967 F.3d 1082
United States Court of Appeals, Tenth Circuit.

FOXFIELD VILLA ASSOCIATES, LLC;
Richard A. Bartlett; Ernest J. Straub, III;
Bartlett Family Real Estate Fund, LLC; PRES, LLC,
Plaintiffs-Appellants,
v.
Paul ROBBEN; RDC Holdings, LLC,
Defendants-Appellees.

No. 18-3054
|
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Appeal from the United States District Court for the District of Kansas (D.C. Nos. 2:12-CV-02528-CM and 2:13-CV-02120-CM-JPO)

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Before LUCERO, HARTZ, and CARSON, Circuit Judges.

Opinion

CARSON, Circuit Judge.

We consider whether ownership interests in a limited liability company are securities under the

Securities Exchange Act of 1934. The specific attributes of the LLC interests in this case compel us to conclude that they are not. We thus affirm the district court's order declining to characterize the LLC interests as securities and granting summary judgment to the defendants on that basis.

I.

This appeal stems from an attempt to hold Defendant Paul Robben liable for securities fraud. In short, various Plaintiffs allege that Mr. Robben fraudulently induced them to purchase ownership interests in a Kansas limited liability company named Foxfield Villa Associates, LLC ("Foxfield"). Plaintiffs also argue that those interests were securities under the Securities Exchange Act of 1934. Plaintiffs thus maintain that Mr. Robben violated section 10(b) of the 1934 Act (its broad antifraud provision) and SEC Rule 10b-5 (an administrative regulation expounding upon that antifraud provision) when engaging in his allegedly deceitful conduct. See generally 15 U.S.C. § 78j(b) (codifying

section 10(b));[1] 17 C.F.R. § 240.10b-5 (codifying SEC Rule 10b-5).[2]

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[1] Section 10(b) contains the following language:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (footnote omitted).

[2] SEC Rule 10b-5 contains the following language:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
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> (a) To employ any device, scheme, or artifice to defraud,
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> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
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> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

The specifics are not so simple. The relevant complaint, for instance, contains 114 pages of allegations against Mr. Robben and his company RDC Holdings, LLC ("RDC")—the other defendant in this case—describing their supposedly fraudulent behavior over several years.[3] Relatedly, the discovery process and procedural history that arose out of those detailed allegations leaves us with a long and dense appellate record. The course of litigation also highlights the case's complexity: the district court issued stays and consolidated lawsuits, parties came and went, and myriad motions peppered the district docket.

Fortunately, we need not discuss most of those details. The district court granted summary judgment to Mr. Robben and RDC on the sole ground that Plaintiffs' interests in Foxfield were *not* securities under the 1934 Act. Because that narrow inquiry—rather than whether Mr. Robben and RDC's conduct was fraudulent—is the lone issue on appeal, we discuss only the factual background and circumstances that influence whether Plaintiffs' interests fall under the 1934 Act's definition of "security."

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[3] In reality, Mr. Robben did not *directly* own RDC. Instead, Development Services Corporation—a company that Mr. Robben directly owned—was RDC's sole member. But because none of the parties contend that distinction is material to the outcome of this appeal, for simplicity we omit any reference to Development Services Corporation as the link between Mr. Robben and RDC. Instead, we discuss RDC as if Mr. Robben owned and operated it outright.

To that end, we begin by examining the history of Foxfield. At the most basic level, Mr. Robben—an experienced residential real estate developer—conceived Foxfield as a vessel through which its members would purchase specific tracts of real estate. Some of the targeted tracts consisted of raw land that remained undeveloped; other tracts had been developed for residential use but had not yet been built upon. Even if further development was necessary, the hope was that the members—again through Foxfield—could eventually sell the acquired land for the construction of residential homes. If all had gone according to plan, the members would have earned considerable profits.

Mr. Robben eventually enlisted his acquaintances Richard Bartlett and Ernest Straub to take part in the Foxfield endeavor. Mr. Bartlett was an established businessman who had earned his wealth in the technology sector. Mr. Straub owned construction companies that specialized in both commercial and residential real estate construction. Both men had participated in real estate development projects with Mr. Robben in the past.

Even so, Mr. Bartlett and Mr. Straub were not actual *members* of Foxfield. That distinction instead belonged to the Bartlett Family Real Estate Fund, LLC ("BFREF") and PRES, LLC ("PRES"), companies which Mr. Bartlett and Mr. Straub respectively owned and operated either in full or in part. BFREF—a company Mr. Bartlett owned outright with his wife—owned a 50% interest in Foxfield. PRES, in turn, owned the remaining 50% interest in Foxfield. But unlike Mr. Bartlett's

ownership of BFREF, Mr. Straub did not own PRES outright. Rather, Mr. Straub held only a 50% ownership interest in PRES. The other 50% of PRES belonged to Mr. Robben's company, RDC.

Foxfield's operating agreement governed how BFREF (read Mr. Bartlett) and PRES (read Mr. Straub *and* Mr. Robben) made decisions and took actions on behalf of the new, member-managed enterprise. Most decisions and actions—e.g., acquiring the targeted real estate, establishing the corresponding sales prices for that land, and selecting and contracting with Foxfield's advisors—required only a majority in interest, which the operating agreement defined as any member or combination of members holding more than a 50% ownership interest in Foxfield. Other specified decisions and actions—e.g., loaning money to other people or entities, assuming the liabilities and obligations of other people or entities, and filing for bankruptcy—required a supermajority in interest, which the operating agreement defined as any member or combination of members holding 65% or more ownership interest in Foxfield. And still other decisions and actions—e.g., merging or consolidating Foxfield with another entity—required the unanimous consent of all members.

Practically speaking, though, the fact that Foxfield comprised only two members with equal ownership interests effectively nullified any distinction between decisions requiring a majority in interest, supermajority in interest, or unanimous consent. After all, given that BFREF and PRES each owned exactly 50% of Foxfield, even a decision requiring just a majority in interest

still required the assent of *both* members; one member acting alone could not tip the scales in its favor. The same held true for decisions requiring a supermajority in interest: no individual member held 65% or more of the ownership interests in Foxfield, so both BFREF and PRES had to agree on any such decision before it could take effect. And by definition, unanimous decisions required the approval of both members.

In any event, one decision that required "only" a majority in interest was the election and removal of Foxfield's officers. The members agreed (and the operating agreement confirms) that Mr. Robben would serve in dual roles as the original president and treasurer. And under the operating agreement, serving as president also made Mr. Robben both the chief executive officer (CEO) and chief operating officer (COO) of Foxfield. Mr. Robben accordingly managed "the day to day operations" of Foxfield and was responsible for "carr[ying] into effect" the decisions of Foxfield's members. As treasurer, Mr. Robben also had the duties of keeping Foxfield's accounts and preparing all of its financial statements.

Mr. Bartlett and Mr. Straub also served as officers of Foxfield. Mr. Bartlett acted as Foxfield's secretary. In that capacity, the operating agreement required him to attend all meetings between members and record the proceedings of those meetings. Mr. Straub, in turn, served as the company's vice president. His primary responsibility in that role was to assume the duties of the president and act in his place should Mr. Robben be unable to do so.

The operating agreement also included other provisions dictating the rights and duties of Foxfield's members. For example, the operating agreement required BFREF and PRES to "devote so much of [their] time and attention as is reasonably necessary and advisable to manage the affairs of [Foxfield] to the best advantage of [Foxfield]." Further, each member—including its designated "agent and representative"—had the right to inspect and copy any of Foxfield's financial records.

Finally, in exchange for their ownership interests, the operating agreement required BFREF and PRES to make capital contributions to Foxfield to help fund the enterprise. To that end, BFREF and PRES each made $200,000 contributions to the company. Mr. Bartlett provided the entire $200,000 on behalf of BFREF. Mr. Straub and Mr. Robben, on the other hand, each provided $100,000 on behalf of PRES.[4]

Several weeks passed between the moment when BFREF and PRES bought their ownership interests in Foxfield and the moment when Foxfield acquired the targeted tracts of real estate. When that day finally arrived, Mr. Robben was the one who purchased that land on behalf of Foxfield and its members. And he did so through a resolution that BFREF and PRES had unanimously passed earlier that very same day. That resolution "authorized and empowered" Mr. Robben to

[4] Relatedly, Mr. Bartlett also made an uncollateralized and uninsured $400,000 loan to Foxfield even though the operating agreement did not obligate him to do so. That loan, however, is not at issue in this appeal.

execute a vast array of banking documents (such as mortgages, promissory notes, etc.) on Foxfield's behalf "in connection with the acquisition of lots, the construction of residences, and the sale of residences." The resolution, in other words, gave Mr. Robben permission to bind Foxfield and its assets without first obtaining BFREF's and PRES's—and therefore Mr. Straub's and Mr. Bartlett's—approval. Thus, in the end, Mr. Robben was no longer just the president of Foxfield who merely "carried into effect" the decisions of BFREF and PRES. Instead, as of the day the resolution passed, he could manage and control the enterprise's assets as he saw fit.

Despite that new power, Mr. Robben's efforts at using the acquired real estate to turn a profit for Foxfield and its members ultimately proved unsuccessful. In response, five Plaintiffs—Mr. Bartlett, Mr. Straub, BFREF, PRES, and Foxfield itself—eventually banded together and sued Mr. Robben and RDC. The relevant document includes one claim based on federal law (the securities fraud action described above) and twenty-three claims based on state law.

As we previously mentioned, the district court granted summary judgment to Mr. Robben and RDC on Plaintiffs' securities fraud claim because the court determined that BFREF's and PRES's membership interests in Foxfield were not securities (at least in the way that the 1934 Act defines that term). That left the twenty-three state law claims, over which the district court declined to exercise supplemental jurisdiction given that no other federal claims remained. See 28

U.S.C. § 1367(c)(3). The district court therefore dismissed the state law claims and entered final judgment for Mr. Robben and RDC.

Plaintiffs now appeal. They first challenge the district court's conclusion that BFREF's and PRES's membership interests in Foxfield were not securities under the 1934 Act. Because that challenge arises from the "district court's grant of summary judgment," our review is de novo. Bird v. West Valley City, 832 F.3d 1188, 1199 (10th Cir. 2016) (quoting Emcasco Ins. Co. v. CE Design, Ltd., 784 F.3d 1371, 1378 (10th Cir. 2015)). Plaintiffs also contest the district court's decision to decline supplemental jurisdiction over their remaining state law claims, an issue that we review for abuse of discretion. Exum v. U.S. Olympic Comm., 389 F.3d 1130, 1139 (10th Cir. 2004). We exercise jurisdiction under 28 U.S.C. § 1291.

II.

Under the Securities Exchange Act of 1934, a "security" is not just a stock that brokers buy and sell on Wall Street. See Marine Bank v. Weaver, 455 U.S. 551, 556, 102 S.Ct. 1220, 71 L.Ed.2d 409 (1982) (observing that "the coverage of the antifraud provisions of the securities laws is not limited to instruments traded at securities exchanges and over-the-counter markets"). That term instead encompasses a much broader set of financial instruments—as the Supreme Court summarized, "virtually any instrument that might be sold as an investment" regardless of its form or name. Reves v.

Ernst & Young, 494 U.S. 56, 61, 110 S.Ct. 945, 108 L.Ed.2d 47 (1990); see also *Security*, Black's Law Dictionary (11th ed. 2019) ("A security indicates an interest based on an investment in a common enterprise rather than direct participation in the enterprise."). The 1934 Act itself, though, does not use that simplified description. Rather, it defines the word "security" by listing the many instruments "that in our commercial world fall within the ordinary concept of a security." United Hous. Found., Inc. v. Forman, 421 U.S. 837, 847–48, 95 S.Ct. 2051, 44 L.Ed.2d 621 (1975) (quoting H.R. Rep. No. 85, 73d Cong., 1st Sess., 11 (1933)). Those instruments include

> any note, stock, treasury stock, security future, security-based swap, bond, debenture, *certificate of interest or participation in any profit-sharing agreement* or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, *investment contract*, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or *in general, any instrument commonly known as a "security"*; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the

> foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

15 U.S.C. § 78c(a)(10) (emphases added).[5]

Today we consider only the three instruments that we emphasize above: investment contracts, certificates of interest or participation in a profit-sharing agreement, and instruments commonly known as securities. Plaintiffs argue that BFREF's and PRES's interests in Foxfield fall under each of those labels and are therefore securities under the 1934 Act. We consider each of the three in turn.[6]

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[5] This definition of "security" under the Securities Exchange Act of 1934 is "essentially identical in meaning" to the definition of that same word under the Securities Act of 1933. SEC v. Edwards, 540 U.S. 389, 393, 124 S.Ct. 892, 157 L.Ed.2d 813 (2004); see also 15 U.S.C. § 77b(a)(1). For that reason, throughout this opinion we "refer to cases involving the 1933 and 1934 Acts without distinguishing between which Act each case involved." SEC v. Thompson, 732 F.3d 1151, 1158 n.5 (10th Cir. 2013) (quoting Resolution Trust Corp. v. Stone, 998 F.2d 1534, 1538 n.3 (10th Cir. 1993)); see also Landreth Timber Co. v. Landreth, 471 U.S. 681, 686 n.1, 105 S.Ct. 2297, 85 L.Ed.2d 692 (1985) ("We have repeatedly ruled that the definitions of 'security' in . . . the 1934 Act and . . . the 1933 Act are virtually identical and will be treated as such in our decisions dealing with the scope of the term.").

[6] Because Plaintiffs do not argue on appeal that BFREF's and PRES's interests in Foxfield constitute any other instruments that fall under the Act's definition of "security"—for example, stocks or bonds—we limit our analysis to the three instruments that Plaintiffs mention. See United States v. Yelloweagle, 643

A.

The Supreme Court first defined an "investment contract"—a term that the 1934 Act itself left undefined—nearly seventy-five years ago in SEC v. W.J. Howey Co., 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946). In that case, the Supreme Court held that an investment contract

> means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits *solely from the efforts of the promoter or a third party*, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.

Id. at 298–99, 66 S.Ct. 1100 (emphasis added). We have since deconstructed that definition into three parts: "(1) an investment, (2) in a common enterprise, (3) with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." SEC v. Scoville, 913 F.3d 1204, 1220 (10th Cir. 2019) (quoting SEC v. Shields, 744 F.3d 633, 643 n.7 (10th Cir. 2014)).

The first and second of those requirements are not at issue. Nobody disputes that BFREF and PRES made investments ($200,000 capital contributions) in a common enterprise (Foxfield). The only question is

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F.3d 1275, 1280 (10th Cir. 2011) (observing that when an appellant does not pursue an issue on appeal, "we ordinarily consider the issue waived").

whether the profits that BFREF and PRES expected to gain as a result were "to come solely from the efforts of others." Howey, 328 U.S. at 301, 66 S.Ct. 1100.

In coming to an answer, we first note that—at least in our circuit—the word "solely" in that phrase does not literally mean "solely." See Crowley v. Montgomery Ward & Co., 570 F.2d 875, 877 (10th Cir. 1975). Instead, to prevent an "unduly restrictive application" of the Howey test, we have held that the word "solely" in the Howey definition more or less means "significant[ly]." Id. The result is that "[a]n investment satisfies [Howey's] third prong when the efforts made by those other than the investor are the ones which affect *significantly* the success or failure of the enterprise." Banghart v. Hollywood Gen. P'ship, 902 F.2d 805, 807 (10th Cir. 1990) (emphasis added).

We also note that our decision in Avenue Capital Management II, L.P. v. Schaden, 843 F.3d 876 (10th Cir. 2016), governs how we apply Howey's third prong when determining whether LLC ownership interests—like those that BFREF and PRES have in Foxfield—are investment contracts. See id. at 882 (determining "whether the [LLC] interests conveyed to [the plaintiffs] constitute investment contracts"). Schaden directs us to look to whether an investor in the LLC has "the ability to control the profitability of his investment, either by his own efforts or by majority vote in group ventures." Id. (quoting Gordon v. Terry, 684 F.2d 736, 741 (11th Cir. 1982)). If he does, then he "is not dependent upon the managerial skills of others." Id. (quoting Gordon, 684 F.2d at 741). Like the Howey test

from which it derives, though, the Schaden analysis is not an all-or-nothing, black-or-white test. Instead, the Schaden "ability to control" test reflects our emphasis on whose efforts were the "undeniably *significant* ones," Maritan v. Birmingham Props., 875 F.2d 1451, 1457 (10th Cir. 1989) (emphasis added), and therefore operates as a sliding scale: "[t]he greater the control acquired by [the investors in the LLC], the weaker the justification to characterize their investments as investment contracts." Schaden, 843 F.3d at 882.

Schaden outlines six factors that we consider "in assessing [that] degree of control": (1) the investors' "access to information"; (2) the investors' "contractual powers"; (3) the investors' "contribution of time and effort to the success of the enterprise"; (4) "the adequacy of financing"; (5) "the nature of the business risks"; and (6) "the level of speculation." Id. Importantly, we list those factors in the order of their significance. The first factor—access to information—"is the most significant factor" because "the 'principal purpose of the securities acts is to protect investors by promoting full disclosure of information necessary to informed investment decisions.' " Shields, 744 F.3d at 645 (quoting Maritan, 875 F.2d at 1457). The second factor—the investors' express and implied contractual powers—follows closely behind. The reason is straightforward: regardless of "whose efforts *actually* affected the success or failure of the enterprise," an investor who has the contractual *power* to control the enterprise—even if he chooses not to use that power—has "the sort of influence" that protects him "against a dependence on others." Maritan,

875 F.2d at 1457–58 (emphasis added) (quoting Matek v. Murat, 862 F.2d 720, 730 (9th Cir. 1988)); see also Schaden, 843 F.3d at 884 ("[W]e analyze the measure of control that [the investors in the LLC] *could* exercise over [the LLC]. . . ." (emphasis added)).

The third factor—the investors' contribution of time and effort—makes clear, though, that the Schaden test does not live and die with the investors' contractual powers. Although those powers do take precedence, see supra, the investors' actual involvement in the LLC (or lack thereof) *can* clarify whether they had the ability to control the profitability of their investments. But those circumstances are narrow. As we alluded to above, for example, "it [is] not enough" that the investors in the LLC were uninvolved simply because they "in fact relied on others for the management of their investment[s]" by choice. Schaden, 843 F.3d at 884 (alteration in original omitted) (quoting Williamson v. Tucker, 645 F.2d 404, 424 (5th Cir. 1981)). Instead, the investors' marginal participation in the LLC must have been because, despite any putative contractual powers to the contrary, they were in reality "so dependent on a particular manager that they [could not] replace him or otherwise exercise ultimate control." Id. (quoting Williamson, 645 F.2d at 424). Schaden's third factor therefore contemplates a practical inability to control the profitability of the investment rather than a voluntary decision not to control it.

And we will generally only conclude that practical inability exists in these circumstances[7]:

> (a) When the investors' *powers as exercised* are so insubstantial, ineffective, or illusory that the LLC is virtually indistinguishable from a limited partnership, an entity "which is usually held to be a security." Shields, 744 F.3d at 644, 647; see also Great Lakes Chem. Corp. v. Monsanto Co., 96 F. Supp. 2d 376, 391 (D. Del. 2000) (observing that limited partners generally cannot "exercise[a] managerial role in the partnership's affairs," so courts usually treat them as "passive investors" who rely solely on the efforts of others).
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> (b) When the investors *themselves* are so "inexperienced and unknowledgeable in business affairs" that they are "incapable of intelligently exercising" their powers under the LLC. Shields, 744 F.3d at 644 (quoting Banghart, 902 F.2d at 807).
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> (c) When the *manager or promoter* of the LLC is so unique that, even if the investors do retain "some practical control" over the LLC, they still "have no realistic alternative to the manager" or promoter. SEC v. Merch. Capital, LLC, 483 F.3d 747, 763 (11th Cir. 2007); see also Shields, 744 F.3d at 644.

See also Williamson, 645 F.2d at 424 (identifying these three circumstances for the first time); Schaden, 843

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[7] We use letters rather than numbers when listing these circumstances to emphasize that they are a subset of Schaden's third factor.

F.3d at 884 ("[W]e view the Williamson approach as a supplement to controlling Supreme Court and circuit precedent in determining . . . whether a particular investment is a security." (alteration in original) (quoting Shields, 744 F.3d at 645)).[8]

The fourth, fifth, and sixth Schaden factors—the adequacy of financing, the business risks, and the level of speculation—are the least relevant. This trio of factors can only *confirm* whether the LLC interests are investment contracts. See Ballard & Cordell Corp. v. Zoller & Danneberg Exploration, Ltd., 544 F.2d 1059, 1065 (10th Cir. 1976) ("*Most* investment contract cases involve the financing of speculative and poorly financed schemes by soliciting funds from uninformed and unskilled investors." (emphasis added)). But they

[8] The Williamson approach originated to rebut the "strong presumption" that general partnerships are not investment contracts. Shields, 744 F.3d at 643 (quoting Banghart, 902 F.2d at 808); see also id. (observing that this presumption exists "because the [general] partners—the investors—are ordinarily granted significant control over the enterprise" (quoting Banghart, 902 F.2d at 808)). Even though we also now apply the Williamson approach when LLCs are at issue, see Schaden, 843 F.3d at 884, we stress that—unlike general partnerships—we do *not* presume that LLCs are not investment contracts. Nor, on the other hand, do we presume that LLCs are investment contracts as we would for limited partnerships. See Shields, 744 F.3d at 647. Instead, given that LLCs "are hybrid entities that combine desirable characteristics of corporations, limited partnerships, and general partnerships," and that the creators of LLCs have "substantial flexibility" in crafting the terms of the LLCs' operating agreements, we simply proceed through each of the six Schaden factors to determine whether the "particular LLC at issue" is, in fact, an investment contract. Great Lakes Chem., 96 F. Supp. 2d at 383, 392.

do not in and of themselves affect whether the investors in the LLC had the ability to control the profitability of their investments. See Howey, 328 U.S. at 301, 66 S.Ct. 1100 ("The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others. If that test be satisfied, it is immaterial whether the enterprise is speculative or non-speculative. . . ."). We therefore employ these last three factors only to corroborate our final conclusion that particular LLC interests are or are not investment contracts.

We observe two final (but still significant) principles that we must consider when weighing the six Schaden factors. First, Schaden's "test of control is an objective one," so we do not consider "the control that [the investors in the LLC] *intended* to exercise."[9] Schaden, 843 F.3d at 884 (emphasis added) (quoting Bailey v. J.W.K. Props., Inc., 904 F.2d 918, 921–22 (4th Cir. 1990)). Second, we assess the LLC investors' degree of control when they bought their interests "rather than at some later time" after the circumstances bearing on control "have developed or evolved." Shields, 744 F.3d at 646 (quoting SEC v. Merch. Capital, LLC, 483 F.3d 747, 756 (11th Cir. 2007)).

With this background in mind, we analyze each of the six Schaden factors in turn to determine whether

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[9] We recognize that a different rule may apply in contexts outside the LLC sphere. See, e.g., Shields, 744 F.3d at 646 (observing that when general partnerships are at issue, we do, in fact, "look at the expectations of control") (quoting SEC v. Merch. Capital, LLC, 483 F.3d 747, 756 (11th Cir. 2007)).

BFREF and PRES had the ability to control the profitability of their investments in Foxfield.

1.

As we noted above, Foxfield's operating agreement allowed BFREF and PRES to inspect and copy all of Foxfield's financial records and documents. That alone powerfully suggests that BFREF and PRES had unfettered access to all necessary information about their investments. See Schaden, 843 F.3d at 883 (noting that the investors in the LLC had full access to information when "the LLC agreement expressly stated" that they "could inspect, examine, and copy" the LLC's books).

Plaintiffs retort, though, that BFREF's and PRES's broad access to *Foxfield's* information is not what matters. Rather, they claim that BFREF and PRES never had access to the financial records and documents of the company *from which* Foxfield bought the tracts of real estate. Mr. Robben could have easily drafted Foxfield's operating agreement to give BFREF and PRES access to that information, Plaintiffs argue, because he was a partial owner of that other company. And without that company's information, the argument continues, BFREF and PRES were unaware of critical financial data that would have quickly proven that purchasing the tracts of real estate was a bad idea. Plaintiffs therefore maintain that BFREF and PRES—unlike Mr. Robben—lacked access to the "information necessary to protect, manage, and control their

investments" in Foxfield under the first Schaden factor. Shields, 744 F.3d at 645.

The problem with Plaintiffs' argument is twofold. First, Plaintiffs direct us to no authority suggesting that LLC members in Kansas have the right to access the financial records and documents of another company. In fact, Kansas statutory law strongly implies that LLC members only have the right to access relevant information about the LLC of which they are a part. See Kan. Stat. Ann. § 17-7690(a)(1) ("Each member of a limited liability company . . . has the right . . . to obtain from the limited liability company . . . [t]rue and full information regarding the status of the business and financial condition *of the limited liability company*." (emphasis added)). We have a difficult time seeing how Schaden's first factor could cover information that BFREF and PRES probably did not have a right to access even under normal circumstances.

But even if Mr. Robben's partial ownership and intimate knowledge of that separate company instilled BFREF and PRES with such a right, see Kan. Stat. Ann. § 17-7690(a)(6) (noting that members of an LLC have the right to access "information regarding the affairs of the [LLC] as is just and reasonable"), Plaintiffs' argument fails for an even more fundamental reason. The fact that Foxfield's operating agreement did not *explicitly grant* BFREF and PRES access to the selling company's information does not mean that BFREF and PRES *lacked* access to that information. Indeed, Plaintiffs do not direct us to any evidence suggesting that some barrier stood in BFREF's and PRES's way that

prevented them from obtaining that company's financial records and documents upon their request. And without that evidence, we fail to see how BFREF and PRES were at any informational disadvantage to Mr. Robben even if they were aware when they bought their interests that he *currently* possessed more information than them. After all, Foxfield did not consummate the purchase of the real estate from the selling company until several weeks after BFREF and PRES had bought into Foxfield. BFREF and PRES thus had more than sufficient time to ask for and obtain the "information necessary to protect, manage, and control their investments" before they finally authorized Mr. Robben to buy that land.[10]

Thus, because BFREF and PRES very well may not have had a right to access the selling company's information in the first place—and even if they did, no evidence suggests that they were unable to access that

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[10] To the extent Plaintiffs are arguing that BFREF and PRES needed access to the selling company's financial records and documents to avoid investing in Foxfield in the first place, we note that that inquiry is outside the scope of this appeal. That question pertains to BFREF's and PRES's *choice to* invest in Foxfield, not who had the ultimate *control over* those investments. And so by extension, that question does not affect whether BFREF's and PRES's interests were securities. See Schaden, 843 F.3d at 882 (observing that whether an LLC interest is an investment contract turns on "who has the ability to control the profitability of [the] investment" (quoting Gordon, 684 F.2d at 741)). Rather, it affects the question of fraud—specifically, whether Mr. Robben unlawfully induced BFREF and PRES to purchase their interests by failing to disclose all relevant information to them from the start. See 15 U.S.C. § 78j(b) (outlawing the use of fraudulent tactics "in connection with the purchase" of "any security").

information—we conclude that they were aware or could have become aware when they purchased their LLC interests of the information necessary to steer the direction of their investments in Foxfield. Thus, the first Schaden factor suggests that BFREF and PRES had the ability to control the profitability of their investments.[11]

2.

BFREF's and PRES's contractual powers were extensive. Most notably, the operating agreement provided that Foxfield was member-managed, meaning that "[t]he management of the [c]ompany [was] vested in the Members." BFREF and PRES were therefore Foxfield's primary decisionmakers. Certain decisions, of course, required different *levels* of agreement among the members—some decisions required a majority in interest, others required a supermajority in interest, and still others required unanimous consent—but BFREF and PRES nonetheless remained responsible for controlling and binding Foxfield. Again, that powerfully suggests that BFREF and PRES had the ability to control the profitability of their investments at the

[11] We emphasize that our conclusion that BFREF and PRES had full access to information under the first Schaden factor is specific to whether their interests in Foxfield were securities. For that reason, we caution future courts and parties alike to not blindly apply the principles we use today when they must analyze questions of fraud. An investor's "access to information" in that context might have a very different meaning and effect than an investor's "access to information" in the securities context. See, e.g., supra n.10.

time of purchase. See Schaden, 843 F.3d at 883 (suggesting that member-managed LLCs allow the members "direct control over" their investments).

True, the operating agreement also required Foxfield to have certain officers, and it specifically required the president (Mr. Robben) to run "the day to day operations" of the company. Even so, the operating agreement also explained that the president was "[s]ubject to the decisions of the [m]embers" and responsible for "caus[ing] all decisions of the [m]embers to be carried into effect." BFREF and PRES thus retained ultimate control over the president (and thus over Foxfield) under the operating agreement, especially because that agreement also gave BFREF and PRES the power to elect and remove the president. See id. ("With the power to choose and remove managers, [the members] could supervise the individuals handling day-to-day operations. . . ."). And even more, the operating agreement provided that Mr. Bartlett (the full owner of BFREF) and Mr. Straub (the partial owner of PRES) *themselves* were officers of Foxfield: Mr. Bartlett was the company's secretary, and Mr. Straub was the company's vice president. So to the extent that Foxfield's officers had a say in the company's management, BFREF's and PRES's own members were among those officers.

Finally, the operating agreement commanded Foxfield's members to "devote so much of [their] time and attention as is reasonably necessary and advisable to manage the affairs of the [c]ompany to the best advantage of the [c]ompany." While not a contractual

power per se, that statement shows that, when BFREF and PRES bought their interests in Foxfield, the operating agreement envisioned they would play a significant role in managing the company and its activities.

Thus, because BFREF's and PRES's contractual powers were so vast, we conclude that the second Schaden factor suggests they had the ability to control the profitability of their investments in Foxfield.

3.

Despite BFREF's and PRES's broad contractual powers on paper, the fact that they were the only two members of Foxfield meant that, as we described above, *every* decision required their mutual assent in practice. Further, the fact that Mr. Robben was a 50% owner of PRES through RDC meant that, under PRES's own operating agreement, PRES could not assent to any decision itself without first obtaining Mr. Robben's consent. As a result, Foxfield could not make any binding decision without Mr. Robben's say-so.

Plaintiffs argue that this reality means Mr. Robben was "irreplaceable or otherwise insulated from" BFREF's and PRES's ultimate control, Schaden, 843 F.3d at 884, because BFREF and PRES could not dissolve Foxfield, amend its operating agreement, remove Mr. Robben as president, or even cause the company to *act*, without first getting the man's explicit approval. Cf. id. at 883–84 (concluding that the investors in the LLC controlled the profitability of their investments because, among other reasons, they had the ability to

amend the LLC's operating agreement, dissolve the LLC, and remove the LLC's officers all on their own). We proceed through each of the three Williamson circumstances to determine whether the effect of these peculiarities are as crippling as Plaintiffs claim they are.

a.

BFREF's and PRES's powers as exercised were robust enough to avoid characterizing Foxfield as a de facto limited partnership. Indeed, although BFREF and PRES arguably required Mr. Robben's consent to make any decision for Foxfield, the opposite also remained true—that is, Mr. Robben could not make decisions[12] on behalf of Foxfield (at least when BFREF and PRES bought their interests) without *their* consent.[13]

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[12] By "decisions," we mean the enumerated decisions listed in Foxfield's operating agreement that require the assent of its members, not the day-to-day decisions that Mr. Robben could make vis-à-vis his role as Foxfield's president.

[13] Or at least, Mr. Robben could not make decisions for Foxfield without BFREF's consent. Indeed, unlike Foxfield's operating agreement, the terms of PRES's operating agreement make clear that PRES was manager-managed (and not member-managed), and the manager at its helm was Mr. Robben's company RDC. And so while Mr. Straub and RDC/Mr. Robben each had 50% ownership interests in PRES, RDC/Mr. Robben could make at least some decisions on behalf of PRES without Mr. Straub's consent.

But we ultimately need not decide whether RDC/Mr. Robben could vote PRES's 50% interest in Foxfield without Mr. Straub's consent. Regardless of the answer, Mr. Robben still needed BFREF's go-ahead to make decisions for Foxfield. The control of Foxfield was thus interdependent no matter how we slice it. Thus,

The relationship was symbiotic: as went BFREF and PRES, so went Mr. Robben. And so at the very least, BFREF and PRES had the requisite powers to *prevent* Mr. Robben from acting on behalf of Foxfield. By any measure, that amount of managerial control exceeds the "restricted rights of a limited partner." Shields, 744 F.3d at 646; see also In re Estate of Hjersted, 285 Kan. 559, 175 P.3d 810, 821 (2008) (observing that limited partners in Kansas "*must* rely on the general partner to make decisions" and enjoy only "significantly restricted" "rights to make decisions regarding partnership operations and property" (emphasis added)).[14]

The power dynamic shifted only when BFREF and PRES passed the resolution authorizing Mr. Robben to make and execute important decisions on behalf of Foxfield. At that point, BFREF and PRES no longer even had the ability to prevent Mr. Robben from doing as he wished. But BFREF and PRES passed that resolution several weeks *after* they had purchased their Foxfield interests. Their voluntary decision to give Mr. Robben the full reins of authority therefore does not

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for ease of application and to prevent confusion, we act *as if* Mr. Robben needed Mr. Straub's consent to vote PRES's 50% interest in Foxfield; presuming as much makes no difference in our analysis of the issues.

[14] Plaintiffs make a half-hearted argument that the relevant comparison is not whether BFREF's and PRES's *powers* were much like that of a limited partner, but whether BFREF and PRES had *limited liability* like a limited partner. Our precedent makes clear that Plaintiffs are mistaken. See Shields, 744 F.3d at 647 (analyzing whether a general partnership "*actually distributed powers* similar to a limited partnership" (emphasis added)).

impact how Foxfield distributed power to its members when they bought their interests. If anything, passing that resolution simply confirms that BFREF and PRES possessed and used significant managerial powers to control how Foxfield operated. See Shields, 744 F.3d at 646 ("[W]e may look at how the [enterprise] actually operated to answer the question of how control was allocated at the outset" (quoting Merch. Cap., 483 F.3d at 754)).

BFREF and PRES nonetheless direct us to various pieces of evidence suggesting that, when they bought their interests, everybody involved (including Mr. Robben) expected Mr. Robben to run and control Foxfield. But even if we assume that is true—and, to take it a step further, even if we assume that the relevant parties intended from the start to pass a resolution granting Mr. Robben plenary powers—BFREF and PRES fare no better. As we described above, Schaden prescribes that, at least in the LLC context, "the test of control is an objective one." Schaden, 843 F.3d at 884 (quoting Bailey, 904 F.2d at 921–22). The relevant inquiry thus concerns how much control BFREF and PRES "could exercise" over Foxfield at the time of purchase, not whether they "expect[ed]" Mr. Robben to solely manage the enterprise. Id. Accordingly, BFREF and PRES's professed intention (and subsequent choice) to *act* in a more limited manner is immaterial; the important detail is that, in reality, their powers were more like those that general partners possess. See Banghart, 902 F.2d at 808 (observing that general partners possess "powers of control and supervision").

Thus, because BFREF and PRES could (and in fact did) exercise a fair amount of control over Foxfield and Mr. Robben in practice, they were not de facto limited partners under the first Williamson circumstance.

b.

When they purchased their interests in Foxfield, both Mr. Bartlett and Mr. Straub possessed enough experience and knowledge in business affairs to intelligently exercise their powers under Foxfield's operating agreement. Their later use of those powers—i.e, passing the resolution—confirms as much.

True, this second Williamson circumstance primarily "focuses on the experience of investors in the *particular* business, not the general business experience of the partners," and we acknowledge that neither Mr. Bartlett nor Mr. Straub were real estate developers by trade. Shields, 744 F.3d at 647 (alteration in original omitted) (emphasis added) (quoting Merch. Capital, 483 F.3d at 762). Even so, both men had participated in real estate development projects with Mr. Robben in the past, and Mr. Straub in particular would have also been at least marginally familiar with the real estate development industry through his expertise in real estate construction. And so while Mr. Bartlett and Mr. Straub were not *as* experienced as Mr. Robben, they were also not naïve or unsophisticated newcomers to the real estate industry who lacked the ability to *intelligently* exercise their powers under Foxfield's operating agreement. Cf., e.g., id. (concluding that the

plaintiffs established the second Williamson circumstance when the enterprise at issue had involved "oil and gas interests" and the investors in the enterprise, whom the marketer had solicited by telephone cold calls, had possessed "little, if any, experience in the oil and gas industry"); Merch. Capital, 483 F.3d at 762 (concluding that the plaintiffs established the second Williamson circumstance when the enterprise at issue had involved "the debt purchasing business" and the investors in the enterprise had been "members of the general public"—specifically, "a railroad retiree, a housewife, and a nurse"—who had "had no experience" in that business).

Further, our focus on the experience of the investors in the particular business does not mean that their general business experience is irrelevant. And here, the broad experience of Mr. Bartlett (a technology businessperson) and Mr. Straub (a real estate construction businessperson) in general business practices can only substantiate the idea that they knew how to intelligently exercise their powers under the operating agreement. At the very least, their substantial general business experience undercuts the opposite idea that they were *unintelligent* in that regard.

Consequently, because Mr. Bartlett and Mr. Straub were capable of intelligently exercising their powers under Foxfield's operating agreement, the second Williamson circumstance also does not show that BFREF and PRES had a practical inability to control the profitability of their investments.

c.

Mr. Robben did not possess an "entrepreneurial or managerial ability" so unique that BFREF and PRES had no realistic option except to rely on his efforts to control the profitability of their investments in Foxfield. Shields, 744 F.3d at 644 (quoting Banghart, 902 F.2d at 807). BFREF and PRES had at least one other realistic option on which to rely when they bought their investments: their own entrepreneurial and managerial abilities.

We recognize that was not the *preferable* option. Indeed, without Mr. Robben's input, BFREF and PRES may have lacked the insight of a man who, as the then-partial-owner of the targeted real estate, was intimately familiar with that land. Plaintiffs also allege that Mr. Robben guaranteed profits to BFREF and PRES by promising to re-buy some of the land from Foxfield at a later date for a substantial sum. If true, BFREF and PRES may have honestly believed when they bought their interests that foregoing Mr. Robben's help would have been foolish because only he could deliver those guaranteed profits.

But a realistic alternative is not necessarily a preferable one. For instance, although Mr. Robben's familiarity with the targeted real estate was advantageous, it was not so extraordinary that it effectively prevented BFREF and PRES from researching the land themselves and independently determining whether they should assent to its purchase. Perhaps that option would have taken longer or been more difficult given

their limited (but material) experience in real estate development, but it was an available option all the same. Further, even if Mr. Robben did in fact guarantee profits to BFREF and PRES via his own promise to rebuy the land in the future, nothing prevented BFREF and PRES from rejecting that offer and testing the waters to see whether a more lucrative option was available. Declining supposedly surefire profits in the hope of making even more money would have been risky and perhaps even unwise (especially because hindsight now suggests that doing so may have been futile). Even so, that does not change the fact that, when they bought their interests in Foxfield, BFREF and PRES had a realistic alternative to relying on Mr. Robben's efforts to make their investments profitable. Cf., e.g., Shields, 744 F.3d at 647–48 (concluding that a fact issue existed as to whether *unexperienced* investors had a realistic alternative to the manager of the enterprise under the third Williamson circumstance when the manager promised them substantial profits *and* the unexperienced investors lacked meaningful managerial powers); Merch. Capital, 483 F.3d at 764 (concluding that the investors had no realistic alternative to the manager of the enterprise under the third Williamson circumstance when the manager "effectively had permanent control over [the investors'] assets").

To be sure, we also recognize that Mr. Robben, as we have discussed, had a de facto veto power that prevented BFREF and PRES from acting on their own without his additional consent. So even if BFREF and PRES wanted to spurn Mr. Robben's offer of

guaranteed profits and pursue profits in another manner, they would have had to persuade him to go along with them. But we do not believe that de facto veto power—at least when the investors in the LLC also have a reciprocal veto power—is so unique as to satisfy the third Williamson circumstance. Such a holding would transform many run-of-the-mill LLC interests into securities even when the investors retain a significant managerial power that makes them something more than limited partners—namely, the power to prevent the manager or promoter from acting. See supra. We do not think that the third Williamson circumstance applies to such a common way to structure and organize an LLC. Rather, the word "unique" in that circumstance is narrower in scope and refers to entrepreneurial and managerial abilities specific to a particular manager or promoter. But as we described above, even if Mr. Robben's abilities were unique, they were not *so* unique under the facts here that they effectively required BFREF and PRES to depend on them. His veto power aside, BFREF and PRES had realistic alternatives to exclusively relying on his efforts.

The third Williamson circumstance therefore does not establish that BFREF and PRES had a practical inability to control the profitability of their investments in Foxfield.[15]

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[15] As we noted above when describing BFREF's and PRES's access to information, see supra n.11, we caution courts and parties alike not to take our conclusion that BFREF and PRES had realistic alternatives to relying on Mr. Robben's efforts to mean that Mr. Robben is not responsible for allegedly defrauding

4.

BFREF and PRES financed Foxfield with capital contributions in the hundreds of thousands of dollars, which could suggest that Foxfield was initially a poorly financed scheme. On the other hand, as we noted above, Mr. Robben allegedly promised BFREF and PRES guaranteed profits, which suggests that the business risks were low and that the enterprise was non-speculative. Thus, the adequacy of financing could suggest that BFREF's and PRES's interest in Foxfield were investment contracts, but the business risks and the level of speculation suggest that those interests were not investment contracts. See Ballard, 544 F.2d at 1065 ("Most investment contract cases involve the financing of speculative and poorly financed schemes by soliciting funds from uninformed and unskilled investors."). We need not, however, sort out these mixed signals from the final three Schaden factors. Again, we use these factors only to corroborate whether LLC interests are investment contracts; they do not help us determine whether the investors had the ability to control the profitability of their investments.

In conclusion, we hold that BFREF's and PRES's ownership interests in Foxfield were not investment contracts. Despite their purported expectation that Mr. Robben would solely manage their investments, the objective facts show that BFREF and PRES had the

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BFREF and PRES. Again, our analysis is specific to whether BFREF's and PRES's LLC interests are securities, not whether Mr. Robben engaged in fraud.

requisite access to information and contractual powers to control the profitability of those investments. And the specific circumstances of this case show that BFREF and PRES were not so dependent on Mr. Robben that they could not exercise ultimate control over their investments under any of the three Williamson circumstances. As a result, even though Mr. Robben exercised a fair amount of control over BFREF's and PRES's investments, his efforts were not so "undeniably significant," Maritan, 875 F.2d at 1457, as to satisfy the Schaden/Howey test. We therefore affirm the district court's conclusion that, "as a matter of law," BFREF's and PRES's interests in Foxfield were not securities under this first basis. Schaden, 843 F.3d at 882.

B.

Plaintiffs argue in the alternative that even if BFREF's and PRES's interests in Foxfield were not investment contracts, the company at the very least operated as a vessel through which BFREF and PRES agreed to share real-estate-development profits with one another. Plaintiffs also observe that BFREF and PRES could have obtained certificates from Foxfield reflecting as much. See Kan. Stat. Ann. § 17–76,112(c) ("Unless otherwise provided in an operating agreement, a member's interest in a limited liability company may be evidenced by a certificate of limited liability company interest issued by the limited liability company."). Plaintiffs therefore conclude that BFREF's and PRES's interests in Foxfield were securities because

those interests could be characterized as "certificate[s] of interest or participation in any profit-sharing agreement." See 15 U.S.C. § 78c(a)(10).

We reject Plaintiffs' argument under the Supreme Court's decision in Marine Bank v. Weaver, 455 U.S. 551, 102 S.Ct. 1220, 71 L.Ed.2d 409 (1982). In that case, the Supreme Court held that profit-sharing agreements that are "not designed to be traded publicly" are not securities under the 1934 Act. Id. at 560, 102 S.Ct. 1220; see also Landreth Timber Co. v. Landreth, 471 U.S. 681, 689 n.4, 105 S.Ct. 2297, 85 L.Ed.2d 692 (1985) (observing that Marine Bank considered whether "a privately negotiated profit[-]sharing agreement" is a security). BFREF's and PRES's interests in Foxfield, in turn, were not designed to be traded publicly; they instead arose out of a "private transaction" between Mr. Robben, Mr. Bartlett, and Mr. Straub. Marine Bank, 455 U.S. at 559, 102 S.Ct. 1220. Thus, even if BFREF's and PRES's interests could be characterized as certificates of interest or participation in a profit-sharing agreement in theory, the economic reality underlying those interests—i.e., that they were intended for private use—prevents us from ruling that they were securities. See id. at 559–60, 102 S.Ct. 1220.

Plaintiffs protest that conclusion by directing us to the Supreme Court's earlier decision in Tcherepnin v. Knight, 389 U.S. 332, 88 S.Ct. 548, 19 L.Ed.2d 564 (1967). In that case, the Supreme Court stated that "[i]nstruments may be included within any of [1934 Act's] definitions, as [a] matter of law, *if on their face* they answer to the name or description." Id. at 339, 88

S.Ct. 548 (emphasis added) (quoting SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344, 351, 64 S.Ct. 120, 88 L.Ed. 88 (1943)). The Tcherepnin Court later concluded that the instruments at issue in that case were securities because they answered to the description of certificates of interest or participation in any profit-sharing agreement. Id. Plaintiffs thus argue that, under Tcherepnin, they need only look to the characteristics of BFREF's and PRES's interests in Foxfield and not the economic reality underlying those interests to prove that the interests were certificates of interest or participation in a profit-sharing agreement.

Plaintiffs are mistaken. The Supreme Court later expounded upon its decision in Tcherepnin and observed that it had concluded that the instruments in that case were certificates of interest or participation in a profit-sharing agreement "only *after* analyzing the economic realities of the transaction." Forman, 421 U.S. at 850 n.15, 95 S.Ct. 2051 (emphasis added). So at best, Tcherepnin merely holds that courts must first examine the economic realities underlying an instrument *before* determining whether that instrument answers to the description of a certificate of interest or participation in a profit-sharing agreement. See id.; cf., e.g., Landreth, 471 U.S. at 685–97, 105 S.Ct. 2297 (holding that courts should look to a financial instrument's name and characteristics alone and not to the economic realities underlying that instrument when determining whether it is common stock). Tcherepnin thus supports rather than contradicts our conclusion that Marine Bank requires us to do more than just

connect the dots between the characteristics of a financial instrument and the characteristics of a certificate of interest or participation in a profit-sharing agreement. See Marine Bank, 455 U.S. at 559–60, 102 S.Ct. 1220; see also Landreth, 471 U.S. at 689 n.4, 690, 105 S.Ct. 2297 (observing that a court must examine the "economic reality underlying" a profit-sharing agreement—a task that requires uncovering whether the agreement was "privately negotiated"—when determining whether that agreement "falls within the usual concept of a security").[16]

So in sum, because BFREF and PRES did not intend to publicly trade their interests in Foxfield, those interests were not certificates of interest or participation in a profit-sharing agreement under the 1934 Act. The economic reality underlying those interests rather than their outward characteristics rules the day. BFREF's and PRES's interests in Foxfield thus were not securities under Plaintiffs' second argument.

C.

Finally, Plaintiffs argue that BFREF's and PRES's interests in Foxfield were securities because those interests were commonly known by that label. See 15

[16] In addition, the Supreme Court has also characterized the statement from C.M. Joiner Leasing on which Tcherepnin rested its conclusion—namely, that instruments "may be" securities "if on their face they answer to the name or description"—as nonbinding dictum. Forman, 421 U.S. at 850, 95 S.Ct. 2051. Given that statement originated as dictum, the persuasive value of the specific portion of Tcherepnin that Plaintiffs cite is far weaker.

U.S.C. § 78c(a)(10) ("The term 'security' means . . . any instrument commonly known as a 'security'. . . ."). Plaintiffs note, for example, that Foxfield's operating agreement says that "an [i]nterest in [Foxfield] shall be and is a 'security' as defined in and governed by Article 8 of the Uniform Commercial Code" for "purposes of the Uniform Transfer on Death Security Registration Act or any similar applicable legislation." Given that all fifty states have accepted Article 8 of the Uniform Commercial Code, Plaintiffs argue that—quite obviously—BFREF's and PRES's interests in Foxfield must have been instruments "commonly known" as securities.

Plaintiffs also observe that Foxfield's operating agreement prohibited the company's members from transferring their interests unless they first registered those interests under the Securities Act of 1933 or obtained legal advice that they were exempt from registration requirements. Plaintiffs maintain that unless those interests were securities in the first place, BFREF and PRES would have had no reason to register those interests under the federal securities laws or obtain advice about exemption. Cf. Tcherepnin, 389 U.S. at 341, 88 S.Ct. 548 ("It seems quite apparent that . . . building and loan [lobbyists] would not have sought an exemption from the registration requirements . . . unless there was general agreement that the [Securities Act of 1933's] definition of security . . . brought building and loan shares within the purview of the 1934 Act."). Again, in Plaintiffs' eyes, that means BFREF's and PRES's interests in Foxfield must have been commonly known as securities as a matter of simple logic.

But once again, Plaintiffs focus solely on the characteristics of BFREF's and PRES's interests in Foxfield, not the economic realities of those interests. See supra. And like certificates of interest or participation in a profit-sharing agreement, the Supreme Court has held that courts must examine those economic realities when evaluating whether a financial instrument is one commonly known as a security. See Forman, 421 U.S. at 851–52, 95 S.Ct. 2051 (commanding courts to "examine . . . the economic realities of the transaction" when determining whether an instrument is commonly known as a security). This time around, however, the economic-reality analysis does not focus on the public or private nature of the instrument. Rather, the Supreme Court has held that the Howey test for investment contracts is the proper economic measure here. See Landreth, 471 U.S. at 691 n.5, 105 S.Ct. 2297 (holding that "the Howey test . . . appl[ies]" when a court must determine whether an instrument is one commonly known as a security); see also Forman, 421 U.S. at 852, 95 S.Ct. 2051 ("We perceive no distinction . . . between an investment contract and an instrument commonly known as a security." (internal quotation marks omitted)). And because BFREF's and PRES's ownership interests in Foxfield do not survive Howey, see supra, that means BFREF's and PRES's interests also were not instruments commonly known as securities even if the characteristics of those interests suggested otherwise.

Thus, like their first two attempts, Plaintiffs' third and final basis for arguing that BFREF's and PRES's interests in Foxfield were securities fails in the end. As

a result, we conclude that those interests were not securities under the 1934 Act, and we affirm the district court's grant of summary judgment to Mr. Robben and RDC on that claim.

III.

As a final note, Plaintiffs argue that the district court abused its discretion by declining supplemental jurisdiction over their twenty-three remaining state law claims. In support, Plaintiffs observe that nearly four years have passed since they filed their relevant complaint, that the parties have engaged in a great deal of discovery and filed many motions, and that the parties have already filed and objected to the pretrial order. Thus, after considering "the nature and extent of pretrial proceedings, judicial economy, convenience, and fairness," Anglemyer v. Hamilton Cty. Hosp., 58 F.3d 533, 541 (10th Cir. 1995) (quoting Thatcher Enters. v. Cache Cty. Corp., 902 F.2d 1472, 1478 (10th Cir. 1990)), Plaintiffs maintain that "[r]equiring the parties to start over again in state court is an affront to judicial economy," especially since that would lead to "dramatically increasing" litigation costs.

For its part, the district court declined to exercise supplemental jurisdiction under 28 U.S.C. § 1367(c)(3) because it concluded that the copious state law issues warranted a Kansas state court's consideration in the absence of the sole federal claim. Further, the district court determined that retaining this case in federal court might lead to inconsistent findings of fact or law

given that a similar, corollary case already existed in Kansas state court.

We discern no abuse of discretion. "[A] district court should normally dismiss supplemental state law claims after all federal claims have been dismissed, particularly when the federal claims are dismissed before trial." United States v. Botefuhr, 309 F.3d 1263, 1273 (10th Cir. 2002). With that said, "we have [also] suggested that it is appropriate, perhaps even advisable, for a district court to retain supplemented state claims after dismissing all federal questions when the parties have already expended a great deal of time and energy on the state law claims." Id. (citing Anglemyer, 58 F.3d at 541). But a district court does not abuse its discretion just because it defies an appropriate and advisable *suggestion*—at least as long as it gives good reasons for doing so. See id. We believe that the many state law claims—twenty-three, to be exact—are a good enough reason under the abuse-of-discretion standard to send this case to the Kansas state courts despite the significant resources that the parties have expended in federal court.

We therefore affirm the district court's decision to decline supplemental jurisdiction over the remaining state law claims.

IV.

For the reasons we describe above, we AFFIRM.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF KANSAS

FOXFIELD VILLA ASSOCIATES, LLC, et al., **Plaintiffs,** **v.** **PAUL ROBBEN and RDC HOLDINGS, LLC,** **Defendants.**	**Case No. 12-2528/13-2120**

MEMORANDUM & ORDER

This matter comes before the court upon defendants RDC Holdings, LLC ("RDC") and Paul Robben's Motion for Summary Judgment on Plaintiff's Sole Federal Claim and Motion to Dismiss for Lack of Subject Matter Jurisdiction (Doc. 183).

Also before the court are:

- Defendants' Motion Regarding Plaintiffs' Rebuttal Experts (Doc. 157)
- Defendants' Motion for Summary Judgment On Plaintiff's State Law Claims (Doc. 179)
- Defendants' Motion for Summary Judgment On Defendants' Affirmative Defenses (Doc 181)
- Plaintiffs Bartlett Family Real Estate Fund, LLC, Richard A. Bartlett, Foxfield Villa Associates, LLC, Pres, LLC, and Ernest J. Straub,

III's Motion for Summary Judgment on Question of Whether PRES, LLC and Bartlett Family Real Estate Fund, LLC FVA Interests, and Bartlett's FVA Note are Securities (Doc. 185)

- Plaintiffs' Motion for Summary Judgment on Defendants' Mitigation of Damages and Statute of Limitations Affirmative Defenses (Doc. 187)
- Plaintiffs' Motion for Summary Judgment on Plaintiffs' Affirmative Claims (Doc. 189)
- Plaintiffs' Motion to Strike [201] Memorandum in Opposition to Motion, [202] Memorandum in Opposition to Motion, [199] Memorandum in Opposition to Motion, Exhibit A to Doc. 201, Exhibit B to Doc. 202, and Exhibit B to Doc. 199 (Doc. 208)
- Plaintiffs' Motion for Leave to file a Sur-reply in Opposition to Defendants' Motion for Summary Judgment on Plaintiffs' State Law Claims and Suggestions in Support (Doc. 215)
- Plaintiffs' Motion to Exclude and/or Strike Expert Evidence from Shawn D. Fox (Doc. 221) and
- Defendants' Motion to Exclude, Strike and/or Limit Testimony of Plaintiffs' Damages Expert (Doc. 223).

For the reasons explained more fully below, defendants' motion (Doc. 183) is granted and the court denies all other motions as moot.

I. Background

Plaintiffs filed this case on August 10, 2012 against various defendants, not including RDC and Robben (Doc. 1). The case was stayed January 17, 2013, pending the resolution of a related action that was pending in the District Court of Johnson County, Kansas (Doc. 34). In the meantime, on March 8, 2014, plaintiffs filed another federal suit involving the same factual basis as this case and nearly identical parties, adding defendants RDC and Robben. On August 9, 2013, the court consolidated the federal cases (Doc. 50). The stay was not lifted until November 25, 2015, when the court granted plaintiffs leave to file an amended complaint that added RDC and Robben to this case (Doc. 65). On May 25, 2016, the court entered a scheduling order, outlining agreed deadlines and procedures for discovery in this case (Doc. 94). It does not appear that the court ordered mediation in this case, in part because it appeared fruitless to mediate when the parties did not have "something remotely approaching a common understanding of whether defendant RDC Holdings, LLC is judgment-proof." (Doc. 111.) "[T]he parties have no common understanding of the fairly simple key facts that should drive whether any judgment plaintiffs might obtain against Mr. Robben's company, co-defendant RDC Holdings, LLC, could be satisfied." (*Id.*)

On April 11, 2017, the court entered a pretrial order (Doc. 170). Plaintiffs objected to the order and sought review (Doc. 175). The undersigned denied plaintiffs' motion for review on January 12, 2018 (Doc.

230). The six motions for summary judgment currently before the court were filed on May 5, 2017. (Docs 179, 181, 183, 185, 187, 189.)

II. Legal Standard

Summary judgment is appropriate if the moving party demonstrates that there is "no genuine issue as to any material fact" and that it is "entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). In applying this standard, the court views the evidence and all reasonable inferences therefrom in the light most favorable to the nonmoving party. *Adler v. Wal-Mart Stores, Inc.*, 144 F.3d 664, 670 (10th Cir. 1998) (citing *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986)).

The party moving for summary judgment has the burden to show "the lack of a genuine issue of material fact." *Ascend Media Prof'l Servs., LLC v. Eaton Hall Corp.*, 531 F. Supp. 2d 1288, 1295 (D. Kan. 2008) (citing *Spaulding v. United Transp. Union*, 279 F.3d 901, 904 (10th Cir. 2002) (citing *Celotex Corp. v. Catrett*, 477 U.S. 317, 327 (1986))). Once the moving party meets this initial burden, the burden then shifts to the nonmovant to "set forth specific facts showing that there is a genuine issue for trial." *Id.* (citing *Spaulding*, 279 F.3d at 904 (citing *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986))).

The nonmovant may not rest on his pleadings or "rely on ignorance of the facts, on speculation, or on suspicion and may not escape summary judgment in

the mere hope that something will turn up at trial." *Id.* (citing *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 259 (1986)); *Conaway v. Smith*, 853 F.2d 789, 794 (10th Cir. 1988). Instead, the nonmovant is required to set forth specific facts, by referencing affidavits, deposition transcripts, or exhibits, from which a rational trier of fact could find for him. Fed R. Civ. P. 56(c)(1); *see also Ascend Media*, 531 F. Supp. 2d at 1295 (citing *Adams v. Am. Guar. & Liab. Ins. Co.*, 233 F.3d 1242, 1246 (10th Cir. 2000)). Summary judgment is not a "disfavored procedural shortcut"—it is an "integral part of the Federal Rules as a whole, which are designed to secure the just, speedy and inexpensive determination of every action." *Celotex Corp.*, 477 U.S. at 327 (quoting Fed. R. Civ. P. 1).

II. Facts

A. The Parties and Their Businesses

The following facts were either uncontroverted or viewed in the light most favorable to plaintiffs. The remaining parties to this suit are: plaintiffs Foxfield Villa Associates, LLC ("FVA"); Richard A. Bartlett; Ernest J. Straub, III; Bartlett Family Real Estate Fund, LLC ("BFREF"); Pres, LLC ("Pres"); and defendants Paul Robben and RDC Holdings, LLC ("RDC").

Defendant Robben is an experienced single-family and multi-family developer and formed RDC. Defendant Robben was involved with a prior company called Foxfield Associates, LLC, that was formed in 2000. Robben owned Woodstone, Inc., a Kansas corporation

that was a 10 percent owner of Foxfield Associates, LLC. The other 90 percent was owned by parties not involved in this litigation. Foxfield Associates, LLC owned the 9.16 acre tract that FVA eventually purchased. It also had millions of dollars of debt liability to Bank of Blue Valley that defendant Robben personally guaranteed.

Defendant RDC has been out of business since 2013, but it had a single member, Development Services Corporation, which was owned by defendant Robben, who was the sole officer, director, and shareholder. RDC's charter was forfeited in 2014 for failing to file an annual report.

Plaintiff Bartlett has started, owned, served as CEO or chairman for, and sold various technology companies earning millions. Plaintiff Bartlett was also involved in several other real estate development projects with defendant Robben in the 2000s, including the Olathe Condo project, the Maple Crest project, and the Foxfield Villa project. Plaintiff BFREF is owned by plaintiff Bartlett and his wife Dena Bartlett, who are the only members.

Plaintiff Straub owns Straub Construction Company, Inc., which was incorporated in Kansas in 1988. He also owns Straub Homes, LLC, which primarily specializes in residential construction. Straub has owned and constructed other real estate development projects over the years, including Town & Country Villas in Shawnee, Kansas, in which he and his father each had a 50 percent interest; and Chapel Ridge

Multifamily, LLC, in which Straub had a 50 percent interest.

In 2006, plaintiff Straub and defendant RDC formed Pres to acquire and develop the Mission Cliffs townhome subdivision in Kansas City, Kansas. Straub's company, Straub Construction, was the contractor on the Mission Cliffs project. RDC was manager of Pres until it resigned on January 1, 2009 because it could not meet required financial contributions. It relinquished its ownership interest in Pres on December 31, 2012. Straub is currently the only member of Pres.

FVA was organized in 2007, and the operating agreement was signed by Robben and Straub on behalf of Pres, and Bartlett on behalf of BFREF. Its members are still Pres and BFREF, but defendant Robben owns no interest.

B. The Foxfield Villa Project and Operating Agreement

In October 2007 defendant Robben sent plaintiffs Bartlett and Straub a copy of a proposed operating agreement for FVA. In 2008, plaintiffs Bartlett and Straub signed the agreement, which granted BFREF and Pres each a 50 percent ownership interest in FVA. At the time, defendant RDC had a 50 percent ownership in Pres, which granted RDC a 25 percent interest in FVA. BFREF and Pres each made a $200,000 capital contribution prior to closing in March 2008. Pres's

contribution consisted of $100,000 contributions from plaintiff Straub and defendant RDC.

The language in the operating agreement provides that action may be taken by a majority in interest, meaning any member or combination of members holding more than 50 percent interest in the company, unless otherwise specified. Some specific actions, such as modifying the business purpose by engaging the company in other business, requires unanimous written consent of all members or a supermajority. The agreement allowed any member with at least a 10 percent interest to request a special meeting at any time and for any member with a majority in interest to request periodic meetings.

Officers were to be elected by a majority in interest, and include a president and secretary. The members were allowed to elect a treasurer, vice presidents, treasurer(s), and secretaries in their discretion. Initially, the officers were defendant Robben serving as president and treasurer; plaintiff Straub serving as vice president; and plaintiff Bartlett serving as secretary. A majority determined salaries, if any, of officers. The president was the CEO and COO of the company and had general management of the day-to-day operations of the company. He was to "cause all decisions of the Members to be carried into effect." (Doc. 198-3, at 18.) The vice president acted in the president's absence. The secretary recorded proceedings of meetings. And the treasurer was to keep accounts and prepare financial statements. Defendant Robben was removed as president and treasurer of FVA in early 2009.

Additionally, each member could designate the names of two officers, directors, partners, members, managers, employees, or other affiliates to serve as the designated representatives of the member at meetings. Each member was an agent for FVA and each was vested with management of the company.

The agreement required a majority in interest to make business decisions as set out by the agreement. The list included, but did not limit, actions requiring a majority to: contracting with FVA's legal, accounting and professional advisors; purchasing property; borrowing from banks; decisions on suppliers and contractors; establishing prices and selling lots; forming and operating home associations; insuring the company and properties; investing funds; and approving documents.

The agreement required a supermajority, or 65 percent of the voting interest, to take certain specified actions, including but not limited to: purchasing land; filing for bankruptcy; assuming obligations or guarantees of other entities; and making loans or advances or investments to other entities.

The agreement provided that "each Member shall devote so much of its time and attention as is reasonably necessary and advisable to manage the affairs of the Company to the best advantage of the Company." (*Id.* at 17.)

The agreement provided that financial records would be maintained at the principal office of FVA and

that every member had the right to inspect and copy records.

In March 2008, to help with what were intended to be short-term cash flow issues, plaintiff Bartlett made an uncollateralized, unsecured $400,000 loan to FVA for which he was to receive an 8 percent return. $200,000 of the loan was repaid in September 2008. Due to the financial crisis, the other $200,000 was not repaid.

III. Discussion

A. Plaintiff's Count 9

1. The Securities Exchange Act of 1934

Whether defendants are entitled to summary judgment on Count 9 depends on whether the investments plaintiffs made in FVA are "securities" within the meaning of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–qq. A plaintiff seeking the protections of federal securities law must show that a defendant's misconduct involved the purchase or sale of a "security" as defined by the Act and interpreted by the federal courts. "The fundamental purpose undergirding the Securities Exchange Acts is to eliminate serious abuses in a largely unregulated securities market." *Reves v. Ernst & Young*, 494 U.S. 56, 60 (1990). The United States Supreme Court explains that Congress intended to encompass

> the virtually limitless scope of human ingenuity, especially in the creation of countless and variable schemes devised by those who seek the use of the money of others on the promise of profits and determined that the best way to achieve its goal of protecting investors was to define the term security in sufficiently broad and general terms so as to include within that definition. . . . broad[ly] to encompass virtually any instrument that might be sold as an investment.

Ernst, 494 U.S. at 60–61. The court noted however, that Congress did not "intend to provide a broad federal remedy for all fraud," leaving the SEC and federal courts ultimate task of determining which financial transactions are covered by the statute. *Id.* at 61 (quoting *Marine Bank v. Weaver*, 455 U.S. 551, 556 (1982)).

Section 3(a)(10) defines "security" as

> any note, stock, treasury stock, security future, security-based swap, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, **investment contract**, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency,

> or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

15 U.S.C. § 78c(a)(10) (emphasis added).

2. Defining Securities Exchange Act "Investment Contracts"

Defendants argue that they are entitled to summary judgment on plaintiffs' Count 9 because the Tenth Circuit in *Avenue Management II, L.P. v. Schaden*, 843 F.3d 876 (10th Cir. 2016), determined that limited liability companies' investments, such as plaintiffs' in this case, are not securities as defined by the Securities Exchange Act of 1934. Plaintiffs argue that their LLC investments are "investment contracts" and that the court should apply the Supreme Court's decision in *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293 (1946). The court finds both decisions applicable, but neither as determinative as the parties would argue, because the definition of "securities" for purposes of coverage by the Securities Exchange Act necessarily depends on the facts of each case and the investment at issue.

Count 9 is brought only against defendant Robben and only by plaintiffs BFREF and Pres based on their ownership interest in FVA and plaintiff Bartlett based on the $400,00[0] loan he made FVA in March 2008. Defendant RDC and plaintiffs FVA and Straub are not parties to Count 9. Count 9 states that defendant Robben violated sections 10(b) and 10(b)5 of the Securities Exchange Act of 1934. Plaintiffs include general factual contentions, but they provide no further details specific to Count 9 in the pretrial order, except to note for the purposes of damages, defendant Robben acted maliciously with wanton reckless disregard to plaintiffs' rights, which should entitle plaintiffs to punitive damages and attorney fees. (Doc. 170, at 40.) The parties do not raise, so the court will not address whether this conclusory assertion is sufficient even to survive the motion to dismiss stage of a case. For example, plaintiffs do not support this allegation with factual allegations about how defendants allegedly violated the Securities Exchange Act. Whether or not plaintiffs explained this allegation in more depth in a former pleading is irrelevant as the pretrial order superseded all previous pleadings. Especially in a case with over twenty separate claims, plaintiffs should have specifically set out which facts supported their Count 9 for violations of the Securities Exchange Act.

An instrument is an "investment contract" for purposes of the Securities Exchange Act if it is "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third

party . . . " *Howey*, 328 U.S. at 298–99. The Tenth Circuit has considered whether investors' "expected profits from [their] investments were to come solely from the efforts of others." *Schaden*, 843 F.3d at 882 (quoting *Howey*, at 301). This is because "[a]n investor who has the ability to control the profitability of his investment, either by his own efforts or by the majority vote in group ventures, is not dependent upon the managerial skills of others." *Id.* (quoting *Gordon v. Terry*, 684 F.2d 736, 741 (11th Cir. 1982)). The greater the control plaintiffs had over their investment, "the weaker the justification to characterize their investments as investment contracts" subject to the protections of the Securities Exchange Act. *Id.* To determine the degree of investor control, courts apply an objective analysis, focusing on the level of control investors could exercise, not the control they chose to exercise in fact. *Id.* at 884. Courts consider investors' "contribution of time and effort to the success of the enterprise, their contractual powers, their access to information, the adequacy of financing, the level of speculation, and the nature of the business risks.["] *Id.*

In *Schaden*, the Tenth Circuit found that owners of an LLC sufficiently controlled the profitability of their investment that they did not constitute investment contracts under the Securities Exchange Act. Specifically, the Tenth Circuit noted that

- although the LLC was manager-managed, the daily operations were controlled by the officers rather than the members, and the members expected the board and officers to operate

> the investment company, the investors retained control because they collectively owned 80 percent of the LLC;
>
> - could freely amend the LLC agreement;
> - could choose eight of nine managers and remove them without cause;
> - could receive audited and unaudited financial statements, and inspect, examine, and copy the investment company's books;
> - designate non-voting members to attend board meetings;
> - and the investors were sophisticated, informed, and capable of making informed decisions.

Id. at 882–85. The Tenth Circuit found that the interests involved in *Schaden* could only be considered investment contracts if the investment company's "managers and officers were irreplaceable or otherwise insulated from [the investors'] ultimate control." *Id.* at 884.

In *Howey*, the United States Supreme Court found that the investments at issue were "investment contracts" as defined by the Securities Exchange Act. Investors were offered

> an opportunity to contribute money and to share in the profits of a large citrus fruit enterprise managed and partly owned by respondents. [Investors resided] in distant localities and [lacked] the equipment and

> experience requisite to the cultivation, harvesting and marketing of the citrus products. Such persons have no desire to occupy the land or to develop it themselves; they are attracted solely by the prospects of a return on their investment. Indeed, individual development of the plots of land that [were] offered and sold would seldom be economically feasible due to their small size. Such tracts gain utility as citrus groves only when cultivated and developed as component parts of a larger area. A common enterprise managed by respondents or third parties with adequate personnel and equipment is therefore essential if the investors are to achieve their paramount aim of a return on their investments. Their respective shares in this enterprise [were] evidenced by land sales contracts and warranty deeds, which serve[d] as a convenient method of determining the investors' allocable shares of the profits.

328 U.S. at 299–300.

3. Plaintiffs' Investments Were Not "Investment Contracts"

The only issue that was briefed and before the court on this motion is whether plaintiffs' investments constituted investment contracts. The investments plaintiffs made in FVA were made between investors in a common scheme for which they expected to receive a financial benefit from profits generated by FVA. The issue then, is whether, according to the *Howey* case and

its progeny, profits were to be derived solely from the efforts of others. The court finds that they were not. Plaintiffs were not mostly passive investors, especially considering that investor control is determined objectively, meaning plaintiffs are considered to have the level of control they could exercise—not necessarily what they in fact chose to exercise.

Plaintiffs collectively owned 75 percent of FVA. Plaintiffs argue that this was in fact, only a 50 percent interest owned by BFREF, because the Pres interest was entirely controlled by defendant RDC and therefore, defendant Robben. RDC did manage Pres at the time FVA was formed and therefore controlled, according to plaintiffs, 100 percent of Pres's interest in FVA. The court is not persuaded by this argument. Both Robben and Straub signed the operating agreement, they contributed equal capital to the venture, and although Straub allowed RDC to manage Pres at the time, there is nothing in the record that suggests that Straub could not have changed management if he so desired or that he relinquished his right to equal representation in the FVA venture by using RDC as a manager. The court finds that despite Straub's decision to put RDC in the role of manager at Pres, plaintiffs collectively had a majority interest in FVA, enough to control all majority in interest and supermajority decisions—nearly all decisions the operating agreement contemplated. They exercised their power by removing Robben from his board roles at FVA.

The members had the ability to elect officers with their simple majority. Nothing in the operating

agreement suggests that the parties intended defendant Robben to manage FVA to the exclusion of plaintiffs taking an active role. The agreement continually suggests that plaintiffs were member-managers, whether they chose to exercise that authority or not. Plaintiffs had the right to appoint two members each to attend meetings. Plaintiffs were business-savvy investors, experienced in real-estate ventures. They engaged in business dealings with defendants on prior occasions and had active roles in the management of those investments. All parties knew the risks inherent to real-estate development and management, even discussing other investments at their depositions. (Docs. 184-10; 184-11.) Nothing in the FVA agreement suggests that such involvement was not contemplated or at the very least objectively allowed under the operating agreement. As noted in the operating agreement, each member was expected to "devote so much of its time and attention as is reasonably necessary and advisable to manage the affairs of the Company to the best advantage of the Company." (Doc. 198-3, at 17.) Although plaintiff Bartlett apparently made significantly more financial contributions to FVA, all members contributed capital contributions.

Plaintiffs had the right to inspect any FVA financial documents at any time and complete access to FVA's information. Plaintiffs argue that they needed access to the initial Foxfield Associates, LLC documents. Plaintiffs were not investors in the Foxfield Associates, LLC venture, but they suggest that banking entities and/or defendants defrauded them by failing

to disclose information relevant to their purchase of the 9.16-acre tract of land. But as noted above, the Securities Exchange Act was not intended to provide a broad federal remedy for all fraud. If plaintiffs cannot show that their investments in FVA are securities as defined by the law for purposes of the Security Exchange Act, federal court is not the proper venue for addressing these claims. Plaintiffs provide no legal authority for their position. The court therefore limits its examination to the FVA agreement, and plaintiffs had complete access to FVA's documents. Plaintiffs complain that defendant Robben and bank executives misrepresented the financial prosperity of Foxfield Associates, LLC. But plaintiffs do not suggest that they did not know there was an initial Foxfield Associates, LLC enterprise. Knowing that an initial enterprise existed, it seems reasonable to the court that they might have demanded to see its financial records before buying in. But such issues are not before the court.

If plaintiffs' investments in FVA had constituted securities under the Act, information about Foxfield Associates, LLC, defendant Robben and the lending institution's alleged actions in attempting to lure plaintiffs into making an investment in FVA and essentially assuming defendant Robben's debts, might have been relevant to the court's analysis of plaintiff's claims. But because the court determines that the investments were not securities, the court does not reach the substance of any claim that defendants violated the Act.

4. Plaintiffs' Investments Were Not Securities for Any Other Reason

Plaintiffs argue that their investments in FVA constitute securities for four additional reasons: because (1) the parties opted-in to the Uniform Commercial Code ("UCC")'s standards on securities transfers in the FVA operating agreement. (Doc. 198-3, at 1); (2) plaintiffs' interests have the same characteristics as stocks and should therefore be considered securities; (3) the interests "can be reflected in certificates showing rights in a profit-sharing agreement" and are therefore securities (Doc. 198, at 29); and (4) plaintiff Bartlett's $400,000 note is presumed a security unless defendants can show that it bears a resemblance to a judicially-enumerated exception. Plaintiffs suggest that defendants' failure to argue that plaintiffs' FVA investments are not "securities" for these four additional reasons should foreclose the possibility of the court granting summary judgment in defendants' favor. The court disagrees.

The court views this as a more fundamental problem—plaintiffs' failure to adequately plead Count 9 in the pretrial order, and likely in previous pleadings. Plaintiffs include no factual allegations supporting their argument that defendants violated the Securities Exchange Act. The statement that defendant Robben violated sections 10(b) and 10(b)5 of the Securities Exchange Act of 1934, does not put defendant Robben on notice of the claims against him. Defendant was unable to know based on this statement whether plaintiff was alleging that plaintiff Bartlett's loan to FVA was a

"note" or that the LLC interests were "investment contracts." An argument could be made that plaintiffs waived their right to recovery on Count 9 for failure to state a claim in the pretrial order.

Regardless, plaintiffs' arguments are unsupported by law or argument (in this set of briefing) and simply listing them as alternate theories (for the first time) is insufficient. Defendants direct the court, should the court consider these arguments on the merits, to the briefing on plaintiffs' motion for summary judgment on the issue of whether BFREF and Pres's interests were securities—a separate set of briefs on a separate motion for summary judgment. (Doc. 185.) The court declines to do so and will decide these issues based on the briefing provided. The parties collectively decided to file six separate motions for summary judgment in this case, dividing the issues. Whether that was a strategy to sidestep the court's page-limits on motions, or some other litigation strategy—because six separate motions were filed, the court has the discretion to address them in the order that promotes judicial efficiency.

Even if the court decided plaintiffs' four additional arguments on the merits, the arguments would fail.

a. Plaintiffs' Interests Are Not "Any Interest or Instrument Commonly Known as a 'Security'" Under the Securities Act

The Securities Act definition of "security" includes "any interest or instrument commonly known as a

'security.'" 15 U.S.C. § 77b(a)(1). Plaintiffs argue that their investments in FVA are "commonly known" to be securities because the UCC section titled "Rules for Determining Whether Certain Obligations and Interests Are Securities or Financial Assets." This section states "An interest in a . . . limited liability company is not a security unless it is dealt in or traded on securities exchanges or in securities markets, its terms expressly provide that it is a security governed by this Article, or it is an investment company security." UCC § 8-103.

Plaintiffs' investments do not fall under the definition of "security" under the Securities Exchange Act. This does not allow them to try again with a new definition from a completely different statute. Plaintiffs cite no authority suggesting that the UCC's definition of "security" may be substituted for the Security Exchange Act's definition, or even suggesting that any investment falling under the UCC's definition would constitute an instrument "commonly known" to be a security. To the contrary, the plain language of the UCC's definition suggests that LLC interests typically are not securities, enumerating a few exceptions to that general rule.

Even if the court accepted plaintiff's argument that the UCC definition could establish instruments commonly understood to be securities, it is not clear that the FVA operating agreement would fall under the UCC definition. It was not dealt or traded on a securities exchange or in a securities market. It is not an investment company security. But plaintiffs argue that

the operating agreement, by its terms, expressly provides that it is governed by the UCC.

First, plaintiffs argue that the language of the operating agreement shows that its members intended it to be governed by the Securities Exchange Act. The agreement says

> THE INTERESTS IN THIS COMPANY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR UNDER THE SECURITIES LAWS OF ANY STATE AND MAY NOT BE SOLD, TRANSFERRED OR OTHERWISE DISPOSED OF UNLESS REGISTERED UNDER THAT ACT AND THE APPLICABLE STATE SECURITIES LAWS, OR THE COMPANY SHALL HAVE RECEIVED AN OPINION OF COUNSEL (WHICH COUNSEL AND OPINION SHALL BE SATISFACTORY TO THE COMPANY'S COUNSEL) THAT REGISTRATION OF SUCH SECURITIES UNDER THAT ACT AND UNDER THE PROVISIONS OF APPLICABLE STATE SECURITIES LAWS IS NOT REQUIRED.

(Doc. 186-7, at 1.) This at best, shows that if a member decided to transfer their interest, they should seek legal advice about which securities laws applied to the interest in order to comply with the law. This statement does not expressly provide that the interests in FVA are securities for the purposes of the UCC or Securities Exchange Act. If the parties intended the agreement to be covered by the Securities Exchange Act they could have stated it, and they did not.

Second, plaintiffs suggest that the definition of "interest" in the operating agreement expressly provides that the FVA interests are governed by the UCC. It states that "For purposes of the Uniform Transfer on Death Security Registration Act or any similar applicable legislation, an Interest in the Company shall be and is a "security" as defined in and governed by Article 8 of the Uniform Commercial Code." (*Id.* at 4.) Again, the court disagrees with plaintiffs' characterization of this language. If anything, it limits the definition of the FVA Interests as "securities" to the Uniform Transfer on Death Security Registration Act. It does not expressly say that the FVA interests should be governed by the UCC generally and it does not even mention the Securities Exchange Act. The drafters could have expressly stated that the FVA interests should be considered securities for purposes of federal securities law. They did not.

b. Plaintiffs' Interests Are Not "Stocks" Under the Act

Next, plaintiffs argue that their interests in FVA have similar characteristics as "stocks" and should therefore be considered "securities" under the Act. The United States Supreme Court's decision in *Landreth Timber Co. v. Landreth*, explained when "stock" is covered by the Securities Exchange Act. 471 U.S. 681 (1985). The Supreme Court explained that investment bearing the name "stock" is covered by the Securities Act if it also has the characteristics usually associated with common stock: "(i) the right to receive dividends

contingent upon an apportionment of profits; (ii) negotiability; (iii); the ability to be pledged or hypothecated; (iv) the conferring of voting rights in proportion to the number of shares owned; and (v) the capacity to appreciate in value." *Id.* at 686. The Supreme Court noted that the definition of "securities" "includes both instruments whose names alone carry well-settled meaning [such as stocks], as well as instruments of more variable character [that] were necessarily designated by more descriptive terms such as investment contract." *Id.* 471 U.S. at 686. The Court explained that if the Securities Act is to apply to unusual categories of investments, they must fall "within the usual concept of a security."

Here, plaintiffs ask the court to find that their investments are "like stock" in that they have the five characteristics of stock outlined in *Landreth Timber Co.* But plaintiffs are misapplying the *Landreth* decision. The Supreme Court noted that it was not enough for an investment to bear the name "stock." It must *also* have the characteristics. Here, plaintiffs' investments were not called stock. They do not even meet the threshold requirement of bearing the label stock, so the court need not determine that they also have the characteristics of stock to qualify them as securities.

c. Plaintiffs' Investments Are Not Certificates of Interest or Participation in a Profit-sharing Agreement

Third, plaintiffs argue that the [sic] they could issue themselves "certificates of LLC interest" and that these papers should be considered "certificate[s] of interest or participation in any profit-sharing agreement" as listed in the definition of "securities" in the Act, relying primarily on the United States Supreme Court's decision in *Tcherepnin v. Knight*, 389 U.S. 332 (1967). The court disagrees.

In determining that the withdrawable capital shares at issue in *Tcherepnin* were covered by the Act, the Supreme Court applied the test for whether an investment contract is a security. The Court specifically relied on the fact that the plaintiffs in that case were dependent on the skill and efforts of others for the success of their investment. This court already determined that under the investment contract analysis, the investments in this case were not securities because plaintiffs retained, at least objectively, the ability to control their investments. Plaintiffs' argument that they could hypothetically issue themselves "certificates of limited liability company interest" because nothing in the FVA operating agreement prohibits such action, does not convince the court that plaintiffs' interests were the types of investments Congress contemplated to be "securities" under the Act.

Likewise, the court is not persuaded by plaintiffs' argument that their investments could constitute securities because the investments could "answer to the name or description" of many of the items in the Act's definition of "security." Plaintiffs' interests in FVA are not the type of interests that on their face seem to represent the very paradigm of a security—such as bonds or shares of stock. Even if they were, the Supreme Court has repeatedly shown that "bearing the label stock is not of itself sufficient to invoke the coverage of the Acts." *Landreth Timber Co.*, 471 U.S. at 686. Courts must view the nature of the investment at issue and determine whether it is the type of investment Congress intended to cover. This "catch-all" argument, without more, is insufficient to survive summary judgment. Such an interpretation of the Act would run directly contrary to the Supreme Court's directive that, when "searching for the meaning and scope of the word 'security' in the Act, form should be disregarded for substance and the emphasis should be on the economic reality." *Tcherepnin.* 389 U.S. at 336.

d. Plaintiff Bartlett's $400,000 Note is Not a Security Under the Act

Finally, plaintiff Bartlett argues that his uncollateralized, unsecured $400,000 loan to FVA, half of which was not repaid, constitutes a note and should be considered a security under the Securities Exchange Act. "[T]he phrase 'any note' [as it appears in the Securities Acts] should not be interpreted to mean literally 'any note,' but must be understood against the

backdrop of what Congress was attempting to accomplish in enacting the Securities Acts." *Reves*, 494 U.S. at 63. A note is presumed to be a security. *Id.* at 67. This presumption may be rebutted by the "family resemblance" test set out in *Reves*. *Id.* at 63–65. Several categories of instruments that are generally considered "notes" but are not "securities" include:

> the note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a 'character' loan to a bank customer, short-term notes secured by an assignment of accounts receivable, or a note which simply formalizes an open-account debt incurred in the ordinary course of business (particularly if, as in the case of the customer of a broker, it is collateralized).

Id. (quoting *Exch. Nat'l Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126, 1138 (2d Cir. 1976)). It may also be rebutted by arguing that another category of instruments should be added to the list by examining:

> the motivations that would prompt a reasonable seller and buyer to enter into [the transaction]; (2) the plan of distribution of the instrument, with an eye on whether it is an instrument in which there is common trading for speculation or investment; (3) the reasonable expectations of the investing public; and (4) whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby

> rendering application of the Securities Acts unnecessary.

S.E.C. v. Thompson, 732 F.3d 1151, 1160 (10th Cir. 2013) (quoting *Reves*, 494 U.S. at 66).

First, regarding Bartlett's motivations for making the loan, the Supreme Court in *Reves* noted that

> [i]f the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a "security." If the note is exchanged to facilitate the purchase and sale of a minor asset or consumer good, to correct for the seller's cash-flow difficulties, or to advance some other commercial or consumer purpose, on the other hand, the note is less sensibly described as a "security."

494 U.S. at 66. Although standing alone, receiving an 8 percent return represents a good investment for Bartlett, and might indicate that the note was a security, the uncontested facts show that Bartlett's loan was intended to finance FVA's short-term cash-flow issues until the company could start selling lots. The loan was intended to be repaid within a short timeframe. And Bartlett's *primary* interest was in his new venture succeeding. If the loan were made by an outside investor, the court would more likely find the outside investor's motivation to be profit on the loan, rather than addressing cash-flow issues. The court

finds that this factor weighs in favor of the loan not resembling a note for purposes of the Securities Act.

Second, plaintiffs make no argument that the loan was a commonly traded instrument. There is no evidence that a request for a loan was made to anyone but Bartlett. Loans were not solicited from the public or even from anyone outside the FVA membership. This factor weighs in favor of the loan not being considered a note.

Third, the court considers whether the loan would be viewed by objective purchasers as an investment. As noted above, if an outside investor had offered to make FVA a loan, the court would likely consider the reasonable expectation of that investor to be profits. But Bartlett was not an outside investor. This factor weighs in favor of finding the loan a note under the Act.

Defendants concede the fourth element. There was no other known regulatory scheme that would reduce the risk of plaintiff Bartlett's loan, rendering the protections of the Securities Act unnecessary. Although this factor weighs in favor of the note being considered a security for purposes of the act, the elements as a whole suggest that it was not a note.

In sum, the court finds that on the very specific facts of this case, that plaintiffs' interests in FVA and the loan plaintiff Bartlett made to FVA are not "securities" as defined by the Securities Exchange Act. The interests were not marketed beyond a very limited number of individuals; ultimately only BFREF and Pres split 50 percent interests. Plaintiffs are not the

type of inexperienced, uninformed investors the federal securities laws were enacted to protect. They both had experience in real estate investments and had previously worked with defendants on other real estate ventures. They were member investors who objectively granted themselves significant control over FVA through the operating agreement they signed. Whether they subjectively intended, or did exercise that control is of limited interest or import to the court's decision. Plaintiffs chose defendant Robben to be FVA's president, thereby granting him the ability to run the day-to-day operations of the enterprise. But the record does not indicate that he was so uniquely entrepreneurial that he could not have been replaced for the enterprise to continue. Plaintiffs were not inexperienced, small investors completely relying on defendant Robben's management because of their own "lack of business knowledge, finances, or control over the operation." *Fargo Partners v. Dain Corp.*, 540 F.2d 912, 915 (8th Cir. 1976).

For all these reasons, the court finds that the investments plaintiffs made in FVA were not securities for purposes of the Securities Exchange Act. Defendants are therefore entitled to summary judgment on plaintiffs' sole federal claim as a matter of law.

B. The Court Declines to Exercise Supplemental Jurisdiction Over Plaintiffs' Remaining 24 Counts

The sole issue remaining before the court is to decide whether this case should remain in federal court in the absence of federal claims. The parties agree that there is no diversity jurisdiction because the parties are all citizens of Kansas. (Doc. 198, at 5 n.1.) If the court dismisses all claims over which it had original jurisdiction, 28 U.S.C. § 1367(c) provides that the court may decline to exercise supplemental jurisdiction over remaining state law claims. Whether to try state claims in the absence of triable federal claim is discretionary, but the court should consider "the nature and extent of pretrial proceedings, judicial economy, convenience, and fairness" when deciding whether to retain jurisdiction. *Anglemyer v. Hamilton Cnty. Hosp.*, 58 F.3d 533, 541 (10th Cir. 1995).

The pretrial proceedings in this case have taken some time due to lengthy stays pending the resolution of related state court actions. Defendant Robben's bankruptcy case was also pending during discovery in this case, requiring further extensions. These delays do not necessarily show that the nature or extent of pretrial proceedings warrants retaining the case in federal court when no federal claims remain. To the contrary, because there was a state court case in Johnson County with similar factual issues and claims, retaining the state claims might result in inconsistent findings of fact or law.

The current governing pleading is the pretrial order. It contains 24 of the original 32 Counts, only one of which was a federal claim. The clear majority of issues in this case were always state law claims and should properly be decided by a state court, especially now that the single federal claim is dismissed. The court finds that the balance of factors favors dismissal. The court declines to retain jurisdiction over the remaining claims. This case is dismissed.

IT IS THEREFORE ORDERED that defendants' Motion for Summary Judgment on Plaintiff's Sole Federal Claim and Motion to Dismiss for Lack of Subject Matter Jurisdiction (Doc. 183) is granted.

IT IS FURTHER ORDERED that:

- Defendants' Motion Regarding Plaintiffs' Rebuttal Experts (Doc. 157)
- Defendants' Motion for Summary Judgment On Plaintiff's State Law Claims (Doc. 179)
- Defendants' Motion for Summary Judgment On Defendants' Affirmative Defenses (Doc 181)
- Plaintiffs Bartlett Family Real Estate Fund, LLC, Richard A. Bartlett, Foxfield Villa Associates, LLC, Pres, LLC, and Ernest J. Straub, III's Motion for Summary Judgment on Question of Whether PRES, LLC and Bartlett Family Real Estate Fund, LLC FVA Interests, and Bartlett's FVA Note are Securities (Doc. 185)

- Plaintiffs' Motion for Summary Judgment on Defendants' Mitigation of Damages and Statute of Limitations Affirmative Defenses (Doc. 187)
- Plaintiffs' Motion for Summary Judgment on Plaintiffs' Affirmative Claims (Doc. 189)
- Plaintiffs' Motion to Strike [201] Memorandum in Opposition to Motion, [202] Memorandum in Opposition to Motion, [199] Memorandum in Opposition to Motion, Exhibit A to Doc. 201, Exhibit B to Doc. 202, and Exhibit B to Doc. 199 (Doc. 208)
- Plaintiffs' Motion for Leave to file a Sur-reply in Opposition to Defendants' Motion for Summary Judgment on Plaintiffs' State Law Claims and Suggestions in Support (Doc. 215)
- Plaintiffs' Motion to Exclude and/or Strike Expert Evidence from Shawn D. Fox (Doc. 221) and
- Defendants' Motion to Exclude, Strike and/or Limit Testimony of Plaintiffs' Damages Expert (Doc. 223).

are denied as moot.

Dated February 26, 2018, at Kansas City, Kansas.

s/ Carlos Murguia
CARLOS MURGUIA
United States District Judge

15 U.S.C. § 78c. Definitions and application

(a)Definitions

When used in this chapter, unless the context otherwise requires –

* * *

(10) The term "security" means any note, stock, treasury stock, security future, security-based swap, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

15 U.S.C. § 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –

(a)(1) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security other than a government security, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(2) Paragraph (1) of this subsection shall not apply to security futures products.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement[1] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(c)(1) To effect, accept, or facilitate a transaction involving the loan or borrowing of securities in contravention of such rules and regulations as the Commission may prescribe as necessary or

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[1] So in original. Probably should be followed by a comma.

appropriate in the public interest or for the protection of investors.

(2) Nothing in paragraph (1) may be construed to limit the authority of the appropriate Federal banking agency (as defined in section 1813(q) of Title 12), the National Credit Union Administration, or any other Federal department or agency having a responsibility under Federal law to prescribe rules or regulations restricting transactions involving the loan or borrowing of securities in order to protect the safety and soundness of a financial institution or to protect the financial system from systemic risk.

Rules promulgated under subsection (b) that prohibit fraud, manipulation, or insider trading (but not rules imposing or specifying reporting or recordkeeping requirements, procedures, or standards as prophylactic measures against fraud, manipulation, or insider trading), and judicial precedents decided under subsection (b) and rules promulgated thereunder that prohibit fraud, manipulation, or insider trading, shall apply to security-based swap agreements to the same extent as they apply to securities. Judicial precedents decided under section 77q(a) of this title and sections 78i, 78o, 78p, 78t, and 78u-1 of this title, and judicial precedents decided under applicable rules promulgated under such sections, shall apply to security-based swap agreements to the same extent as they apply to securities.

17 C.F.R. § 240.10b–5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

(Authority: Sec. 10; 48 Stat. 891; 15 U.S.C. 78j)