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UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of **LOUIS V. SCHOOLER,** **Respondent.**	**ADMINISTRATIVE PROCEEDING** **FILE NO. 3-17115**

RESPONDENT'S OPPOSITION & RESPONSE

TO THE DIVISION'S MOTION FOR SUMMARY DISPOSITION

Respondent Louis V. Schooler ("SCHOOLER") files the Response to the Division of Enforcement's (the "DIVISION") Motion for Summary Disposition (the "MOTION") in the above captioned Administrative Proceeding (the "PROCEEDING") initiated by the Securities and Exchange Commission (the "SEC") in its Order Initiating Proceeding (the "OIP") dated February 12, 2016.

I. INTRODUCTION.

While this Response does not argue that Schooler did not consent to a permanent injunction, Schooler has denied all allegations and challenges the Division's assertions that he engaged in conduct amounting to violations of Section 17(a) of the Securities Act of 1933 or Rule 10(b) of the Securities and Exchange Act of 1934.

Given the pending appeal before the Ninth Circuit as to all issues in the SEC's lawsuit in the District Court against Schooler, including the foundational issue of whether the raw-land general partnerships established through Western Financial Planning Corporation ("Western") are securities (let alone the issues of lack of registration, offering in interstate commerce, fraud in the marketing and sale of the general partnership interests, and the amounts of disgorgement and civil penalties), the MOTION – and the additional punishment requested, above and beyond that imposed by the District Court's Final Judgment in the SEC's lawsuit - should be denied.

II. LEGAL ARGUMENTS & AUTHORITIES.

A. Procedural Background.

This is a follow-up proceeding which originates from a Final Judgment entered against Schooler on January 21, 2016, in the civil action entitled *Securities and Exchange Commission v. Schooler*, Case No. 3:12-cv-2164-GPC-JMA, in the United States District Court for the Southern District of California (the "Court") that permanently enjoined Schooler from future violations of Sections 5 and 17(a) of the Securities Act of 1933 (the "Securities Act") and Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 thereunder, and that imposed an order to pay $147,610,280 in disgorged profits and prejudgment interest and $1,050,000 in civil penalties. (Decl. of Sara Kalin in Support of Motion for Summary Disposition, Ex. 7.) Respondent has appealed from the Final Judgment to the Ninth Circuit, and the SEC has cross-appealed.

To get to the Final Judgment, the SEC moved for, and obtained, summary judgment on various issues:

- That the equity interests in general partnerships established for the sole purpose of acquiring and reselling undeveloped land ("GPs"), which were marketed and sold by Western to investors, are investment contracts and hence "securities" for purposes of the Securities Act and Exchange Act, on the basis that at the time the investors executed the general partnership agreements and handed over their money to Western, the space on the first page of the partnership agreement listing the agreement's effective date was blank.
- That the blank space on the first page of the partnership agreement listing the agreement's effective date somehow made the GP interests "securities" under the first of the three disjunctive factors *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981) and adopted by the Ninth Circuit in *Hocking v. Dubois*, 885 F.2d 1449 (9th Cir. 1989) (en banc) and *Koch v. Hankins*, 928 F.2d 1471, 1477-1478 (9th Cir. 1991) for determining whether an investment denominated as a general partnership was in fact a security, even though the governing test of the first *Williamson* factor is determining whether the partnership agreement on paper vests the investors with control over the management of the partnership, without

regard to whether the effective-date space on the partnership agreement is filled in at the time money is handed over by the investor.

- That Schooler and Western could not successfully raise affirmative defenses to the cause of action for the offering and sale of unregistered securities, notwithstanding the lack of evidence of general solicitation of investors and the fact that several of the GPs would qualify, based on number of investors and amounts invested, for the exception of SEC Rule 506(b) for limited private offerings.
- That Schooler and Western made material misrepresentations and omissions to investors by failing to disclose what Defendants had paid for the land before reselling to the investors through the GPs, failing to disclose the existence of underlying mortgages, and providing "comps" listing the sale of properties not truly comparable to the properties that the GPs would acquire, even though the SEC's supporting evidence of the purported fraud had been rejected by a different District Court judge when used to try to obtain a preliminary injunction on the basis of fraud.
- That the SEC was entitled to a disgorgement of $136,654,250 representing 31 years' worth of purported profit, with minimal offset for the price of the real estate acquired for resale to the investor-controlled GPs and no offset for legitimate business expenses.
- That the SEC was entitled to $1,050,000 in civil penalties, despite no evidentiary hearing on the issue of scienter, and despite the absence of any losses by any of the seven persons identified by the SEC in support of its request for civil penalties – three of whom did not invest at all and hence had no substantial risk of significant losses.

Schooler has contested each and every contention raised by the SEC in its motions for summary judgment before the District Court, which were adopted wholesale by the District Court. See Exhibit A attached hereto (Schooler's Appellant's Opening Brief, Ninth Circuit Case No. 16-55167).

Schooler has at each juncture of this proceeding and in the underlying civil case cooperated and voluntarily complied with the requests of the Commission to the greatest extent possible, without sacrificing procedural and due process rights available to him.

B. Allegations Deemed True.

While the Motion for Summary Disposition by the Division is eager to attribute additional responsibility to Schooler's conduct, this Proceeding is scheduled to be resolved *after* the District Court's Final Judgment, but *before* the hearing and decision of the Ninth Circuit.

For purposes of this Proceeding these are the only allegations deemed true by the Respondent:

1. Exhibits 1-3 and 5-8 to the Declaration of Sara Kalin filed in support of the Division's Motion are true and correct copies of the complaint, TRO, preliminary injunction, summary-judgment orders, and Final Judgment in the District Court action and Schooler's notice of appeal.
2. Schooler is the sole owner of First Financial Planning Corporation d/b/a Western Financial Planning Corporation.

The remainder of the allegations are contested by Schooler, for the reasons set forth in Exhibit A.

C. Applicable Standards.

This Commission has broad discretion to set sanctions in administrative proceedings. *Butz v Glover Livestock Comm'n Co.,* 411 U.S. 182, 188-189 (1973); *In re Philip A. Lehman,* SEC Release No, 34-54660, 2006 WL 3054584 at 3 (Oct. 27, 2006). When the Commission determines administrative sanctions, it considers the following factors:

1. The egregiousness of the defendant's actions;
2. The isolated or recurrent nature of the infraction;
3. The degree of scienter involved;
4. The sincerity of the defendant's assurances against future violations;
5. The defendant's recognition of the wrongful nature of his conduct; and
6. The likelihood that the defendant's occupation will present opportunities for future violations.

See: Steadman v. SEC, 603 F. 2d 1126, 1140 (5th Cir. 1979) quoting *SEC v. Blatt*, 583 F. 2d 1325, 1334 n.29 (5th Cir. 1978) affirmed on other grounds, 450 U.S. 91 (1981). In addition, the Commission must determine the sanctions pursuant to a public interest standard. In considering whether a sanction is in the public interest, the Commission may consider the following factors:

1. Whether the act for which the penalty is assessed involved fraud, deceit, manipulation, or deliberate reckless disregard of a regulatory requirement;
2. The harm to other persons as a result of the respondent's actions;
3. The extent to which the respondent was unjustly enriched, taking into account any restitution made to persons injured by the behavior;
4. Whether the respondent previously violated federal securities (and other) laws;
5. The need for deterrence; and
6. Other matters as justice may require.

See: Exchange Act Section 21B(c); Advisors Act Section 203(i)(3); and Investment Company Act Section 9(d)(3). An analysis of these factors demonstrates the sanctions requested by the Division are not in the public interest and unwarranted under the circumstances.

1. Nature of Schooler's Actions.

The first three of the *Steadman* factors relate to the nature of the respondent's actions and violations. *Steadman*, 603 F.2d at 1140. These factors are the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, and the degree of scienter involved. *Id.* All three factors, although facially leaning against Schooler, must be analyzed in light of the ongoing appeal from the Final Judgment and the District Court's interlocutory grants of summary judgment, because a ruling in Schooler's favor on appeal would eviscerate the Division's case by fatally undermining its contentions. The SEC, in the District Court, failed to present any evidence that any investors had lost money; the District Court made rulings grossly inconsistent with Ninth Circuit precedent; and the District Court erred by finding scienter when such a finding is inappropriate at the summary judgment stage. *See* Exhibit A.

There is no evidence of misappropriation here, and ***no*** evidence that any investor lost any money by investing in the GPs. In fact, during the period at issue, 19 other GPs were formed, acquired property, and resold their property to developers, with the average investor tripling his or her investment. Furthermore, the District Court refused to freeze Schooler's assets on the basis of fraud, and found the SEC's case for fraud too weak to result in a preliminary injunction, relying instead on a *prima facie* case of selling unregistered securities. *See* Exhibit A.

2. Schooler's Post Violation Conduct.

The final three *Steadman* factors relate to the Respondent's post-violation conduct: the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will

present opportunities for future violations. Because Schooler contests each and every one of the District Court's rulings leading up to and including the Final Judgment on the grounds that the District Court's rulings are a gross misstatement of Ninth Circuit precedent regarding when and whether general partnerships are securities, the final three *Steadman* factors should be disregarded as inapplicable.

D. Penalties.

The initiation of the underlying civil case in Schooler has until the present time (and will in perpetuity) end Schooler's career in the real-estate and investment industries. As Schooler is [redacted] old, restarting his career in a different field is not a realistic option.

The permanent bar can "permanently deprive" a respondent of his/her "career and livelihood" and is a harsh remedy in and of itself. *SEC v. Jasper*, No. C-07-06122, 2010 WL 8781211 at 10-11 (N.D.Cal. July 21, 2010) (noting that the permanent bar can be an unduly harsh and draconian sanction in certain circumstances); *Arthur Lipper Corp. v. SEC*, 547 F. 2d 171, 184 (2nd Cir 1976) (describing the permanent bar as severe).

Despite the weight of factors in Schooler's favor, including Schooler's lack of any prior violations and the unlikeliness that his future occupation (if any) will present opportunities for future violations, the Division now seeks additional penalties in the form of a permanent bar which is unjust, unreasonable, and unsupported by the evidence. Given that this proceeding was brought after Schooler filed his appeal from a colossal judgment of disgorgement, the only logical conclusion that can be drawn is that the SEC is acting out of pure vengeance and spite, akin to not only killing a person, but kicking and mutilating the corpse.

A permanent bar will preclude Schooler from participation in the profession he has worked in his entire professional life. Schooler respectfully requests the Commission order no sanctions at all, as the issues are still in dispute due to the pendency of the Ninth Circuit appeal. Should the Commission impose associational and penny-stock bars against Schooler based on rulings and orders that are later vacated on appeal, Schooler will have suffered a gross injustice.

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III. CONCLUSION.

WHEREFORE, the Respondent, Louis V. Schooler, by and through his undersigned counsel requests the Court consider the arguments and authorities set forth in this Response and Opposition to the Division's Motion for Summary Disposition (including Exhibit A) as an alternative means for resolution of the OIP in a manner consistent with the objective and purpose behind the SEC's policy on administrative proceedings.

DATED: May 12, 2016

Respectfully submitted,

/s/Philip H. Dyson

Philip H. Dyson, Esq.
Law Office of Philip H. Dyson
8461 La Mesa Boulevard
La Mesa, CA 91942
Counsel for Respondent Louis V. Schooler

In the Matter of Louis V. Schooler
Administrative Proceeding File No. 3-17115

Service List

Pursuant to Commission Rule of Practice 151 (17 C.F.R. § 201.151), I certify that the attached:

RESPONSE & OPPOSITION TO THE MOTION FOR SUMMARY DISPOSITION BY RESPONDENT LOUIS V. SCHOOLER

On May 12, 2016.

By: Facsimile and Overnight Mail

Brent J. Fields, Secretary
Securities and Exchange Commission
100 F. Street, N.E., Mail Stop 1090
Washington, DC 20549-1090
Facsimile: (202) 772-9324
By: Facsimile: Original Administrative MSJ Opposition
By: Express Mail: Original Administrative MSJ Opposition and Exhibit without Transcripts referred to in Exhibit and Transcripts referred to in Exhibit in Electronic Form
(as agreed to by the SEC)

Lynn M. Dean, Esq.
Sara D. Kalin, Esq.
Securities and Exchange Commission
Division of Enforcement
444 S. Flower Street, Suite 900
Los Angeles, CA 90071
Facsimile: (213) 443-1904
By: Facsimile: Original Administrative MSJ Opposition
By Express Mail: Original Administrative MSJ Opposition and Exhibit without Transcripts referred to in Exhibit
(as agreed to by the SEC)

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By: Email
Honorable Carol Fox Foelak
Administrative Law Judge
Securities and Exchange Commission
100 F Street, N.E., Mail Stop 2557
Washington, DC 20549-2557
Email: alj@sec.gov

DATED: May 12, 2016

Respectfully submitted,

/s/Philip H. Dyson
Philip H. Dyson, Esq.
Law Office of Philip H. Dyson
8461 La Mesa Boulevard
La Mesa, CA 91942
Counsel for Respondent Louis V. Schooler

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No. 16-55167, 16-55414

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

Securities and Exchange Commission, Plaintiff–Appellee, v. Louis V. Schooler and First Financial Planning Corporation d/b/a Western Financial Planning Corporation, Defendants-Appellants. Thomas C. Hebrank, Receiver-Appellee.	Appeal from the United States District Court for the Southern District of California No. 12-CV-2164-GPC-JMA

APPELLANTS' OPENING BRIEF

Philip H. Dyson (Cal. Bar 097528)
Law Office of Philip H. Dyson
8461 La Mesa Boulevard
La Mesa, CA 91942
Telephone: (619) 462-3311
phil@phildysonlaw.com

Attorneys for Defendants-Appellants Louis V. Schooler and First Financial Planning Corporation d/b/a Western Financial Planning Corporation

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, Defendant-Appellant First Financial Planning Corporation d/b/a Western Financial Planning Corporation makes the following disclosures:

1) For non-governmental corporate parties please list all parent corporations: None.

2) For non-governmental corporate parties please list all publicly held companies that hold 10% or more of the party's stock: None.

DATE: May 10, 2016

Respectfully submitted,

/s/Philip H. Dyson

Philip H. Dyson
Law Office of Philip H. Dyson
8461 La Mesa Boulevard
La Mesa, CA 91942
Telephone: (619) 462-3311

Counsel for Defendants-Appellants

STATEMENT REGARDING ORAL ARGUMENT

Defendants believe that oral argument is necessary and warranted in this appeal.

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JURISDICTIONAL STATEMENT

The District Court has jurisdiction in this case pursuant to 28 U.S.C. §§ 1331 and 1345, because this case was brought by Plaintiff-Appellee Securities and Exchange Commission ("SEC"), an agency of the United States, for alleged civil violations of the Securities Act of 1933 (15 U.S.C. §§ 77t, 77v) and the Securities Exchange Act of 1934 (15 U.S.C. §§ 78u, 78aa), which means this case arises under the laws of the United States.

This Court has jurisdiction pursuant to 28 U.S.C. § 1291, because this is an appeal from a final judgment of a United States district court, although the issues were determined by non-appealable interlocutory orders of partial summary judgment.

The final judgment was entered and docketed by the District Court on January 21, 2016, and the Notice of Appeal was filed February 2, 2016. The appeal is timely under Rule 4(a)(1)(B)(ii) of the Federal Rules of Appellate Procedure.

ISSUES PRESENTED FOR REVIEW

1. Whether the District Court erred in granting the SEC's first motion for partial summary judgment on the issue of whether the general partnership equity interests offered and sold by Defendants to investors were investment contracts and hence "securities" for purposes of the Securities Act and Exchange Act, on the

basis that at the time the investors executed the general partnership agreements and handed over their money to Defendants, the space on the first page of the partnership agreement listing the agreement's effective date was blank.

2. Whether the District Court erred in denying Defendants' motion for partial summary judgment on the issue of whether the general partnership equity interests offered and sold by Defendants to investors were *not* securities under the first and second of the three disjunctive factors formulated in *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981) and adopted by this Court in *Hocking v. Dubois*, 885 F.2d 1449 (9th Cir. 1989) (en banc) and *Koch v. Hankins*, 928 F.2d 1471, 1477-1478 (9th Cir. 1991) for determining whether an investment denominated as a general partnership was in fact a security, thereby overcoming the presumption that general partnerships are not securities.

3. Whether the District Court erred in granting the SEC's motion for partial summary judgment as to the offering and sale of unregistered securities, particularly when it reversed its earlier ruling denying that motion with leave to amend, and then based its reversal solely on an amended motion filed by the SEC without providing Defendants any opportunity to respond to the SEC's amended motion.

4. Whether the District Court erred in ordering the disgorgement of all moneys received by Defendants over 31 years of business, with minimal offset for

the value of the real estate bought by Defendants and resold to investors, and with no offset for legitimate business expenses and no adjudication of liability for securities fraud at the time the order of disgorgement was entered.

5. Whether the District Court erred in granting in part the SEC's motion for partial summary judgment as to fraud in the offering, sale, or purchase of securities.

6. Whether the District Court erred in granting the SEC's motion for final judgment, including awarding the SEC its entire requested amount of civil penalties.

STATEMENT OF THE CASE AND FACTS

The SEC filed suit in the District Court on September 4, 2012, alleging that Defendants-Appellants Louis V. Schooler ("Mr. Schooler") and First Financial Planning Corporation d/b/a Western Financial Planning Corporation ("Western") engaged in securities fraud within section 17(a) of the Securities Act (Count 1) and section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 (Count 2) and the offering and sale of unregistered securities in violation of section 5 of the Securities Act (Count 4) with Mr. Schooler being jointly and severally liable as Western's control person (Count 3). Excerpts of Record ("ER") 3510-3530. The case was initially assigned to District Judge Larry A. Burns.

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A. Western's Operations and Formation of GPs

Mr. Schooler, a licensed real-estate broker in California and Nevada, had established Western in 1978 for the purpose of (1) acquiring undeveloped real estate and (2) forming general partnerships ("GPs") to purchase the undeveloped real estate (from Western) and hold it long-term for eventual resale to developers at a substantial profit. Western acquired most parcels using seller carryback financing; these underlying mortgages later bound the GPs upon the GPs' purchase of the parcels through an all-inclusive deed of trust ("AITD") executed with the close of escrow, whereby the GPs' mortgage payments would be passed through Western to the original sellers. ER 3370-3382. In the event Western defaulted or ceased business, the AITD enabled the GPs to pay the underlying mortgages directly. *Id.*

The GPs were established as investment vehicles. Investors would buy equity in the GPs and thereby become partners; when enough investors had joined a GP, the offering was closed and the GP took title to its property. Some GPs owned their own individual parcels, while others owned their land in cotenancies of two to four GPs per parcel with each co-tenant GP holding a fractional undivided interest. ER 1211-1217, 3161-3171.

The GPs were not established to develop the properties, improve them, or manage existing improvements. The properties were not used for farming, ranching, grazing, or mining. ER 2817.

At the time the SEC filed suit, there were 86 GPs holding title to 23 parcels or groups of parcels located in California, Nevada, New Mexico, and Arizona, with each GP having between 19 and over 200 investors. ER 3204-3240. These GPs had been established between 1981 and 2012. *Id.* During that same period, 19 other GPs had been formed by Defendants, took title to land, and resold their parcels to third parties. ER 1129-1130. The average investor in those 19 selling GPs made a profit of approximately three times his or her original investment. *Id.*

There were a total of over 3,500 investors in the 86 GPs, with many investors owning interests in more than one GP. However, each GP had its own bank account, its own IRS registration number, and so on.

B. The GP Governing Documents

Before investing in a GP, an investor would be presented with, and required to sign prior to investing, various documents including the Partner's Representations and Partnership Agreement forming the GP. ER 2936.

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Specifically, the Partnership Agreement states:

- Each GP investor-partner has the right to access, and may inspect and copy, any of the GP's records during all reasonable times. ER 2945 (¶2.6).
- Any Signatory Partner in a GP (an investor authorized by the other partners to perform the ministerial tasks of executing contracts and other documents on behalf of the GP) may be removed by an affirmative vote of the partners holding a majority of the capital contributed to the GP. The partners elect the replacement Signatory Partners. ER 2947 (¶4.2.3).
- Notwithstanding the provisions for Signatory Partners, each investor-partner "shall participate in the control, management, and direction of the business" of the GP. ER 2949 (¶5.1.1).
- All GP decisions shall be made in accordance with a vote of the partners holding a majority of the capital contributed to the GP who are entitled to vote. ER 2949 (¶5.1.2).
- Defendants, various other specified companies owned by Mr. Schooler, and any and all persons or entities receiving any compensation from Mr. Schooler or those companies are "non-voting partners" who are prohibited from voting on any matter involving the

GP that is to be put to a vote of the investor-partners. ER 2949 (¶5.1.3).

- Any GP investor-partner, including non-voting partners such as Mr. Schooler and Western, may initiate a matter for a vote of the partners by submitting a written request to the Partnership Administrator, who is a secretary or administrative assistant responsible for sending out periodic payments of mortgages, property taxes, and insurance premiums, mailing notices to investors, and conducting balloting. ER 2949 (¶5.2).
- The Partnership Administrator has no discretion regarding any written request by an investor-partner to request a vote of the GP on a matter; the Partnership Administrator "will" prepare and distribute ballots to the partners who are entitled to vote. ER 2949 (¶5.2.2).
- The contact information and percentage-of-overall-ownership information for each GP investor-partner is provided to all of the other partners in the GP. ER 2950 (¶5.4).
- The GP investor-partners may remove the Partnership Administrator by a vote of the partners holding a majority of the capital invested in the GP who are entitled to vote. ER 2953 (¶7.1.4).

- The GP can be terminated by the decision of the partners holding a majority of the capital invested in the GP. ER 2955 (¶9.1.3).
- The signatory powers of the Signatory Partners for the GPs are subject to all other provisions of the Partnership Agreement, including the requirement that decisions affecting the partnership must first be approved by a vote of those investor-partners who hold a majority of the GP capital *and* who are entitled to vote. ER 2947 (¶4.2.4).
- The Partnership Agreement can be amended only by the vote of those partners with a majority of the capital in the GP who are entitled to vote. ER 2962 (¶11.17).

In the Partner's Representations, the investor-partners stated, in writing and under penalty of perjury, that "In connection with my desire to acquire an ownership interest...in...a California general partnership":

- "I have sufficient experience, knowledge, and understanding of real estate and financial matters such that I am capable of evaluating the merits and risks of my investment in the Partnership." ER 2968 (¶2).
- "I am aware that the Partnership has no financial or operating history and that the Partnership Interests are speculative investments. I understand that this investment involves a high degree of risk and I could lose my entire investment in the Partnership." ER 2968 (¶6).

- "I further understand that if the Partnership...does not complete formation, the Purchase Agreement [for the GP's acquisition of title to the property] will be terminated and all money invested will be returned to the partners." ER 2969 (¶12).
- "I understand that the Partnership is formed for the purpose of holding, maintaining, and protecting its interest in the Subject Property for a period of years in the hopes of realizing a profit from possible future appreciation in the saleable value of the Subject Property. I understand that there is no way of predicting the number of years the Partnership will hold this investment." ER 2969 (¶14).
- "I understand that my Partnership Interest will not generate any periodic dividends or other disbursements to me and I do not look to the efforts of any other partner, nor to any person, corporation, or entity for the management, development, maintenance, mining, or farming of the Subject Property in order to make a profit. I look solely to the potential appreciation in value of the Subject Property over the years for any profit I may derive from this transaction, and I understand that (i) any such potential profit is subject to the uncertainty and unpredictability of the market, the type and pace of development in the area, and many other factors that can affect the

value of real property, and (ii) any such potential profit can only be realized through the sale of the Subject Property by the Partnership to a willing buyer in the open market." ER 2969 (¶15).

- "I do not enter into this investment with any expectation that the Subject Property will be developed by the Partnership or that any profit or return on my investment will be generated through the development, conversion, or active use of the Subject Property for any means during the life of my investment." ER 2969-2970 (¶16).
- "In determining the advisability of this investment, I am not relying on any representations by any other Partner, [Defendants] or any related person or entity regarding the present value, projected future value, or other opinion or projection of any kind regarding the value or potential value of any real property the Partnership has acquired or may acquire." ER 2970 (¶19).
- "I have been provided with my own copy, have read, carefully reviewed in detail, and understand the terms and operation of each of the following documents" (and listing the various documents including the Partnership Agreement and Purchase Agreement). ER 2970 (¶20).

- "I have carefully reviewed the Partnership and Operating Agreements and I understand them. I have been given the opportunity to make further inquiries concerning the respective operations of the Partnership...I understand that by signing the Partnership Agreement, I am authorizing the Signatory Partners to execute, on behalf of the Partnership...the Operating Agreement, the Purchase Agreement, the Co-Tenancy Agreement, and all other documents related to the acquisition of the Subject Property and the financing thereof, including, but not limited to, the documents described above and related note(s), deed(s) of trust, and other appropriate or required documents." ER 2971 (¶23).
- "I understand that in order to facilitate the efficient and orderly administration of the Partnership's various clerical, administrative, regulatory, and organizational needs, the Partnership will enter into a Partnership Administration Agreement with EBS Land Co. [an entity partially owned by Mr. Schooler]...to serve as 'Partnership Administrator' as described in the Partnership Agreement. I understand that EBS Land Co. will be compensated for its services. I also understand that the Partnership, by a Majority Vote (as that term is defined in the Partnership Agreement), can terminate the

Partnership Administrator and the Partnership Administration Agreement, with or without cause, upon 30 days written notice." ER 2971 (¶24).

- "I understand that [Defendants] and any and all persons or entities receiving compensation of any kind from [Defendants] purchasing any Partnership Interests shall be considered 'Non-Voting Partners' and shall not be entitled to any of the voting privileges described in...the Partnership Agreement. However, Non-Voting Partners shall be afforded all other rights and privileges granted to all other General Partners under the terms and conditions of such Agreement." ER 2977 (¶72).
- "I have been fully informed that [Defendants], as owner or seller or both, will be making a very substantial profit in the sale of the real property to the Partnership. Therefore, as between those entities and myself there exists a conflict of interest and *no* fiduciary relationship." ER 2977 (¶74).
- "It never has been represented, guaranteed, or warranted to me by [Defendants], their agents, or employees, any broker, or any other persons expressly or by implication, that...I will receive any

approximate or exact amount of return or other type of consideration, profit or loss...as a result of this venture." ER 2977(¶¶75, 75.2).

C. Early Investigations by State; Defendants Seek Legal Advice

Defendants never believed that they were selling securities. Indeed, Defendants relied on a series of legal memoranda from various attorneys issued between 1995 and 2010 that concluded, based on a review of documents, that it was more likely than not that the GP interests were not securities under any of the three *Williamson* factors. ER 628-727.

In 1993 and 1994, Defendants had received written inquiries from the California Departments of Real Estate and Corporations regarding the formation of the GPs and their acquisition of property from Western. The state agencies expressed concern that the GP interests were securities. Defendants provided the state agencies with copies of the partnership agreements and partners' representations, and no formal action was taken against Defendants until the SEC filed suit. ER 629.

D. The SEC Files Suit, Obtains TRO

The SEC's complaint alleged that Defendants purchased raw land from third parties, formed the GPs to hold title to the land, recruited unsophisticated investors to invest in the GPs, and then sold the land to the GPs at prices many times greater than what Defendants had paid without disclosing Defendants' original purchase

price, what comparable properties were worth, or the existence and amount of underlying mortgages between Defendants and the persons from whom Defendants had purchased the land. The SEC *did not* allege that any GP investors had lost money.

Simultaneously with the complaint, the SEC filed a petition for a temporary restraining order ("TRO"), an asset freeze of all bank accounts allegedly held by Defendants and the GPs, and appointment of Receiver-Appellee Thomas C. Hebrank, CPA ("Hebrank") as temporary receiver for both Western and the GPs. ER 3453-3490.

The District Court granted the SEC's application for TRO, asset freeze, and appointment of Hebrank as temporary receiver on September 6, 2012, without providing a hearing. ER 3433-3452.

Defendants moved to dissolve the TRO, and provided copies of relevant GP documents including a Partnership Agreement, an AITD, and Partners' Representations. ER 3370-3432.

E. Court Upholds TRO and Enters Preliminary Injunction – But Finds No Fraud and SEC's Case Weak

Judge Burns denied Defendants' motion to dissolve the TRO on September 12, 2012, and issued an order on October 5, 2012 converting the TRO into a preliminary injunction and continuing the receivership over Western and the GPs. *SEC v. Schooler*, 902 F. Supp. 2d 1341 (S.D. Cal. 2012); ER 3276-3301.

In the order converting the TRO into a preliminary injunction, Judge Burns held, "***[T]he Court has explicitly avoided staking its preliminary injunction on the SEC's allegations of fraud...All the Court has found here, by contrast, is that the SEC has made out a prima facie case that the general partnership interests Western sells are securities.***" *SEC v. Schooler*, 902 F. Supp. 2d at 1360 (emphasis added). The District Court analyzed the three *Williamson* factors and determined that only on the third *Williamson* factor had the SEC made a *prima facie* case.

After further briefing from Defendants, the District Court reversed itself and lifted the asset freeze on November 30, 2012, finding the SEC had not shown sufficient cause. ER 3264-3275.[1] In the same order, the District Court also lifted the receivership as to Mr. Schooler and clarified that the receivership's sole purpose was "to clarify Western's financial affairs." *Id.*

On March 13, 2013, the District Court issued a Preliminary Injunction Order appointing Hebrank as permanent receiver over Western and the GPs. ER 3242-3263. The Preliminary Injunction Order also ordered, *inter alia*, that Defendants were enjoined from further sales of GP equity interests. *Id.*

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[1] At this point, the case had been reassigned to District Judge Gonzalo P. Curiel.

F. District Court Denies Motion to Dismiss, Finds SEC Has Not Shown GP Interests to be Securities under First or Second *Williamson* Factor

On July 1, 2013, the District Court denied Defendants' motion to dismiss the SEC's complaint. ER 3129-3138. The District Court concluded that the SEC's complaint on its face adequately pled that the GP interests were securities under the second and third *Williamson* factors. *Id.* However, the District Court concluded that the SEC had not adequately pled that the GP interests were securities under the first *Williamson* factor. *Id.*

Defendants then filed an answer on July 15, 2013, raising various affirmative defenses including a "catchall" for "additional affirmative defenses currently unknown to Defendants which may be ascertained during the course of this litigation through discovery," which "Defendants...reserve[d] the right to assert...should it become necessary or desirable to do so to conform to proof." ER 3491-3509.

G. Cross-Motions for Partial Summary Judgment: District Court Finds GP Interests to be Securities as Matter of Law – But on Vastly Different Grounds from Preliminary Injunction Order

On January 24, 2014, Defendants moved for partial summary judgment on the grounds that no genuine issue of material fact existed as to the GP interests not being securities under the first and second *Williamson* factors. ER 2915-2986. The SEC filed a cross-motion for partial summary judgment on March 28, 2014 on

the grounds that there was no genuine issue of material fact as to the GP interests being securities under all three *Williamson* factors. ER 2832-2914.

On April 25, 2014, after extensive briefing but allowing no oral argument, the District Court issued an order on the cross-motions for partial summary judgment, which granted in part and denied in part the SEC's motion for partial summary judgment, while denying Defendants' motion for partial summary judgment entirely. ER 80-101. The District Court held that the SEC had not shown that the GP interests were securities under the second and third *Williamson* factors. However, a different result was reached as to the first *Williamson* factor.

The District Court ruled that as a matter of law, the GP equity interests were securities under the first *Williamson* factor because at the time an investor handed over money to Defendants to invest in a GP, the space on the first page of the partnership agreement for the agreement's effective date was blank. ER 94-95.

The District Court also stated in its order that because it had now found that the GP interests were securities as a matter of law, it would reconsider *sua sponte* its order of August 16, 2013 releasing the GPs from receivership. ER 99.

Defendants moved for partial reconsideration of the District Court's order on May 23, 2014, and argued that the District Court's order was inconsistent with California partnership law and this Court's precedent, as no court had ever held that a general partnership was a security based on the effective date space on the

partnership agreement being blank at the time of signature and investment by all but the last investor in the offering. ER 2104-2139. The District Court denied Defendants' motion on July 30, 2014. ER 2020-2029. Defendants then moved for certification of the District Court's order for interlocutory appeal on August 13, 2014. ER 2000-2019. Following briefing, the District Court denied certification for interlocutory appeal on November 5, 2014. ER 1246-1251.

On March 4, 2015, the District Court entered an order modifying its April 25, 2014 order declaring that the GP interests were securities. ER 78-79. The District Court stated that it "does not alter any of its legal conclusions" from its earlier order, but found it "appropriate to clarify its reasoning regarding its conclusion that the general partnerships in this case are, as a matter of law, securities, in order to assist any potential review of this Court's orders on appeal." The District Court amended its previous order by adding the following paragraph:

> Finally, though the Court finds that the effective date of the Partnership and Co-Tenancy Agreements is relevant under the first *Williamson* factor, the Court recognizes that no other court has looked to an agreement's effective date under this factor. However, even if the effective date were not specifically pertinent to the first *Williamson* factor, both the Fifth Circuit in *Williamson* and the Ninth Circuit in *Hocking* recognized that other factors may be relevant to whether a general partnership agreement constitutes an investment contract and thus a security. *See Williamson*, 645 F.2d at 424 n.15 ("But this is not to say that other factors could not also give rise to such a dependence on the promoter or manager that the exercise of partnership powers would be effectively precluded."); *Hocking*, 885 F.2d at 1460. Accordingly, an agreement's effective date is relevant under *Williamson* and *Howey*, whether that is under the first *Williamson* factor or some other factor.

ER 79.

H. SEC Moves for Partial Summary Judgment on Liability for Sale of Unregistered Securities and Disgorgement – Court Denies, Then Changes its Mind Based Solely on Amended Motion that SEC Was Allowed to File After Motion Cut-Off

The SEC moved for partial summary judgment on September 10, 2014, stating that there was no genuine issue of material fact as to Defendants' liability under Count 4 for the offering and sale of unregistered securities, and requesting an order of disgorgement of $152,982,250, the amount of investor funds received by Defendants between 1981 and 2012 for the 86 extant GPs. ER 1541-1704. In its motion, the SEC explained why various affirmative defenses, including the exemption for limited private offerings under Rule 506(b) (17 C.F.R. § 230.506(b)), were unavailable. *Id.* Defendants' opposition stated that Rule 506(b) did apply, at least to some of the GPs that had fewer than 36 investors, and no evidence of general solicitation existed. ER 1111-1136. The SEC's reply analyzed Rule 506(b) at length. ER 1045-1077.

On April 3, 2015, the District Court entered an order ***denying*** the SEC's motion for partial summary judgment as to Count 4, on the grounds that Defendants had shown a genuine issue of material fact as to the applicability of Rule 506(b). ER 62-77. The District Court also denied the SEC's request for a disgorgement order. *Id.*

However, the District Court granted leave to the SEC to file an amended motion for partial summary judgment by April 24, 2015 to address the applicability of Rule 506(b), on the grounds of avoiding prejudice to the SEC, notwithstanding that:

- The SEC had addressed Rule 506(b) at length in its motion *and* reply brief;
- The deadline for completing fact-based discovery had expired on February 13, 2015, and
- The deadline for filing all dispositive motions other than motions *in limine* had expired on March 13, 2015.

ER 76-77; ER 1240-1245 (District Court scheduling order).

The SEC filed its amended motion for partial summary judgment on April 24, 2015, arguing that Defendants had the burden of proof of the Rule 506(b) defense, and submitting declarations from 42 investors stating that they were non-accredited investors by virtue of having a net worth of less than $1 million and/or net income of less than $300,000 per year at the time of investing in the GPs. ER 315-457.

The hearing on the SEC's amended motion was noticed for May 29, 2015 and the District Court issued no briefing schedule, which meant that Defendants' opposition was due by May 15, 2015. ER 314; S.D. Cal. Civil Local Rule 7.1.e.2

("each party opposing a motion, application or order to show cause must file that opposition or statement of non-opposition with the clerk and serve the movant or the movant's attorney not later than fourteen (14) calendar days prior to the noticed hearing").

Because the SEC's amended motion was filed *after* the deadlines for completing fact-based discovery and filing dispositive motions and featured the declarations of dozens of investors who had not been previously deposed, Defendants and the SEC filed a Joint Motion on May 1, 2015, in which Defendants sought the reopening of discovery and a 150-day extension of time in which to take the depositions of the investor-declarants and prepare a full opposition, with the SEC opposed to any reopening of discovery or extensions of time. ER 299-314.

However, on May 11, 2015, before the Joint Motion had been ruled upon and before the deadline for Defendants to oppose the SEC's amended motion, the District Court issued an order stating that "***Based on the SEC's amended motion***...the Court finds it appropriate to amend its initial order [denying the SEC's original motion for partial summary judgment as to Count 4 and disgorgement]" and noticed a hearing on the SEC's original motion for May 15, 2015 while ordering a stay of briefing and hearing on the SEC's amended motion. ER 209-210 (emphasis added).

The District Court then issued a tentative decision on May 14, 2015 stating that it would amend its April 3, 2015 order to grant the SEC's original motion for partial summary judgment as to Count 4 and disgorgement because of "a correct interpretation of the law" governing the burdens of affirmative defenses in motions for summary judgment. ER 202-208. Specifically, the District Court held that its previous determination that the SEC had failed to meet its burden of disproving the Rule 506(b) affirmative defense at the summary-judgment stage, as required by *SEC v. Murphy*, 626 F.2d 633 (9th Cir. 1980), was erroneous because *Murphy* had been overturned by *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986). ER 202-203. The District Court then held that Defendants had failed to show a genuine issue of material fact as to the Rule 506(b) exemption, thereby resulting in summary judgment as to liability on Count 4, and that the SEC was entitled to its requested disgorgement of $152,982,250, minus $16,328,000 for the appraised value of the GP-held properties, for a total of $136,654,250, plus prejudgment interest. ER 208. ***The District Court gave Defendants no opportunity to address these issues in writing and relied solely on the SEC's untimely amended motion.***

On May 19, 2015, the District Court issued an order adopting its tentative decision of May 14, 2015, vacating the May 1, 2015 Joint Motion as moot, and amending its April 3, 2015 order to grant the SEC's motion for partial summary judgment on Count 4 and ordering disgorgement in the amount of $136,654,250,

with prejudgment interest. ER 34-61. ***The District Court issued its order without allowing Defendants an opportunity to respond in writing to the SEC's amended motion – the amended motion that, by the District Court's own admission, was the sole basis of the District Court revising its previous order and granting partial summary judgment and disgorgement to the SEC.***

I. SEC Obtains Partial Summary Judgment as to Securities Fraud, then Obtains Final Judgment with Civil Penalties

The SEC filed another motion for partial summary judgment on March 13, 2015, seeking judgment for liability on Counts 1 and 2 and an award of civil penalties. ER 727-870. With a list of 62 purportedly undisputed material facts – 51 of which had been regurgitated from the SEC's TRO application, on which the SEC had failed to prove a *prima facie* case of fraud – the SEC contended that Defendants had made material misrepresentations and omissions to investors by failing to disclose what Defendants had paid for the land before reselling to the investors through the GPs, failing to disclose the existence of underlying mortgages, and providing "comps" listing the sale of properties not truly comparable to the properties that the GPs would acquire. ER 764-778. The SEC also included in its separate statement of facts that Mr. Schooler was Western's "control person" – an *unproven* legal argument, as the SEC was not moving for partial summary judgment on Count 3. ER 765.

Defendants opposed the SEC's motion by stating, *inter alia*, that the SEC recycled the TRO application's defective facts, that the investors represented their understanding in writing that Defendants would make a "very substantial profit" from the sale of the land to the GPs, and that there was no fiduciary duty between Defendants and the investors. ER 458-726.

On June 3, 2015, again without oral argument, the Court issued an order granting in part and denying in part the SEC's motion for partial summary judgment as to Counts 1 and 2. The Court granted partial summary judgment on all elements of Counts 1 and 2 as to the representation of the fair market value of the "Stead" property in Western's advertising brochure. ER 14-33. The District Court also granted partial summary judgment on the elements of offer or sale of a security and interstate commerce as to the other alleged misrepresentations and omissions, while denying partial summary judgment as to materiality and intent for those alleged misrepresentations and omissions. *Id.* The District Court did not include an award of civil penalties.

On September 25, 2015, the SEC moved for injunctive relief, monetary remedies, and final judgment against Mr. Schooler – but not Western - and requested civil penalties in the amount of $1,050,000, consisting of maximum third-tier penalties for the advertising of the Stead offerings to seven potential investors. ER 127-201. On January 21, 2016, the District Court granted the SEC's

motion and entered judgment against Mr. Schooler on all causes of action with total disgorgement of $136,654,250, prejudgment interest of $10,956,030, civil penalties of $1,050,000, a permanent injunction, and an officer-director bar as to Mr. Schooler. ER 1-13.

Defendants filed their Notice of Appeal on February 2, 2016. ER 101-103.

ARGUMENT

I. Standard of Review

A district court's decisions regarding the interpretation and application of federal law and/or federal statutes are reviewed *de novo*. *Exxon Co. v. Sofec, Inc.*, 54 F.3d 570, 573 (9th Cir. 1995), *aff'd*, 517 U.S. 830 (1996); *Torres-Lopez v. May*, 111 F.3d 633, 638 (9th Cir. 1997).

An order granting a summary judgment motion is also reviewed *de novo*. The reviewing court must decide whether, viewing the evidence in the light most favorable to the nonmoving party, there are any genuine issues of material fact and whether the district court correctly applied the relevant substantive law. *Forsyth v. Humana, Inc.*, 114 F.3d 1467, 1474 (9th Cir.), *cert. denied*, 522 U.S. 996 (1997); *Robi v. Reed*, 173 F.3d 736, 739 (9th Cir.), *cert. denied*, 528 U.S. 952 (1999). "In reviewing a grant of summary judgment, the task of the appellate court is *identical* to that of the trial court." *Brinson v. Linda Rose Joint Venture*, 53 F.3d 1044, 1047 (9th Cir. 1995) (emphasis added).

This is a two-step process. First, the reviewing court must determine if the moving party has satisfied its heavy burden of identifying those parts of the record that indicate the absence of a genuine issue of material fact. If that burden is met, the nonmoving party must designate specific facts showing that there is a genuine issue for trial. *Brinson*, 53 F.3d at 1047.

With reference to the disgorgement awarded by the district court, this Court reviews that decision for abuse of discretion. *SEC v. Clark*, 915 F.2d 439, 453 (9th Cir. 1990). The same standard applies to the imposition and amount of civil penalties. *SEC v. Sargent*, 329 F.3d 34, 38 (1st Cir. 2003).

II. The District Court Erred in Granting Partial Summary Judgment to the SEC as to Whether the GP Interests were Securities, While Denying Defendants' Motion for Partial Summary Judgment on the Same Issue

The threshold issue is whether the general partnership interests marketed and sold by Defendants are "investment contracts" and hence securities under section 2(1) of the Securities Act, as interpreted by the Supreme Court in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). In *Howey*, the Court specified a three-factor test for determining the existence of an investment contract: (1) an investment of money; (2) in a common enterprise; and (3) on an expectation of profits to be derived solely from the efforts of individuals other than the investor.

In *Williamson*, the Fifth Circuit stated that although a general partnership met the first two *Howey* factors by being an investment of money in a common

enterprise, the third *Howey* factor was generally not met for a general partnership because the partners ran the partnership and hence there would be no expectation of profits to be derived solely or mainly from the efforts of anyone but the investors. Thus, "a general partnership...generally cannot be an investment contract" and that "an investor who claims his general partnership... interest is an investment contract has a difficult burden to overcome." 645 F.2d at 421, 424.

However, the Fifth Circuit then held that the presumption was rebuttable by establishing three factors for showing that an ostensible general partnership was actually an investment contract under the third *Howey* factor:

> (1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; or (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.
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> *Williamson*, 645 F.2d at 424.

Under the first *Williamson* factor, as interpreted by this Court and other circuits, the analysis is to look *solely to the face* of the partnership's governing documents to determine *if the documents list sufficient powers* to be vested in the investors. *Matek v. Murat*, 862 F.2d 720 (9th Cir. 1988); *Hocking v. Dubois*, 885 F.2d 1449 (9th Cir. 1989) (en banc); *Koch v. Hankins*, 928 F.2d 1471, 1477-1478 (9th Cir. 1991); *Holden v. Hagopian*, 978 F.2d 1115 (9th Cir. 1992); *Youmans v.*

Simon, 791 F.2d 341, 346-47 (5th Cir. 1986); *Banghart v. Hollywood General Partnership*, 902 F.2d 805, 808 (10th Cir. 1990); *Gordon v. Terry*, 684 F.2d 736, 742 (11th Cir. 1982).

The trial court's inquiry is "limited to an examination of the legal powers afforded the investor by the partnership agreement and other formal documents that comprised the partnership agreement or arrangement." *Holden*, 978 F.2d at 1119-1120; *see also Hocking*, 885 F.2d at 1461 ("He has not raised facts showing that his Arrangement...leaves him so little power as to place him in a position analogous to a limited partner"); *Koch*, 972 F.2d at 1478 ("It is clear from both *Williamson* itself and from *Hocking* that the first factor is addressed to the legal powers afforded the investor by the formal documents without regard to the practical impossibility of the investors invoking them...Here, the partnership agreement clearly affords the partners significant legal powers"); *Matek*, 862 F.2d at 731 ("[T]he partnership agreement clearly creates a standard general partnership which on its face provided the plaintiffs with sufficient power to protect their investments").

Reviewing the plain text of the partnership agreements is the test in other circuits for determining the existence of the first *Williamson* factor. *Youmans*, *supra*, 791 F.2d at 346-47 ("A review of the joint venture agreement indicates that substantial authority was retained by the investors"); *Banghart*, *supra*, 902 F.2d at

808 ("[T]here must be evidence that the governing partnership agreement did not, or would not in the future, afford general partners their customary powers or that general partners had been, or would be, prevented from exercising those powers"); *Gordon, supra,* 684 F.2d at 742 ("[W]e begin with the written agreements...They undeniably give Gordon control through his voting powers over the fate of his investments").

This Court did not examine whether the governing documents were in effect at the time that investors contributed their money to the promoters. Neither this Court, nor the other circuits, applied the first *Williamson* factor to the formation or subscription stage of the investment, as the District Court did in its order.

The District Court's Order completely misapplies the first *Williamson* factor because the District Court did not review the GP documents' plain language to determine what powers the investors were to possess. Instead of actually analyzing the documents, the District Court concluded the Partnership Agreement was not in effect during the subscription phase of the investment and that there was no need to conduct an analysis of the Partnership Agreement under the first *Williamson* factor.

As the District Court admitted in its subsequent order seeking to justify its earlier ruling, ***no court – including this Court and any of the district courts within this Court's territorial jurisdiction – has found that a general partnership investment is a security under the first Williamson factor based on the absence of***

a filled-in effective date on the partnership agreement at the time it is signed by investors.

The inquiry into the first *Williamson* factor is not whether the investors actually had such powers or whether the powers were illusory. All that is needed to show that factor's absence is to look at the plain language of the partnership documents to see if they provide the investors with sufficient powers and authority.

By shifting the inquiry into what rights the investors had prior to the investment contract taking effect, the District Court completely rewrote the first *Williamson* factor and conducted an inquiry into an area never before identified by any other court as the relevant inquiry. This is a clear error of law requiring the reversal of the District Court's April 25, 2014 order, which therefore requires reversal of the entire case because then the threshold question of whether the GP interests were securities must be answered in the negative at the summary judgment stage.

The District Court's April 25, 2014 Order is clear error for another reason: its statement that "the GPs...did not formally exist...because a GP offering would be closed before required formation paperwork was filed with the State of California." ER 85. The District Court's statement misstates California partnership law.

Under the Uniform Partnership Act of 1994, as adopted by California statute (Cal. Corp. Code §§ 16100-16962), a "partnership" is defined as "an association of two or more persons to carry on as coowners a business for profit" (excepting limited partnerships) and "statement" is defined as including, *inter alia*, a Statement of Partnership Authority. Cal. Corp. Code §§ 16101(9), 16303. Statements of Partnership Authority may be filed with the Secretary of State. Cal. Corp. Code §§ 16105(a), 16303(a). However, it is optional under the Uniform Partnership Act for a general partnership to file a Statement of Partnership Authority with the Secretary of State in order to transact business or acquire property.

The purpose of filing a Statement of Partnership Authority is to supplement the authority of a partner to enter into transactions on behalf of the partnership and to protect potential creditors and purchasers of partnership property. Cal. Corp. Code § 16303(d); *Owens v. Palos Verdes Monaco*, 142 Cal.App.3d 855, 868, 191 Cal.Rptr. 381 (1983), *overruled on other grounds by Applied Equipment Corp. v. Litton Saudi Arabia Ltd.*, 7 Cal.4th 503, 869 P.2d 454 (1994); *Federal Deposit Ins. Corp. v. Superior Court*, 54 Cal.App.4th 337, 62 Cal.Rptr.2d 713 (1997).

The District Court's reliance on *Solomont v. Polk Dev. Co.*, 245 Cal.App.2d 488 (1966) to support its ruling in the April 25, 2014 Order that the Partnership Agreements were ineffective and therefore did not vest the investors with

substantial power on paper is misplaced. *Solomont* involved the formation of a limited partnership, which requires the filing and recording of a certificate of limited partnership in order to become legally established, and which is generally presumed to be a security. Cal. Corp. Code § 15902.01(a) (filing of certificate of limited partnership required as condition to legal formation); *SEC v. Murphy*, 626 F.2d 633, 640 (9th Cir. 1980). In contrast, a general partnership – which is generally presumed not to be a security - can be legally formed in California without a Statement of Partnership Authority being filed.

Furthermore, one of the indicia cited to by the *Solomont* court for the absence of a limited partnership – that the investor-limited partners' money was deposited in the defendants' account and not in an account for the limited partnership – is absent here; the GPs had their own bank accounts for receiving investment checks. ER 85.

Moreover, the Partnership Agreements stated that they shall be effective upon their execution. ER 2942 (¶1.4). Once two or more investors have signed the Partnership Agreements, for purposes of partnership law a general partnership has been established since there is now "an association of two or more persons to carry on as coowners a business for profit." Cal. Corp. Code §§ 16101(9), 16202(a). The filling-in of the date at the top of the Partnership Agreement, after all the investor-partners had signed, is not the same as the happening of a future

contingency. Since the Partnership Agreement states that the GP is established "at the present time for the purpose of acquiring" real property, the GP does not have to have title to land at the time the investor-partners sign the Partnership Agreement. ER 2942 (¶1.3). Thus the acquisition of land is not the happening of a future contingency either; the intent is to form the GP and then acquire the land. Also, the Partnership Agreement states that the signatory partner is empowered to sign the purchase agreement to acquire the real property. ER 2946 (¶4.2). In other words, the investors are fully informed at the time they execute the partnership agreement that the GPs do not yet own the real property but are established to eventually own it.

The factual basis for the District Court's Order consists of a combination of misreading of the plain language of the Partnership Agreement and Co-Tenancy Agreement, used to imply their lack of legal effectiveness, and the SEC's parade of immaterial, incorrect and irrelevant purported "facts". Standard contract interpretation and a review of the record show that the District Court's Order is factually unsound, hence clear error.

A contract must be interpreted so as to give effect to the parties' intentions at the time the contract is made. Cal. Civ. Code § 1636. "The language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity." Cal. Civ. Code § 1638. "It is not the province of the court

to alter a contract by construction, or to make a new contract for the parties, nor can the court rewrite the clear terms of a lawful contract." *Mitchel v. Brown*, 43 Cal.App.2d 217, 221, 110 P.2d 456 (1941) (emphasis added).

With regard to the Co-Tenancy Agreement, the April 25, 2014 Order incorrectly concluded that the Co-Tenancy Agreement "'alter[s] the powers to control the partnership'...and should thus be considered under the first *Williamson* factor." ER 93-95, quoting *Holden*, 978 F.2d at 1120 n.7. As described in the plain text of the Partnership Agreement, the Co-Tenancy Agreement was to apply to the management of the co-tenant GPs' master parcel as a whole. ER 3165-3166 (¶6). Indeed, the Co-Tenancy Agreement allowed the GPs to sell their respective fractional interests (subject to a right of first refusal) in the master parcel, and presumably seek a partition action if needed. ER 3164 (¶4.2). Therefore, the District Court erred in holding that the co-tenant GPs could not take any action with regard to their properties until the Co-Tenancy Agreement was in place.

The District Court also completely misread the Co-Tenancy Agreement and its provisions whereby a partner in a co-tenant GP can submit requests for co-tenancy action. ER 88, fn. 7. Contrary to the District Court's interpretation, the Co-Tenancy Agreement expressly states that any individual partner in any of the co-tenant GPs can simply request a ballot to be issued not only within his/her own GP, but for that ballot to also be issued for a vote of all the members of all the

other co-tenant GPs. ER 3163-3164 (¶3.5.1). Also, there is no requirement that a member's GP first vote on the issue of whether a ballot request be sent to the other co-tenant GPs. This additional obstacle written into the agreement by the District Court does not exist. Any individual investor has the ability to force a vote to be taken by his/her GP and also all of the co-tenant GPs on any business matter relevant to the GPs. It is a simple process that gives each investor direct, immediate ability to bring a matter of business to a full vote upon request. Rather than being the limitation on power that the District Court imagines, it is evidence of the significant broad powers provided to the investors to initiate action and play a direct role in the management and direction of their investment.

If it were intended that a vote be taken on whether to submit a written request for a vote or distribution of information among the co-tenant GPs, such a provision would be written into the Co-Tenancy Agreement. However, such a provision was not written in, and therefore the District Court rewrote a clearly-written agreement.

Furthermore, the Co-Tenancy Agreement does not "alter the powers to control the partnership" because it is an agreement between the GPs, not between the individual investors. ER 3161. The plain language of the Co-Tenancy Agreement shows that the individual investors of each GP are not parties to the Co-Tenancy Agreement; the co-tenant GPs are the named parties. *Id.* The

individual investors do not sign the Co-Tenancy Agreement; the signatory partners sign on behalf of each co-tenant GP. *Id.*

Under the Uniform Partnership Act, a general partnership is an entity distinct from its partners. Cal. Corp. Code § 16201; *United States v. Galletti*, 541 U.S. 114, 121 (2004); *Gleason v. White*, 34 Cal. 258, 263 (1867) ("A partnership has an existence separate and distinct from that of the several partners and their respective estates").

When combined with the individual GPs' ability to convey their fractional interests or seek judicial partition of the master parcels, the Co-Tenancy Agreement, and its delayed effectiveness, is not an alteration of power that results in a finding that the first *Williamson* factor has been met.

The District Court had to inject its additional, legally-unsupported language about going outside of the *Williamson* factors to find that the GP interests were securities in order to avoid being crushed by the weight of the caselaw.

Although the District Court correctly quoted *Williamson*'s statement that "under different facts or legal arrangements other factors might [also] give rise to such a dependence on the promoter or manager that exercise of control would be effectively precluded" (645 F.2d at 424 n. 15), the District Court ignored the fact that that statement in *Williamson* is *pure dicta*.

Every court – including this Court in Matek, Hocking, Koch, and Holden - that has cited to the non-exclusivity of the three Williamson factors still analyzed the investment at issue under the three Williamson factors without stating whether there was an analysis of any other factors present that caused the investment to be a security under Howey. *See Holden, supra,* 978 F.2d at 1119 n. 5, 1120-22; *Koch, supra,* 928 F.2d at 1477 n. 11, 1478; *Hocking, supra,* 885 F.2d at 1460-61; *Matek, supra,* 862 F.2d at 730, n. 14 & 15 (relying solely on first *Williamson* factor, but explained why claim failed under other two factors).

In contrast, Defendants' cross-motion correctly described how the GP interests are not securities under the first *Williamson* factor. Taking the partnership documents at their face value, as this Court in *Matek, Hocking, Koch,* and *Holden* says one must, those documents clearly do not leave so little power in the GP investors' hands so as to transform the GPs into *de facto* limited partnerships.

In *Holden,* this Court found in affirming a trial court's grant of a motion to dismiss that the first *Williamson* factor had not been met because the agreement required a majority vote – or in some cases a specific supermajority vote – of the investor-partners for "[a] substantial number of partnership acts" including "all decisions respecting partnership business; the transfer, sale, or encumbrance of partnership interests; compensation of a partner for work on behalf of the partnership; and the empowerment and direction of one or more partners or an

agent to negotiate and conclude sales of property," and also the amendment of the partnership agreement and dissolution of the partnership. *Holden*, 978 F.2d at 1120. The investor-partners in *Holden* also "retained reasonable access to the partnership books maintained at [the partnership's] principal office," the promoter-manager was limited to managerial and clerical tasks and could not enter into contracts or make promises without express written authority of the partners, and the partners could fire the promoter-manager at any time without cause. *Id.*

Similarly, this Court held in *Koch* that the first *Williamson* factor had not been met because "the partnership agreement clearly affords the partners significant legal powers," including the requirement of a majority vote for "decisions regarding the management and control of the business" and the ability to remove any person from a management position through a majority of the partnership units. Thus, "the investors here could – theoretically, at least – vote to cease farming, replace the operating general partner, terminate services by the on-site manager, vote to interplant rows of alfalfa, etc." 928 F.2d at 1479.

Here, the Partnership Agreement and Partner Representations executed by all investors in the GPs, as a condition precedent to acquiring the equity interests, do not leave so little power in the investors' hands so as to transform the GPs into limited partnerships. Therefore, the first *Williamson* factor does not apply.

...

As stated above, the Partnership Agreement vests the GP investors with strong powers, while rendering Defendants impotent through the inability to vote on matters affecting the GPs.

The Partnership Agreement thus provides the investor-partners with wide-ranging powers and partnership rights. Defendants, as non-voting members, have none of the authority, power, or discretion that would be necessary for the GPs to be transmuted into limited partnerships. The governing documents clothe the investors, not Defendants, with all control and authority over GP matters. The District Court did not dispute any of these essential facts, but instead evaded the plain language of the Partnership Agreement by its reliance on formalism and dicta by placing all its weight on the unfilled effective-date space.

The District Court's order is particularly puzzling because it had already held twice – first, in converting the temporary restraining order into a preliminary injunction (ER 3276-3301), and second, in its order on Defendants' motion to dismiss (ER 3129-3138) – ***that the SEC's allegations were insufficient to prove the first Williamson factor.***

As previously noted in the TRO conversion order, the Court reviewed the Partnership Agreement and found "that under the formal documents the partnership members don't necessarily have 'so little power' that they are effectively limited partners." *SEC v. Schooler*, 902 F. Supp. 2d at 1350.

Given the plain text of the Partnership Agreement and Co-Tenancy Agreement, there is no triable issue of material fact as to the presence of the first *Williamson* factor in this case. For that reason, the District Court's order of April 25, 2014 should be reversed and the District Court directed to enter an order stating that there is no genuine issue of material fact and that the GP interests are not securities under the first *Williamson* factor.

III. The District Court Erred in Granting Partial Summary Judgment to the SEC for the Offering and Sale of Unregistered Securities, and Violated Defendants' Due Process Rights in Doing So

In its original and amended orders on the SEC's motion for partial summary judgment as to Count 4, the District Court held that Defendants had conducted one unified offering for purposes of determining the applicability of any exemptions to the registration requirement. ER 14-33, 62-77. The District Court held this despite the facts that (1) each GP or group of GPs owned its own parcel independent of the other GPs, (2) each GP had its own bank account for deposit of funds that was not accessible by the other GPs, (3) the GP interests were not all sold at the same time but over intervals totaling 31 years, and (4) the GP parcels were scattered throughout four different states.

The District Court's ruling that the GPs were to be considered one integrated offering was erroneous. To contend that 31 years' worth of sales of equity interests in legally separate GPs holding title to separate parcels of raw land

scattered among four different states with different investors constitutes an integrated offering stretches the doctrine to the breaking point.

For those non-cotenant GPs, the proceeds from the sale of their parcels would not be shared with the other GPs, and since the co-tenancies only featured two to four GPs, if a co-tenancy property sold, then the GPs in each co-tenancy would split the proceeds only among themselves.

At most, any finding of "integrated offerings" would have to be limited to the GPs in co-tenancy with each other, and in the case of the GPs identified by Defendants as having 35 or fewer investors, those GPs held title to their own parcels and were not in co-tenancy.[2]

Moreover, Defendants' not furnishing investors with financial statements does not necessarily mean that the Rule 506 exemption is lost. Defendants did not provide financial statements because they relied in good faith on legal advice of counsel that the GP interests were not securities. ER 628-726. Ergo, if the GP interests were not securities, there would be no need to provide financial statements.

Courts have held that defendants' failure to provide financial statements, audited balance sheets, etc. as required by Rule 502(b)(2), if done in good-faith reliance on advice of counsel, can be excused under Rule 508 (17 C.F.R. §

[2] These GPs should also be excluded from inclusion in a disgorgement award.

230.508) as an "insignificant deviation" because the provision of such documents is not "significant" under Rule 508. *SEC v. Ishopnomarkup.com, Inc.*, 2007 U.S. Dist. LEXIS 70684 at *25-27 (E.D.N.Y. Sept. 24, 2007)(genuine issue of material fact existed with regard to defendants' failure to provide financial-disclosure documents required by Rule 502 and excuse under Rule 508, because defendants submitted evidence of good-faith reliance on counsel's advice in not providing financial-disclosure documents).

Furthermore, the District Court's original and amended orders were erroneous because they deprived Defendants of due process.

The original order granted leave to the SEC to file an amended motion for partial summary judgment to address Defendants' affirmative defenses, based on the District Court's perceived notion that the SEC had been prejudiced, even though the SEC had argued there were no applicable affirmative defenses in the original motion and sought to rebut Defendants' stated affirmative defenses in its reply brief. ER 76-77.

Moreover, the District Court's original order gave the SEC an unjustified procedural second bite at the apple by allowing the SEC to file its amended motion ***two months after the close of fact-based discovery and one month after the cutoff date for the filing of any dispositive motions other than motions in limine.***

...

Notably, the District Court's decision to allow the SEC to file an amended motion was *sua sponte*. The SEC did not ask for leave to file an amended motion or complain of prejudice.

When the District Court issued its *sua sponte* order reversing the original order and granting partial summary judgment and disgorgement to the SEC, it expressly stated that it so acted ***based solely on the SEC's amended motion*** – and did not allow Defendants to file any written opposition to address the SEC's contentions in the amended motion, since it also ordered a stay on all briefing.

In effect, the District Court chose to abdicate its role as a neutral arbiter and provide all sorts of procedural advantages to the SEC, even those that the SEC did not request. For those reasons alone, reversal of the District Court's orders of April 3, 2015 and May 19, 2015 with remand to a different judge is necessary.

IV. The District Court Erred in Ordering the Disgorgement of 31 Years' Worth of Earnings with Minimal Overall Offset, No Offset for Legitimate Business Expenses, No Accounting for Future Value of the Property, and No Adjudication of Liability for Fraud

A. Failure to Acknowledge Legitimate Business Expenses

Business expenses that are not "incurred to perpetuate an *entirely fraudulent* operation" may be allowed by the court as an offset against the claimed disgorgement. *SEC v. JT Wallenbrock*, 440 F.3d 1109, 1114-15 (9th Cir. 2006) (emphasis in original) (suggesting that business expenses not incurred to further a fraudulent scheme could offset a disgorgement award); *SEC v. Thomas James*

Assoc., Inc., 738 F. Supp. 88 (W.D.N.Y. 1990); *Litton Indus., Inc. v. Lehman Bros. Kuhn Loeb, Inc.*, 734 F. Supp. 1071 (S.D.N.Y. 1990), *rev'd on other grounds*, 967 F.2d 742 (2d Cir. 1992). Defendants submitted proof of such legitimate expenses to the District Court, which ignored that proof in determining the amount of disgorgement and thereby abused its discretion.

The funds derived from the investments in the GP interests went to pay underlying mortgages on the properties transferred to the GPs, costs of forming the partnerships, payment of corporate taxes, and other legitimate business expenses.

As Western's corporate tax returns for the years 1984 through 1986 and 1988 through 2012 showed, Defendants' itemized business expenses (excluding compensation paid to Mr. Schooler) totaled at least $98,195,528, including salaries, accounting services, regular legal services, engineering and consulting services in connection with the acquisition of properties, employees' health insurance, pension plans, and other fringe benefits, and other expenses that are part and parcel of running any business. ER 1137-1199.

The Receiver admitted in his deposition that he had not conducted any analysis of Western's business expenses for the period of 1981 to 2004, even though he acknowledged that it would be reasonable for Western to have incurred expenses during that period. ER 1137-1199.

...

Despite this wealth of evidence, the District Court refused to acknowledge any of it. ER 56. The District Court failed to recognize that Defendants' *entire business* consisted of the acquisition of land and the marketing and sale of interests in GPs established to acquire that land for eventual resale; as a result, *the expenses listed by Defendants in the tax returns plainly reduced their actual profit.* Western had no other business. Therefore, all of Western's expenses, excluding Mr. Schooler's compensation, would have to be included in the calculations.

B. Erroneous Reliance on Out-of-Date and Inaccurate Appraisals and Failure to Account for Investors Receiving Something of Actual Value with Potential for Appreciation

The District Court contended that "Contrary to Defendants' assertion, the value of the land need not be 'fixed through its sale to third parties'; that value can be determined through other methods such as appraisals" and concluded that, based on Hebrank's appraisals, the value of the GP-held land was $16,328,000, not the $21,168,464 that Defendants paid for the various parcels. ER 53.

However, Hebrank's appraisals were from the spring of 2013, almost three years before the entry of a final judgment. ER 3204-3220. Thus, the District Court's reliance on those appraisals was misguided. At a minimum, the District Court should have ordered *current* appraisals prior to entering any order of disgorgement with a specific dollar amount.

....

Moreover, the District Court's other orders showed the weakness of its own reliance on the past appraisals. In the order granting in part partial summary judgment as to Counts 1 and 2, the District Court acknowledged that the SEC's expert appraiser had erred by excluding a value for the valuable water rights that transferred with the Stead property. ER 26. Adding the water rights' value increased the property's appraised value to approximately $0.96 per square foot. *Id.* Hebrank's 2013 appraisal made the same error as the SEC's expert appraisal by not including the water rights, which would explain the arbitrarily low appraised value of $395,000 for the Stead/P51 property. ER 3204-3220.

Thus, the price that the Defendants paid for the parcels would be more accurate as a disgorgement offset, as compared to appraisals, which are not as suitable as what a willing buyer and willing seller (such as Defendants and the original sellers) agree to.

Furthermore, the District Court's order ignores the fact that the assets consist not of cash but of raw, unimproved land, whose present value is highly speculative, and which have no income stream.

In any event, the GP investors received something of actual value – interests in general partnerships that own title to land worth millions of dollars, and potentially worth hundreds of millions of dollars. The value of the land, when it is sold, would offset the requested amount of disgorgement. Based on the past track

record for the other GPs that resold their property, it is highly likely that the resale of the land would wipe out the entire disgorgement award. Almost a score of GPs have resold their properties to third parties for a profit, while the remaining 86 GPs wait for the market to improve or for development to reach the properties for buyers to express an interest. ER 1129. In the case of two GPs (Rainbow Partners and Horizon Partners), one of America's major commercial real estate brokerages offered to list their jointly-held property in Las Vegas for $2.6 million – approximately twice what the investors, through their GPs, paid for it. *Id.*

The GPs are established and will remain as legally free-standing entities with title to land, whether or not Defendants go out of business. The GPs will still hold title, and the investors will still hold their equity interests, with their potential for realizing significant profits.

Thus, the District Court's disgorgement order was an abuse of discretion by being unwarranted and premature.

C. The Order of Disgorgement Was Punitive and Inequitable

In its zeal to punish Defendants based upon its pre-judged conclusion that Defendants were criminal fraudsters, the District Court forgot that disgorgement is not intended to be punitive and based upon remote acts, and in so doing tries to ignore this Court's clear directive in *SEC v. Rind*, 991 F.2d 1486 (9th Cir. 1993).

...

The District Court ignored the facts that (1) Hebrank's Forensic Accounting Reports uncovered no nefarious business practices, improper moving of money, or other accounting or banking shenanigans by Defendants (ER 3222-3241), (2) the SEC had presented no evidence that any investor had lost a penny in these investments, and (3) the SEC had not proven that Defendants had control over when and to whom the GP-owned land would be sold, and Defendants had no such power because the partnership agreements and co-tenancy agreements do not permit Defendants to vote, or to cancel a vote of the investors, or to nullify such a vote. ER 1128.

The District Court tries to evade *Rind* by claiming that this Court's statement in *Rind* that "A court can and should consider the remoteness of the defendant's past violations in deciding whether to grant the requested equitable relief" (91 F.2d at 1492) had nothing to do with disgorgement because it was based upon two district court cases not involving disgorgement. ER 59.

The District Court's misreading of *Rind* is egregious. Had this Court wanted to exempt disgorgement – an *equitable* remedy (*Rind*, 991 F.2d at 1493) – from being considered as "requested equitable relief" in SEC actions for purposes of consideration of remoteness, it could have written so in *Rind* or its subsequent decisions. Yet, this Court did not, and hence remoteness of past violations should be considered in deciding the requested equitable relief, which includes

disgorgement as stated in the SEC's complaint.

Since the District Court issued an order of disgorgement covering a 31-year period, well beyond the five-year limit for imposition of civil penalties, the District Court did not follow the instructions of this Court in *Rind* to consider the remoteness of Defendants' actions in deciding whether to order disgorgement and in what amount.

V. The District Court Erred in Granting Summary Judgment to the SEC for the Securities Fraud Counts

A. The District Court Preliminarily Did Not Find that Defendants Committed Fraud

In its Order of October 5, 2012, the District Court stated that the basis for its converting the TRO into a preliminary injunction was that a *prima facie* case had been found for the offering and sale of unregistered securities. *SEC v. Schooler*, 902 F. Supp. 2d at 1360. The District Court further stated that it "has explicitly avoided staking its preliminary injunction on the SEC's allegations of fraud." *Id.* Since no *prima facie* claim of fraud had been found, the District Court did not have to determine the existence of scienter.

At the time the District Court made its ruling, it had been furnished with a number of voluminous exhibits from the SEC, including appraisals of three listed properties (Dayton IV, Pyramid Highway, and Stead), copies of Western's advertising brochures for the Stead property, a "track record" of properties

obtained and resold by other Western-formed GPs, and declarations from investors. Thus, it had plenty of potential evidence to consider – and after reviewing those documents, correctly concluded that the SEC's case was too thin to merit a preliminary injunction on any basis other than a *prima facie* case of selling unregistered securities.

B. Based on Substantially the Same Evidence, the District Court Reversed Direction and Erroneously Concluded -- On Summary Judgment -- That Defendants Had Committed Intentional or Reckless Fraud

In its June 3, 2015 Order, the District Court concluded that Defendants made material misrepresentations of fact regarding the Stead property's fair market value, by stating in their investor-information brochure that the fair market value was $2.50 per square foot when the fair market value, as determined by an unrebutted appraisal, was approximately $0.96 to $0.99 per square foot between August 2010 and July 2012 (and Defendants had paid $0.40 per square foot on April 1, 2010 to buy the land). ER 26. The District Court's determination was based upon two exhibits from the SEC's TRO application: an appraisal submitted by the SEC, and Defendant's advertising brochure. ER 23-25; see ER 3453-3490.

As explained above, the SEC's supporting evidence was regurgitated virtually entirely and verbatim from its TRO application exhibits. ER 479-520 (Defendants' separate statement in opposition, reprinting SEC's separate statement in full).

Thus, the District Court, after reviewing the same evidence that had been found insufficient to constitute a *prima facie* case of fraud for purposes of an injunction and asset freeze, reversed course and found that the same evidence was now sufficient to meet the different standards for the entry of summary judgment!

The standard for a preliminary injunction differs from the standard for summary judgment. *Compare Winter v. Natural Res. Def. Council, Inc.*, 555 U.S. 7, 20 (2008) ("A plaintiff seeking a preliminary injunction must establish that he is likely to succeed on the merits") *with* Fed. R. Civ. P. 56(c) (absence of genuine dispute of material fact). For the same factual reasons that the SEC failed to get a preliminary injunction on the basis of fraud, it was not entitled to summary judgment on the basis of fraud, and yet the District Court granted partial summary judgment based on the same deficient evidence.

Scienter is "a mental state embracing [an] intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976); *Vernazza v. SEC*, 327 F.3d 851, 860 (9th Cir. 2003) (definition of scienter in Securities Act section 17(a)(1), Exchange Act section 10(b), and Rule 10b-5 is similar).

"Generally, scienter should not be resolved by summary judgment." *Provenz v. Miller*, 102 F.3d 1478, 1489 (9th Cir. 1996); *SEC v. Seaboard Corp.*, 677 F.2d 1289, 1295 (9th Cir. 1982) ("when intent is at issue, the court should be

cautious in granting summary judgment...In such a case, the moving party bears a heavier burden of showing that there exists no genuine issue of material fact").

Good-faith reliance on the advice of accountants and attorneys is a recognized defense to scienter in securities-fraud cases. *SEC v. Goldfield Deep Mines Co.*, 758 F.2d 459, 467 (9th Cir. 1985); *Newton v. Uniwest Fin. Corp.*, 802 F.Supp. 361, 367-68 (D. Nev. 1990), *aff'd*, 967 F.2d 340 (9th Cir. 1992); *Markowski v. SEC*, 34 F.3d 99, 104-05 (2d Cir. 1994).

For a defendant to claim the defense of good-faith reliance on advice of counsel against a claim of securities fraud, the defendant must show that he (1) made a complete disclosure to counsel; (2) requested counsel's advice as to the legality of the proposed action; (3) received advice that the proposed action was legal; and (4) relied in good faith on that advice. *SEC v. Goldfield Deep Mines Co.*, 758 F.2d at 467.

Defendants made complete disclosures to various counsel between 1995 and 2010. ER 473-476. Defendants sought legal advice – including updated advice – as to the legality of the sale of GP units and the disclosures associated with the GP units' marketing and sale. The various memoranda constituted advice as to the legality and sufficiency of the disclosures (including those made during the Stead offerings) and Defendants relied in good faith on that advice. ER 473-476.

...

Furthermore, the District Court's decision was wildly inconsistent as to its statements regarding the fair market value of the Stead property, such that its basis for finding scienter is seriously questionable. On pages 13 and 14 of its June 3, 2015 order, it stated that the Stead property had a fair market value of approximately one dollar per square foot as of August 2010 when it was offered to investors (ER 25-26), but then on page 18 it claimed that the fair market value of the land on April 1, 2010 – four months prior to the date used for the appraisal - was only $0.40 per square foot (ER 30). The District Court's order does not explain how the Stead property, which was sold to Defendants with the same water rights that boosted its value to a dollar a square foot, mysteriously increased in value 150% from what Defendants had paid in just four months when there was no construction on the property. Assuming *arguendo* that the property was worth a dollar a square foot at or around the time of its acquisition by Defendants and subsequent marketing to investors, Defendants' purchase price of $0.40 a square foot was consistent with Defendants' practices of acquiring land on the cheap. Thus, Defendants' markup was not such an "extreme departure from the standards of ordinary care" (*Hollinger v. Titan Cap. Corp.*, 914 F.2d 1564, 1569 (9th Cir. 1990)) as to necessarily result in a finding of intent.

...

...

VI. The Amount of Civil Penalties Imposed on Defendants was an Abuse of Discretion

In a securities-law enforcement action, the court may impose third-tier civil penalties up to the greater of $150,000 or "the gross amount of pecuniary gain to [the] defendant as a result of the violation" if the defendant's actions "resulted in substantial losses or created a significant risk of substantial losses to other persons." 15 U.S.C. §§ 77t(d)(2)(C), 78u(d)(3)(B)(iii).

In this case, the District Court imposed $1,050,000 in third-tier civil penalties arising from *purported* losses or *purported* substantial risk of loss *allegedly* risked or suffered by seven persons shown advertising brochures for the Stead/P51 property. ER 6-8.

The GP investors received something of actual value – interests in general partnerships that owned or own title to land potentially worth hundreds of millions of dollars. The value of the land, when it is sold, would therefore offset the amount invested. Therefore, there were no substantial losses, or creation of a significant risk of substantial losses, to investors.

> In determining whether civil penalties should be imposed, and the amount of the fine, courts look to a number of factors, including (1) the egregiousness of the defendant's conduct; (2) the degree of the defendant's scienter; (3) whether the defendant's conduct created substantial losses or the risk of substantial losses to other persons; (4) whether the defendant's conduct was isolated or recurrent; and (5) whether the penalty should be reduced due to the defendant's demonstrated current and future financial condition.
>
> *SEC v. Haligiannis*, 470 F. Supp. 2d 373, 386 (S.D.N.Y. 2007).

The imposition of civil penalties on Mr. Schooler is unjustified under the second, third, and fifth *Haligiannis* factors.

The District Court imposed civil penalties even though the SEC could not allege *any* losses, let alone prove "substantial losses" or the "risk of substantial losses" – the third *Haligiannis* factor. Because of the nature of the GP investments, there have been no "substantial losses" or risk thereof.

Any losses would not materialize unless and until properties are sold – and unless the District Court decides to strip the investors of their agreed-upon balloting powers and empower the Receiver to unilaterally sell the parcels, no sale would ever occur without the investors' consent. Therefore, the necessary second element for third-tier penalties was not met.

The other element for imposition of third-tier penalties is whether the violation "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement." 15 U.S.C. §77t(d)(2)(C). Thus, the imposition of third-tier penalties requires an assessment of scienter – the second *Haligiannis* factor. *SEC v. M&A West, Inc.*, 538 F.3d 1043, 1055 (9th Cir. 2008).

This Court's decision in *M&A West* is instructive. There, the district court granted summary judgment in the SEC's favor and rejected the defendant's assertion of good faith. After finding that the defendant had acted with the requisite scienter, the district court imposed a second-tier civil penalty. This Court

reversed and held that the district court erred in granting summary judgment because the SEC's claims involved a question of scienter, and noted that it is well-established that issues of scienter are inappropriate for summary judgment and "such an assessment may only be made after a full evidentiary hearing." *Id.* at 1055. This Court then reversed the district court's imposition of a civil penalty and remanded for a full evidentiary hearing "before any penalty requiring an assessment of scienter may be imposed." *Id.*

Here, Mr. Schooler had no intent to defraud or deceive anyone. As in *M&A West*, the issue of scienter was inappropriate for summary judgment and it would be additionally improper to impose a penalty that requires a finding of scienter.

To support its award of $1.5 million of civil penalties, the District Court accepted wholesale the SEC's purported evidence of seven investors, each of which would allegedly justify a third-tier penalty. However, the SEC's evidence is insufficient to support its claims, and the District Court's reliance resulted in an abuse of discretion.

First, only four of the seven people actually invested in the Stead GPs. Since the other three persons did not invest, they had no sufficient risk of loss, and therefore were not to have been included in the calculation. The District Court erred in including those persons.

Second, the "evidence" is legally inadmissible and factually weak. The [redacted] Gorwin exhibit is hearsay not within an exception; Ms. Gorwin never testified under oath, and is not able to be cross-examined. Mary Ingertson's declaration is hearsay, and also vague and ambiguous; she cannot recall the date or salesperson's identity. [redacted] Lawrence's testimony was not subject to cross-examination either. As for [redacted] Hamilton's declaration, there is no evidence that anyone else mentioned in it, other than Mr. Sathre (a Western employee), actually invested in the Stead GPs. ER 150-190.

Because civil penalties are punitive, Mr. Schooler was entitled to an evidentiary hearing at which the purported witnesses could be summoned and subjected to cross-examination. And since SEC counsel Sara Kalin testified, in her declaration, to direct communications with investors, she was a witness who would have to be questioned under oath. ER 151-152.

Furthermore, when determining whether to impose penalties at all – or what tier and amount – the District Court's exercise of discretion must include the absence of prior SEC investigations. *SEC v. Alpha Telecom, Inc.,* 187 F. Supp. 2d 1250, 1263 (D.Or. 2002); *see also SEC v. Ross*, 504 F.3d 1130, 1134 (9th Cir. 2007).

In *Alpha Telecom*, the district court concluded civil penalties were unwarranted against the defendant, in part because "this offense was [Defendant]'s

first violation" of securities law. 187 F. Supp. 2d at 1263. This Court in *SEC v. Ross* viewed the district court's decision with approval. 504 F.3d at 1134. Similarly, Mr. Schooler has never been investigated by the SEC until now.

While courts can under Section 20(d) of the Securities Act award civil penalties for *each* violation, courts have routinely ordered only one civil penalty notwithstanding numerous violations. *See e.g., SEC v. Aqua Vie Beverage Corp.*, No. CV 04-414-S-SJL, 2008 WL 1914723, at *3 (D. Idaho April 29, 2008); *SEC v. Poirier*, 140 F. Supp. 2d 1033, 1049 (D. Ariz. 2001).

Furthermore, the sufficient deterrent effect of a permanent injunction and massive disgorgement and prejudgment interest justifies a reduction in the amount and number of civil penalties. *SEC v. Smith*, 2015 DNH 189, 2015 U.S. Dist. LEXIS 134175 (D. N.H. Oct. 1, 2015)(declining to grant SEC's request for full $150,000 third-tier penalty, and ordering $43,342.88).

In *Aqua Vie*, the SEC sought civil penalties for unlawfully selling unregistered securities, fraudulently promoting the company's stock by faxing millions of tout sheets to homes and businesses, and failing to comply with public reporting requirements. *See* No. CV 04-414-S-SJL, 2008 WL 1914723, at *1 (emphasis added). The district court even noted the CEO defendant's "repeated[] fail[ure] to acknowledge the wrongful nature of his conduct." *Id.* Notwithstanding

literally millions of violations and the CEO defendant's lack of remorse, the district ordered just one third-tier penalty for $120,000. *Id.* at *3.

In *Poirier*, the SEC sought civil penalties for causing the dissemination of false information about the corporation to enter the marketplace via at least two press releases and two publications of false information. *Id.* at 1040-41. Nonetheless, the district court ordered only one civil penalty of $100,000 per defendant. *Id.* at 1049.

Aqua Vie and *Poirier* establish that a court has discretion to issue only one civil penalty notwithstanding the existence of multiple violations or lack of remorse.

Moreover, in light of the enormous deterrent effect of the permanent injunctions, disgorgement, and order of prejudgment interest, this Court should recognize that no further deterrence is required if it upholds the District Court's order of disgorgement and interest.

Under the fifth *Haligiannis* factor, Mr. Schooler's current and future financial condition must be considered. Mr. Schooler's net worth at the start of the case was insufficient to cover the disgorgement; at most, he would have been able to pay the civil penalties. Now, after over three years of draining litigation, with no business operating, he is in less financial shape to pay any civil penalties.

Accordingly, the District Court should not have ordered any civil penalties under Section 20(d) of the Securities Act. The District Court's imposition of third-tier penalties was thus an abuse of discretion.

CONCLUSION

The District Court's entry of judgment for the SEC was based upon a series of partial-summary-judgment orders lacking both legal and factual support. Beginning with its initial decision that the GP interests were securities as a matter of law, solely on the basis that the space on the Partnership Agreements for the effective date was blank at the time the investors signed them, and then snowballing into determinations that the GPs were to be considered as a unified offering, that the SEC was entitled to disgorgement of $136 million without consideration of the investors actually receiving something of value or offset for legitimate business expenses, and that Defendants had defrauded the investors despite no evidence of any losses, the District Court swallowed the SEC's thin arguments without serious consideration, and then had to adopt a further legally-specious amended ruling upon realizing that its conclusion was wholly unsupported by this Court's precedents.

For these reasons, Defendants respectfully request that the District Court's entry of judgment for the SEC, including the disgorgement order and order of civil penalties, be reversed and the case remanded with reassignment to a different judge

as the current assigned judge has repeatedly shown such clear antipathy toward Defendants as to deny them due process of law.

DATED: May 10, 2016

Respectfully submitted,

/s/Philip H. Dyson

Philip H. Dyson, Esq.
Law Office of Philip H. Dyson
8461 La Mesa Boulevard
La Mesa, CA 91942
Counsel for Defendants-Appellants

CERTIFICATE OF COMPLIANCE WITH RULE 32(A)

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains ***13,750*** words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word in 14-point Times New Roman type.

DATED: May 10, 2016

Respectfully submitted,

/s/Philip H. Dyson

Philip H. Dyson, Esq.
Law Office of Philip H. Dyson
8461 La Mesa Boulevard
La Mesa, CA 91942

Counsel for Defendants-Appellants

STATEMENT OF RELATED CASES

There were four related cases before this Court, including one cross-appeal:

1. *SEC v. Schooler*, Cases 13-56761 and 13-56948

Interlocutory cross-appeals from District Court order of August 16, 2013 granting in part and denying in part Defendants-Appellants' motion for modification of preliminary injunction for removal of the GPs from receivership. All briefing has been completed. By order of June 19, 2014 (Case 13-56761, Dkt. No. 44), this Court stayed all further appellate proceedings (including oral argument scheduled for July 11, 2014) pending the District Court's *sua sponte* reconsideration of the August 16, 2013 order. The District Court then entered an order on March 4, 2015 superseding the August 16, 2013 order and denying Defendants-Appellants' motion for modification, thereby mooting the appeals in Cases 13-56761 and 13-56948. On April 3, 2015, on motion of the SEC, this Court issued an order consolidating the appeals in Cases 13-56761, 13-56948, and 14-56315 and declaring them to be moot.

2. *SEC v. Schooler*, Case 14-56313

Defendants-Appellants' interlocutory appeal from District Court order of June 16, 2014 denying Defendants-Appellants' motion for modification of preliminary injunction for removal of Western Financial from receivership. After completion of briefing and the noticing of oral argument for July 6, 2015,

Defendants-Appellants moved to voluntarily dismiss their appeal following the District Court's granting of partial summary judgment to the SEC and order of disgorgement. This Court granted Defendants-Appellants' motion to dismiss on June 1, 2015.

3. *SEC v. Schooler*, Case 14-56315

Defendants-Appellants' interlocutory appeal from District Court order of July 22, 2014 reconsidering its order of August 16, 2013 granting in part and denying in part Defendants-Appellants' motion for modification of preliminary injunction for removal of the GPs from receivership. The District Court then entered an order on March 4, 2015 superseding the August 16, 2013 order and denying Defendants-Appellants' motion for modification. On April 3, 2015, on motion of the SEC, this Court issued an order consolidating the appeals in Cases 13-56761, 13-56948, and 14-56315 and declaring them to be moot.

CERTIFICATION OF SERVICE

I hereby certify that on the 10th day of May 2016, I electronically filed the foregoing with the Clerk of the Court of Appeals using the CM/ECF system, which sent notification of such filing to the following counsels of record:

Lynn M. Dean, Esq.
Sara D. Kalin, Esq.
Securities and Exchange Commission
444 S. Flower Street, 9th Floor
Los Angeles, CA 90071

Susan S. McDonald, Esq.
Stephen G. Yoder, Esq.
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-9040

Ted Fates, Esq.
Allen Matkins Leck Gamble Mallory & Natsis
501 West Broadway, 15th Floor
San Diego, CA 92101

/s/Philip H. Dyson
Philip H. Dyson