 275 other investors in his or her GP, a majority vote would be required before any
18 action was taken on behalf of that GP with regard to the co-tenancy as a whole. If a GP
19 voted to take action with regard to the co-tenancy as a whole, a ballot would be sent to
20 the other GP co-tenants. Defendants have acknowledged that the unanimity
21 requirement under the co-tenancy agreements is “potentially unworkable” and would
22 produce a “liberum veto” effect.

23
24 ⁷ Section 6.3.2 of the Partnership Agreement provides: “A Partner Member of one Co-Tenant
25 can submit a written request to its Partnership Administrator for a formal Co-Tenancy Communication
26 requesting the other Co-Tenants to distribute information and/or initiate a ballot vote on matters
27 regarding the Master Parcel that are of consequence or importance to all Co-Tenants.” There are
28 several problems with this provision. First, the effect of a “Partner Member” “submitting a written
request to its Partnership Administrator for a formal Co-Tenancy Communication” is unclear. Section
5.1.2 provides that all partnership decisions must be made by majority vote. It seems the decision
whether to submit a ballot to other co-tenants would be a partnership decision. The Court thus reads
Section 6.3.2 as permitting an investor to submit a request to his or her partnership administrator for
a vote to be taken as to whether that investor’s GP wants to initiate some action among the other GP
co-tenants.

1 Further, because anywhere from two to eleven GPs would eventually own any
2 given master parcel, the length of time between the closing of the first GP and the
3 closing of the last GP (and therefore the formation of the co-tenancy) could be years.
4 While Western would transfer an undivided fractional interest of a master parcel to
5 each GP as they closed, none of the GPs could take any action with regard to their
6 properties until the co-tenancy agreement was in place. Western held the unsold
7 interests in the master parcel until each GP closed. For example, the Borda master
8 parcel was sold to four different GPs. The first investor in the first GP formed to own
9 a parcel of that property (Eagle View Partners) invested in March 2007, and the Eagle
10 View Partners GP was closed in October 2008. The fourth GP to own part of the Borda
11 master parcel, however, did not close until November 2010. Thus, until the master
12 parcel was completely sold off and the co-tenancy agreement formed, the first three
13 GPs depended on Western to, not only sell the remaining undivided interests in their
14 land, but to also coordinate any action required as to the master parcel.

15 Several facts illustrate the GPs are financially intertwined with Western. First,
16 Western borrowed roughly \$14.2 million to buy certain properties that it later
17 transferred to GPs. These loans are secured by mortgages on these properties. Thus,
18 a default by Western could result in the foreclosure of these properties.

19 Second, many investors borrowed money from Western to buy GP units.
20 Defendants structured this debt so the GPs, rather than individual investors, owed
21 Western money. That is, Defendants would lend money to the GPs to cover individual
22 investor shortfalls in exchange for promissory notes from the GPs. Some GPs also
23 owed Western additional money for loans Western made to GPs to cover operational
24 expenses. Despite the existence of these loans, Western rarely collected on them until
25 a GP's property was sold.

26 Third, investors in Western's third GP offering have no property interest, even
27 indirectly, because the offering never closed, their prospective GP (F-86 Partners) was
28 never formed, and thus title was never transferred to the GP. The halting of this

1 offering was due in large part to the SEC filing the instant suit. Nonetheless, under the
2 structure set up by Defendants, these investors paid Western \$780,000. None of this
3 money was used to purchase the interest in land the investors were promised. Instead,
4 \$711,000 of the funds were transferred to Western, which amount Western spent before
5 the SEC filed this action. Only \$69,000 remained in the bank account set up for the
6 prospective GP at the beginning of this action.

7 Fourth, on several occasions—including twice since this action was
8 filed—Schooler has covered shortfalls in Western’s or the GPs’ expenses.

9 Fifth, Western bought and retained an equity, albeit non-voting, interest in every
10 GP. In the aggregate, these interests had a purported value of \$10 million (based on
11 the prices Defendants charged investors for their interests), but the current fair market
12 value of these interests has been estimated to be about \$1 million. While the Receiver
13 has obtained an appraisal of the GP properties, the current fair market value of the GP
14 properties remains disputed.

15 LEGAL STANDARD

16 Summary judgment is appropriate where the moving party demonstrates the
17 absence of a genuine issue of material fact and entitlement to judgment as a matter of
18 law. Fed. R. Civ. P. 56(c); Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986). A fact
19 is material when, under the governing substantive law, it could affect the outcome of
20 the case. See Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986); Freeman v.
21 Arpaio, 125 F.3d 732, 735 (9th Cir. 1997). A dispute about a material fact is genuine
22 if “the evidence is such that a reasonable jury could return a verdict for the nonmoving
23 party.” Anderson, 477 U.S. at 248.

24 A party seeking summary judgment always bears the initial burden of
25 establishing the absence of a genuine issue of material fact. See Celotex, 477 U.S. at
26 323. The moving party may satisfy this burden in two ways: (1) by presenting evidence
27 that negates an essential element of the nonmoving party’s case, or (2) by
28 demonstrating that the nonmoving party failed to make a sufficient showing on an

1 essential element of its case. Id. at 322-23.

2 Where the moving party does not bear the burden of proof at trial, it may show
3 that no genuine issue of material fact exists by demonstrating “there is an absence of
4 evidence to support the non-moving party’s case.” Id. at 325. The moving party is not
5 required to produce evidence showing the absence of a genuine issue of material fact,
6 nor is it required to offer evidence negating the moving party’s claim. Lujan v.
7 National Wildlife Fed’n, 497 U.S. 871, 885 (1990); United Steelworkers v. Phelps
8 Dodge Corp., 865 F.2d 1539, 1542 (9th Cir. 1989). “Rather, the motion may, and
9 should, be granted so long as whatever is before the District Court demonstrates that
10 the standard for the entry of judgment, as set forth in Rule 56(c), is satisfied.” Lujan,
11 497 U.S. at 885 (quoting Celotex, 477 U.S. at 323). If the moving party fails to
12 discharge this initial burden, summary judgment must be denied and the court need not
13 consider the nonmoving party’s evidence. See Adickes v. S.H. Kress & Co., 398 U.S.
14 144, 159-60 (1970).

15 If the moving party meets the initial burden, the nonmoving party cannot defeat
16 summary judgment merely by demonstrating “that there is some metaphysical doubt
17 as to the material facts.” Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp., 475
18 U.S. 574, 586 (1986); see also Anderson, 477 U.S. at 252 (“The mere existence of a
19 scintilla of evidence in support of the nonmoving party’s position is not sufficient.”).
20 Rather, the nonmoving party must “go beyond the pleadings and by her own affidavits,
21 or by the depositions, answers to interrogatories, and admissions on file, designate
22 specific facts showing that there is a genuine issue for trial.” Celotex, 477 U.S. at 324
23 (quoting Fed. R. Civ. P. 56(e)) (internal quotations omitted).

24 “Disputes over irrelevant or unnecessary facts will not preclude a grant of
25 summary judgment.” T.W. Elec. Serv., Inc. v. Pacific Elec. Contractors Ass’n, 809 F.2d
26 626, 630 (9th Cir. 1987). “The district court may limit its review to the documents
27 submitted for purpose of summary judgment and those parts of the record specifically
28 referenced therein.” Carmen v. San Francisco Unified Sch. Dist., 237 F.3d 1026, 1030

1 (9th Cir. 2001). Therefore, the court need not “scour the record in search of a genuine
2 issue of triable fact.” Keenan v. Allen, 91 F.3d 1275, 1279 (9th Cir. 1996) (citing
3 Richards v. Combined Ins. Co., 55 F.3d 247, 251 (7th Cir. 1995)).

4 The court may not make credibility determinations, and inferences to be drawn
5 from the facts must be viewed in the light most favorable to the party opposing the
6 motion. Masson v. New Yorker Magazine, 501 U.S. 496, 520 (1991); see Anderson,
7 477 U.S. at 255; Matsushita, 475 U.S. at 587.

8 “The mere fact that the parties make cross-motions for summary judgment does
9 not necessarily mean that there are no disputed issues of material fact and does not
10 necessarily permit the judge to render judgment in favor of one side or the other.”
11 Starsky v. Williams, 512 F.2d 109, 112 (9th Cir. 1975). Rather, courts must consider
12 each motion separately “on its own merits” to determine whether any genuine issue of
13 material fact exists. Fair Housing Council of Riverside County, Inc. v. Riverside Two,
14 249 F.3d 1132, 1136 (9th Cir. 2001); Starsky, 512 F.2d at 112. When evaluating
15 cross-motions for summary judgment, the court must analyze whether the record
16 demonstrates the existence of genuine issues of material fact, both in cases where the
17 parties assert no material factual issues exist, as well as where the parties dispute the
18 facts. See Fair Housing Council of Riverside County, 249 F.3d at 1136 (citing
19 Chevron USA, Inc. v. Cayetano, 224 F.3d 1030, 1037 & n.5 (9th Cir. 2000)).

20 DISCUSSION

21 Defendants move for summary judgment on the issue of whether the GP units
22 at issue in this case are securities under the first two factors announced in Williamson
23 v. Tucker, 645 F.2d 404, 424 (1981), for determining whether a transaction is an
24 investment contract (and thus a security) for purposes of federal securities laws.
25 Defendants assert the GP units are not securities under either of the first two
26 Williamson factors. Defendants argue the rights and powers enumerated in the
27 Partnership Agreements demonstrate the first Williamson factor is unmet here.
28 Defendants then argue the representations made under penalty of perjury in the

1 Partnership Representations demonstrate the second Williamson factor is also
2 unsatisfied here.

3 The SEC opposes Defendants' MSJ as to the first two Williamson factors and
4 independently moves for summary judgment on all three Williamson factors. The SEC
5 argues that, notwithstanding the rights and powers enumerated in the Partnership
6 Agreements, the Partnership Agreements were ineffective until each GP closed. The
7 SEC thus argues that, at the time they invested, individuals actually had no rights and
8 powers under the Partnership Agreements. With regard to the second Williamson
9 factor, the SEC argues it is entitled to summary judgment based solely on the fact that
10 Defendants engaged in a broad, indiscriminate program of solicitation. The SEC
11 asserts that, to the extent this Court requires more than broad solicitation to satisfy this
12 factor, that there is at least a dispute of material fact with regard to the level of
13 sophistication of investors. The SEC further asserts that, even if this Court were to rely
14 on the Partnership Representations, investors did not represent that they are
15 experienced in general business matters; investors merely signed a form stating they
16 are able to evaluate "the merits and risk of the investment."

17 **I. Investment Contracts**

18 Sections 2(a)(1) of the Securities Act and 3(a)(10) of the Exchange Act include
19 investment contracts in their definitions of a "security." 15 U.S.C. §§ 77b(a)(1) &
20 78c(a)(10). An investment contract is "a contract, transaction, or scheme whereby a
21 person invests his money in a common enterprise and is led to expect profits solely
22 from the efforts of the promoter or a third party." SEC v. W.J. Howey Co., 328 U.S.
23 293, 298-99 (1946). The three elements of the Howey test are thus: (1) an investment
24 of money, (2) a common enterprise, and (3) the expectation of profits to be derived
25 solely from the efforts of others. See Koch v. Hankins, 928 F.2d 1471, 1476 (9th Cir.
26 1991); Alluni v. Dev. Res. Group, LLC, 445 Fed. Appx. 288, 295 (11th Cir. 2011).

27 Generally, the Howey test revolves around the third, "control," element of the
28 test. Koch 928 F.2d at 1476. In Koch, the Ninth Circuit made clear that the Fifth

1 Circuit’s three-factor test for analyzing the third Howey element applies in the Ninth
2 Circuit. 928 F.2d at 1478. The Fifth Circuit’s three-factor test, articulated in
3 Williamson v. Tucker, provides that the third Howey element will be satisfied if one
4 of the following three factors is present:

5 (1) an agreement among the parties leaves so little power in the hands of
6 the partner or venturer that the arrangement in fact distributes power as
7 would a limited partnership; or (2) the partner or venturer is so
8 inexperienced and unknowledgeable in business affairs that he is
9 incapable of intelligently exercising his partnership or venture powers; or
10 (3) the partner or venturer is so dependent on some unique entrepreneurial
11 or managerial ability of the promoter or manager that he cannot replace
12 the manager of the enterprise or otherwise exercise meaningful
13 partnership or venture powers.

14 Williamson, 645 F.2d 404, 424 (1981). These factors are not exhaustive. Id. at 424
15 n.15.

16 “The focus under Williamson is on the investor’s expectations at the time of the
17 original investment, and is not directed at what actually transpires after the investment
18 was made” Holden v. Hagopian, 978 F.2d 1115, 1119 n.6 (9th Cir. 1992).

19 The Supreme Court has emphasized that “form should be disregarded for
20 substance,” and that courts should focus on the “economic reality underlying a
21 transaction, and not on the name appended thereto.” United Housing Found., Inc. v.
22 Forman, 421 U.S. 837, 848-49 (1975); Tcherepnin v. Knight, 389 U.S. 332, 336
23 (1967); Williamson, 645 F.2d at 418.

24 **II. Written Agreements & Other Formal Documents**

25 The first factor under the Williamson test is “limited to an examination of the
26 legal powers afforded the investor by the partnership agreement and other formal
27 documents that comprised the partnership agreement or arrangement.” Holden, 978
28 F.2d at 1119-20. To be considered, the documents must “establish how the legal
powers and duties in the partnership are divided” or “alter the powers to control the
partnership business.” See id. at 1120 n.7.

Here, it is undisputed that, “at the time of the original investment,” see id. at
1119 n.6, a large majority of the investors had no powers under the Partnership

1 Agreements. This is because, by their very terms, the Partnership Agreements were not
2 effective until months or years after the first investment was made. In other words, at
3 the time investors sent money to Western, the GPs in which they were investing did not
4 formally exist. And, under California law, a GP could not have existed informally
5 until—at a minimum—the GP was closed because, “where the parties purport to
6 establish a partnership to engage in a business at a future time or upon the happening
7 of a contingency, the partnership does not come into being until the time specified or
8 until the contingency is removed.” Solomont v. Polk Dev. Co., 245 Cal. App. 2d 488,
9 496 (1966). Thus, regardless of whether the rights and powers enumerated in the
10 Partnership Agreements eventually accrued, it is clear that, at the time of investing,
11 most investors had no formal rights and powers under the Partnership Agreements.

12 Moreover, Defendants largely ignore the Co-Tenancy Agreements in their MSJ,
13 focusing almost entirely on the Partnership Agreements for purposes of the first
14 Williamson factor. Based on the record before it, however, the Court concludes the
15 Co-Tenancy Agreements “alter the powers to control the partnership,” Holden, 978
16 F.2d at 1120 n.7, and should thus be considered under the first Williamson factor.
17 Considering the Co-Tenancy Agreements, the Court finds they are subject to the same
18 delayed effectiveness as the Partnership Agreements. Whereas the Partnership
19 Agreements would become effective upon a GP’s closing, however, the Co-Tenancy
20 Agreements were not generally executed until an entire master parcel was sold off to
21 various GPs. The Court thus finds the Co-Tenancy Agreements did not confer any
22 rights or powers on investors at the time of investing.

23 Based on the foregoing, the Court will **DENY** Defendants’ MSJ and **GRANT**
24 the SEC’s MSJ as to the first Williamson factor.⁸ Because the presence of only one
25 Williamson factor is necessary to establish that the GP units are securities, the Court

26
27 ⁸ While this Court has in the past determined that the Partnership Agreements provide
28 significant rights and powers to investors, (ECF No. 212 at 6), this is the first time the Court has
considered whether the Partnership Agreements were actually effective at the time of investing.
Moreover, the Court’s prior determination was made at the pleading stage, not the summary judgment
stage as is the case here.

1 concludes, as a matter of law, that the GP units are securities. The Court nonetheless
2 proceeds to analyzing the remaining two Williamson factors.

3 **III. Investor Knowledge of Business Matters**

4 The second Williamson factor examines “whether the partners are inexperienced
5 or unknowledgeable ‘in business affairs’ generally, not whether they are experienced
6 and sophisticated in the particular industry or area in which the partnership engaged
7 and they have invested.” Holden, 978 F.2d at 1121; but see SEC v. Shields, 744 F.3d
8 633, 647 (10th Cir. 2014) (observing that, in the Tenth Circuit, the second Williamson
9 factor “focus[es] on the experience of investors in the particular business, not the
10 general business experience of the partners”).

11 The SEC relies on Reves v. Ernst & Young, 494 U.S. 56, 66-68 (1990), to
12 support its argument that a broad solicitation of investors, by itself, satisfies the second
13 Williamson prong. In Reves, however, the Supreme Court articulated the “family
14 resemblance” test for determining whether a promissory note is a security and
15 specifically rejected the Howey test for use in this situation. Reves, 494 U.S. at 64.
16 It thus appears the Supreme Court intended the Howey test (and thus the Williamson
17 test, which is the progeny of Howey) to be separate and distinct from the “family
18 resemblance” test. See Fox v. Dream Trust, 743 F. Supp. 2d 389, 398 n.7 (D.N.J.
19 2010) (“Notes and investment contracts are analyzed differently.”). Nonetheless, the
20 Court finds it appropriate to consider Defendants’ broad solicitation of investors in
21 determining whether the second Williamson factor is present. Though, rather than
22 being decisive, as such a solicitation would likely be under the “family resemblance
23 test,” see Reves, 494 U.S. at 68, the Court concludes Defendants’ broad solicitation is
24 merely an additional fact to consider when determining, under the second Williamson
25 factor, whether investors lacked the level of sophistication necessary to intelligently
26 exercise their partnership powers.

27 The Court turns next to Defendants’ assertion that the Partnership
28 Representations require a finding that the second Williamson factor is unmet. It is

1 undisputed that investors were generally required to sign the Partnership
2 Representations upon investing and that the Partnership Representations include the
3 following statement: “I have sufficient experience, knowledge, and understanding of
4 real estate and financial matters such that I am capable of evaluating the merits and
5 risks of my investment in the Partnership.” Based on these facts, Defendants assert
6 investors are bound by this representation and that any contrary statement regarding
7 their knowledge of business affairs is impeached by their having signed the Partnership
8 Representations. In support of this argument, Defendants rely on Holden.

9 There, the Ninth Circuit observed that an agreement in which investors indicated
10 “they considered themselves experienced in general business matters” was “the only
11 evidence in the record regarding investors’ general business experience and
12 sophistication.” 978 F.2d at 1121. Here, however, the SEC has offered additional
13 evidence indicating many investors do not own or manage businesses and had never
14 invested in real estate partnerships. Some investors include a pharmaceutical salesman,
15 a retired software programmer, and a casino employee. While the fact that investors
16 are employed in these professions is not dispositive under the second Williamson
17 factor, the Court finds it is relevant to assessing the general business knowledge of
18 investors. And, as set forth above, the Court has concluded that Defendants’ broad
19 program of solicitation is an additional relevant fact under the second Williamson
20 factor.

21 While it may be in some instances that “[a] party who signs a written agreement
22 is bound by its terms, even though the party neither reads the agreement nor considers
23 the legal consequences of signing it,” Employee Painters’ Trust v. J & B Finishes, 77
24 F.3d 1188, 1192 (9th Cir. 1996), the Court finds this rule is overridden in the context
25 of the Williamson analysis because of the Supreme Court’s emphasis that “form should
26 be disregarded for substance,” and that courts should focus on the “economic reality
27 underlying a transaction,” Forman, 421 U.S. at 848-49. In other words, the Court finds
28 that, under the second Williamson factor, the proper consideration of the Partnership

1 Representations, along with the circumstances surrounding investors’ execution of
2 these documents, lies not in the formal legal effect of these documents, but rather in the
3 context of determining whether, at the time of investing, investors actually had
4 sufficient knowledge in general business matters to intelligently exercise their
5 partnership powers.⁹

6 The Court further notes that, even if it were to rely exclusively on the Partnership
7 Representations, these documents alone do not conclusively establish that the second
8 Williamson factor is unmet. This is because the Partnership Representations state that
9 the signer has sufficient knowledge “such that [he or she] is capable of evaluating the
10 merits and risks of [his or her] investment.” The Court reads this qualification as
11 limiting the signer’s purported knowledge to whether he or she understands the risks
12 of this particular investment. The Partnership Representations are silent as to
13 investors’ actual knowledge of general business matters. And, as the SEC notes,
14 “[u]nderstanding that one might lose money from land depreciation is not the same as
15 having enough business experience to manage a large partnership.”

16 Based on the foregoing, the Court will **DENY** both the SEC’s and the
17 Defendants’ MSJs as to the second Williamson factor.

18 **IV. Investor Dependence**

19 The third and final Williamson factor focuses on whether an investor “is so
20 dependent on some unique entrepreneurial or managerial ability of the promoter or
21 manager that he cannot replace the manager of the enterprise or otherwise exercise
22 meaningful partnership or venture powers.” 645 F.2d at 424. For purposes of
23 summary judgment, the Court finds the analysis of this factor more straightforward
24 than the previous two factors.

25 On one hand, the SEC asserts the co-tenancy structure is unworkable without a

26
27 ⁹ Given the Court’s conclusion that investors had no formal partnership powers at the time of
28 investing, the Court questions the utility of the second Williamson factor in this case. This is because
the second Williamson factor focuses on whether, at the time of investing, investors had sufficient
knowledge to “intelligently exercis[e] his partnership or venture powers.” Williamson, 645 F.2d at
424 (emphasis added).

1 manager and that investors depended on Defendants to manage the GPs and generate
2 a return. On the other hand, Defendants assert the co-tenancy structure's information-
3 sharing and balloting procedures make the co-tenancy structure workable without a
4 manager and that any operational activities undertaken by the Defendants (or the
5 Partnership Administrators, who Defendants assert are not Western employees) fell
6 within the powers provided to them under the Partnership Agreements. Having
7 considered the parties' arguments and submission regarding this factor, the Court is not
8 prepared to conclude, as a matter of law, that Defendants' GP scheme satisfies the third
9 Williamson factor. Rather, the Court finds the balancing of the parties' positions on
10 this factor is best left to the trier of fact. As such, the Court will **DENY** the SEC's MSJ
11 as to the third Williamson factor.

12 **CONCLUSION & ORDER**

13 For the foregoing reasons, **IT IS HEREBY ORDERED** that:


- 14 1. Defendants' MSJ, (ECF No. 553), is **DENIED**;
- 15 2. The SEC's MSJ, (ECF No. 563), is **GRANTED** with respect to the first
16 Williamson factor and **DENIED** as to the second and third Williamson
17 factors;
- 18 3. It is established that the GP units at issue in this case are "securities" for
19 purposes of federal securities laws;
- 20 4. Given the Court's conclusion that the GP units are securities, the Court
21 finds good cause to sua sponte reconsider its August 16, 2013 order
22 removing the GPs from the receivership.¹⁰ The Court sets this issue for
23 consideration at a hearing on **July 18, 2014, at 1:30 p.m.** The parties are
24 directed to file briefs on whether, given the Court's conclusion that the
25 GP units are securities, the Court should reconsider its order removing the
26 GPs from the receivership. The parties should address how the parties'

27
28 ¹⁰ Under Federal Rule of Civil Procedure 54(b), district courts have the inherent authority to reconsider interlocutory rulings until a final judgment is entered. Level 3 Communs., LLC v. Lidco Imperial Valley, Inc., 2013 WL 394059, at *2 (S.D. Cal. Jan. 20, 2013).

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

cross-appeals to the Ninth Circuit affect the Court’s desire to reconsider its August 16, 2013 order. The parties should also address the need to provide investors with an opportunity to file briefs and appear at the July 18, 2014 hearing. The parties shall each file an opening brief on or before **May 9, 2014**, and may file a responsive brief on or before **May 23, 2014**. No reply briefs will be permitted. Opening and responsive briefs shall be limited to twenty-five pages each.

DATED: April 25, 2014


HON. GONZALO P. CURIEL
United States District Judge