No. 11-55479

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

TAMER SALAMEH, et al.,
on Behalf of Themselves and All Others Similarly Situated
Plaintiffs-Appellants

v.

TARSADIA HOTEL, a California Corporation, et al.,
Defendants-Appellees

v.

SPYGLASS PARTNERS, INC.,
Third-party-Plaintiff-Appellee.

On Appeal From the United States District Court
For the Southern District of California

No. 3:09-cv-02739-DMS-CAB
The Honorable Dana M. Sabraw, Judge

APPELLANTS' OPENING BRIEF

Michael J. Aguirre, Esq., CSB 060402
Christopher S. Morris, Esq., CSB 163188
Maria C. Severson, Esq., CSB 173967
AGUIRRE, MORRIS & SEVERSON LLP
444 West C Street, Suite 210
San Diego, CA 92101
Telephone: (619) 876-5364
Facsimile: (619) 876-5368
Attorneys for Plaintiffs/Appellant

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, there are no nongovernmental corporation party appellants in this matter.

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STATEMENT OF JURISDICTION

The district court had jurisdiction pursuant to 12 U.S.C. § 1819(b)(2)(B) and 28 U.S.C. § 1331. Final judgment was entered for the defendants on 22 March 2011 and the appellants filed their notice of appeal on 23 March 2011 within the time provided by 28 U.S.C. § 2107(a). This Court has jurisdiction pursuant to 28 U.S.C. § 1291.

STATEMENT OF THE ISSUES PRESENTED

This is an appeal by investor appellants from a final judgment in a civil enforcement action alleging violations of the anti-fraud provisions of the 1933 Securities Act, the 1934 Securities & Exchange Act, the California Corporations Code and the California Civil Code. ER3-4 (judgment), ER1-2 (notice of appeal), ER5-23 (order granting motions to dismiss). The promoter and its affiliates sold and appellants purchased investment contracts consisting of rooms and suites in the Hard Rock Hotel San Diego together with rental management agreements. ER28, ER34, ER39-40, ER41, ER43, ER51, ER56. Despite being marketed a Hard Rock Hotel condo, the investors learned that unless they relinquished their room rental rights to the hotel operator and affiliates, they could not use their rooms as "Hard Rock" property without first contracting to give approximately 57% of their room revenue to the Hotel operator. ER45-46 ¶¶ 100-105; ER463.

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The district court did not follow Ninth Circuit controlling authority *Hocking v. Dubois*, 885 F.2d 1449 (9th Cir. 1989) when it found the sale of units with rental management agreements in the San Diego Hard Rock Hotel by the hotel's owner and operator were not securities. ER15-16.

The district court's error in granting Motions to Dismiss filed by Tarsadia Hotel (Tarsadia), Gaslamp Holdings, LLC (Gaslamp), Tushar Patel and B.U. Patel (collectively "Patels"), Gregory Casserly, 5th Rock LLC (5th Rock), MKP One, LLC (MKP One)[1], Playground Destination Properties, Inc. (Playground) and Erskine Corp. (Erskine) present the following issues:

1. Whether the sale of hotel rooms and suites in the San Diego Hard Rock Hotel with rental management agreements was a security when the unit seller and hotel operator are commonly owned by affiliated companies and persons.

2. Whether the statute of limitations precludes all claims in the operative complaint when the action was brought within the time permitted, especially when appellants were represented by a fiduciary in the underlying transaction.

3. Whether the operative complaint's allegations regarding the fraud are pled with sufficient specificity.

4. Whether the operative complaint alleges justifiable reliance on the seller and rental management operator's misrepresentations and omission of facts

[1] MKP One, LLC was erroneously named in the suit as MPK One, LLC. ER698:12-13 (MKP One, LLC's answer.)

needed to make those stated not misleading.

5. Whether leave to amend should be denied where it is not clear the complaint could not be saved by amendment, especially when no prejudice to appellees was found.

STATEMENT OF THE CASE

I. NATURE OF THE CASE

This is an appeal from a final judgment in a civil enforcement action of federal and state investor protection and fraud laws brought by purchasers of investment contracts issued by the owners and affiliate operators of the Hard Rock Hotel in San Diego, California. The appellants' second amended complaint alleged the Patels, Gregory Casserly and the entities they owned and controlled -- 5th Rock, Tarsadia, Gaslamp and MKP One -- engaged in a fraudulent scheme to sell to appellants investment contracts in the Hard Rock Hotel San Diego that were unregistered with the Securities & Exchange Commission (SEC) and unqualified by the California Department of Corporations (DOC).

This is also an appeal from a final judgment in this action brought by purchasers of the Hard Rock Hotel investment contracts sold by California real estate broker Playground. The operative complaint alleged Playground – unlicensed to sell securities -- also engaged in the fraudulent scheme to sell to appellants investment contracts in Hard Rock Hotel San Diego that were

unregistered with the SEC and unqualified by the California DOC.

The operative complaint alleged that the Patels, Casserly and their owned and controlled affiliates 5th Rock, MKP One, Tarsadia, and Gaslamp made material misrepresentations or omitted to state facts needed to make those stated not misleading in connection with the sale of the hotel investment contract securities in violation of section 12(a)(2) of the 1933 Securities Act, Section 10 and Rule 10(b)(5) of the Securities Exchange Act, sections 25401, 25501 and 25504 of the California Corporations Code, and sections 1572, 1709 and 1710 of the California Civil Code.

The operative complaint alleged when 5th Rock, MKP One, Tarsadia and Gaslamp engaged in the violations of state and federal securities and fraud law, they were under the control of the Patels and Casserly. Further, the complaint alleged that Playground violated section 25501.5 of the California Corporations Code which prohibits unlicensed broker dealers from selling securities, and that Erskine through the Erskine Group and its principals assisted the promoters in violations of securities and fraud laws.

The district court granted defendants' motions to dismiss the operative complaint without leave to amend under Federal Rules of Civil Procedure 12(b)(6).

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II. STATEMENT OF FACTS

A. The Scheme Crafted by Patels and Their Affiliates

In June 2004, developer 5th Rock was building a 388-room Hard Rock Hotel in downtown San Diego. ER46 ¶ 106. As of July 2005, 5th Rock promoters changed their business model after determining the risks of developing the hotel were too great and could instead be shifted to investors by selling them investment contract interests in the hotel. ER48:26-49:3, 23-28; ER40 ¶ 90.

The Patels, as owners of 5th Rock, Gaslamp, MKP One and Tarsadia (referred to at times collectively as 5th Rock promoters) were the ultimate decision makers in carrying out the fraudulent scheme, while Gregory Casserly controlled Tarsadia as its President. ER56 ¶ 138.

5th Rock promoters changed their hotel project to a commercial non-residential condominium project and increased the number of rooms from 388 to 420. ER40 ¶90, ER46 ¶ 106; ER47 ¶¶ 109-110. 5th Rock promoters then sold appellants investment contracts in the Hard Rock Hotel consisting of 420 room units divided into one parcel of 257 rooms, and another parcel of 163 rooms (ER39:4-5) coupled with uniform Rental Management Agreements (RMA). ER40:25; ER43 ¶¶ 95-96; ER45:5-11, ER45 ¶¶ 102-104; ER51 ¶ 119; ER454.

While appellants' hotel rooms were required to be managed as commercial units as part of the Hard Rock brand hotel in conformity with project standards in a

license agreement with Lifestar Hotels, LLC, the unit purchase agreement and the unit maintenance agreement prohibited appellant hotel room owners from using the Hard Rock trademarks or logos. ER40:1-2; 41:8-9; ER43:11-12; ER45:4-5; ER46:5-5; ER47:26-28; ER378 ¶ 9; ER438 ¶ 5.1(c).

The unit purchase, the unit maintenance and operation, and the rental management agreements were interdependent and closed, or came into effect, at the same time. The unit purchase agreement closed when the hotel construction was completed. ER 360 ¶J. The unit maintenance and operation agreement came into effect when the owner acquired fee title, which occurred when hotel construction was completed. ER 433 ¶ 1. The 3-year term of the Rental Management Agreement began when the hotel opened, post-construction. ER 468 ¶ 8.1. Thus, the RMA did not become effective until the unit purchase agreement closed *and* the unit maintenance and operation commenced in December 2007, as illustrated by this time line:

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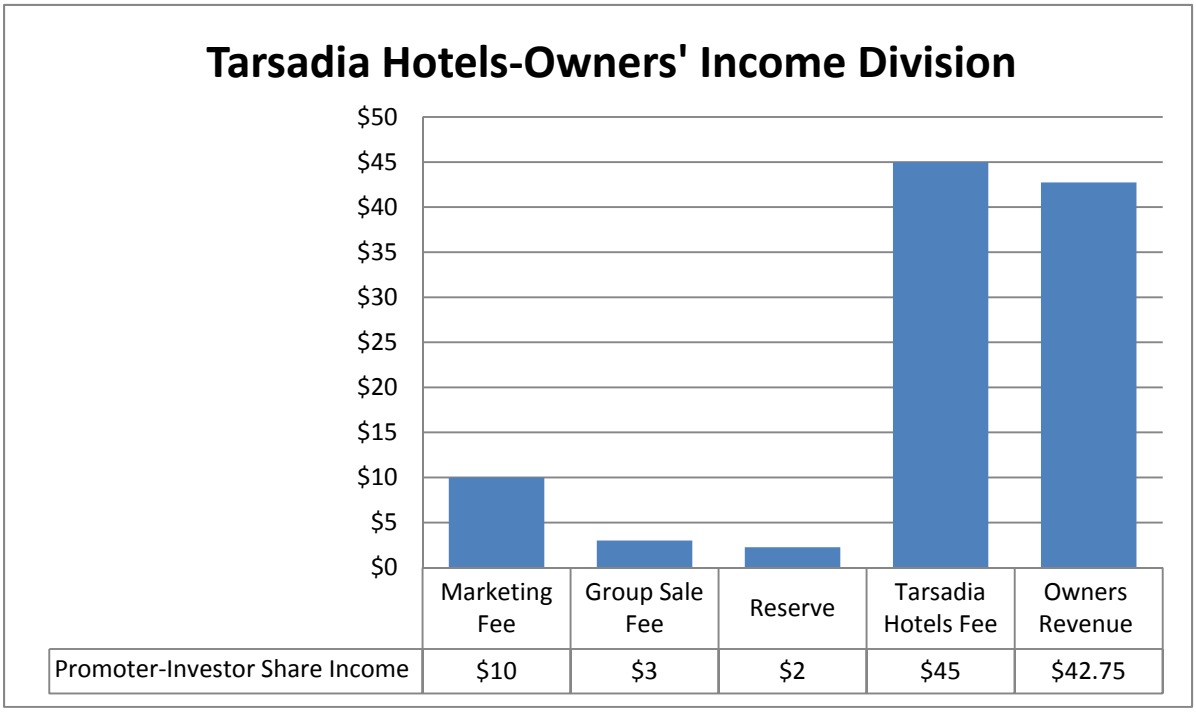
Under the Tarsadia Hotels Rental Management Agreement, the fortunes of investors were linked with those of the 5th Rock promoters, as illustrated in an example of how revenues were to be divided for every $100 of revenue (ER463):



The 5th Rock promoters induced investors to expect their profits from the efforts of 5th Rock's affiliate, Tarsadia. In this regard, the Hard Rock Hotel's "Frequently Asked Questions" (FAQ) distributed to investors stated the hotel's goal was "[T]o maximize revenue by renting the participating suites for the most number of nights at the highest possible rate." In the FAQs, Tarsadia further represented to appellants, "We've got the team. We've got the ideas. We've got the experience. Now we want you." And "[A]gain, please know that the sooner we receive your signed RMA, the sooner we'll be able to get your suite into the rental rotation." ER45-46 ¶¶100-103. Investors were told the Hard Rock Hotel was "one of the most desirable markets in the world." ER49:23-28.

The opportunity to invest was carried out through a public offering advertised on television, in magazines, and in publications in California and other states. ER44 ¶99. The offering was neither registered with the SEC nor qualified by the California DOC. ER28 ¶ 2.

5th Rock promoters did not want federal and state securities regulators to review the Hard Rock Hotel investment contracts. ER28 ¶ 3. 5th Rock promoters knew the SEC Corporate Finance Division would review, from the point of view of investors, the investment features of the project to determine if the materials used to promote the investment contained material misrepresentations or omitted facts needed to make those stated not misleading. ER28 ¶ 3. 5th Rock promoters knew

the California DOC would not issue a permit if the DOC determined the hotel investment contracts were not fair, just and equitable. ER28 ¶ 3. In order to avoid this scrutiny, the promoters elected to disregard their legal duties to submit the investment contracts to the federal and state investment regulators. ER28 ¶ 3.

The promoters failed to provide to investors the requisite details under applicable SEC and DOC regulations such as: (1) business strategy; (2) recent developments; (3) use of proceeds: (4) risk factors; (5) certified financial statement; (6) liquidity and capital resources; (7) qualitative and quantitative disclosures about market risk; (8) detailed statement of the business; (9) market analysis; (10) suitability standards; and (11) conflicts of interests. ER49:1-9.

Instead, the investments were sold to investors based upon misrepresentations and omissions of facts needed to make those stated not misleading contained in the writings that defined the relationship between investors and promoters such as (1) the California Department of Real Estate (DRE) public report issued 4 April 2006 (ER 38-39 ¶¶ 83-87); (2) a Hard Rock Hotel Guide (ER48-50 ¶ 113); and (3) the Rental Management Agreement FAQs (ER45-46 ¶¶ 100-103), and (4) other writings and promotion materials. ER38-39 ¶¶ 83-88; ER48-50 ¶ 113.

5th Rock promoters used the DRE Report, the Hard Rock "Guide," the Rental Management Agreement FAQs and other promotion materials to market

and sell the investments in Hard Rock Hotel to appellants. ER38-39 ¶¶ 83-88; ER45 ¶ 100; ER45-46 ¶ 103; ER48-50 ¶113; ER53:13-15; ER54:10-14. The Guide and other promotional materials were used by Playground real estate agents, Tarsadia and 5th Rock's principals, and Erskine's agents to make sales to appellants. ER48 ¶ 113. The Guide began by reassuring investors that the sales staff was there for investors and that they should trust the staff to help appellants understand the terms of the investment:

> **We will help you through this process** and our goal is equally simple… To ensure you consider every opportunity that'll **exceed your expectations** and desires. So just have fun with this. Circle anything that catches your eye. We're here to make this a fantastic experience. Call us anytime. Rock on, [7 signatures]
> The Hard Rock Condo-Hotel Sales Team ER48:20-25.

The Guide included a false account of how the Hard Rock Hotel came to be over the preceding 3 years:

> **We've been working on this project for three years and at the end of the day we have a fantastic project that works all day long**. When you get a site like this one and the right team with the right ideas, there's nothing holding you back. ER50:1-3.

The statement was false because it failed to state the fact the 5th Rock promoters (the Patels, Casserly and their Tarsadia affilates) had decided to shift the risks of their hotel to investors after discovering that market conditions did not support their original business model. ER50:7-12. The hotel did not "work all day long," and the statement "there's nothing holding you back" was untrue because

the developer, having determined that market conditions were holding the project back, shifted from a hotel project to the commercial condominium project. ER50:1-12. The statement was false because it omitted to state that 5th Rock promoters structured the investment to shift to appellants the substantial risk of the investment in Hard Rock Hotel, while leaving a substantial upside for the 5th Rock and Tarsadia affiliate promoters. ER28:4; ER29:9; ER22:23-28; ER23:4-6; ER49:1-3; ER126:11-13; ER53:18-19.

The Guide went on to misrepresent that it contained all of the details of the transaction, when in fact it omitted the most significant details: the terms of the RMA.

> Enclosed you'll find the Hard Rock Guide and within its pages **all the details** of San Diego's first and most rockin' branded condo-hotel. Everything's here, from the floor plates to the plans to the preferred lenders. (Emphasis added) ER48:17-49:9.

The material details of the terms that permitted the units to rent under the "Hard Rock" brand were not disclosed until the Rental Management Agreement. In the RMA, investors first learned that they had to give the Hotel Operator nearly 57% of their room revenue. ER463.

The Guide contained repeated references to the financial opportunity and chance for financial success because San Diego was California's hottest performing market:

California's Hottest Performing Hotel Market ER49:9-11
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Q. What's the one greatest differentiator of this project?

A. **A project like this is one in a million**. All the stars are aligned: **great location, great brand**, great dining and entertainment, great design and great partners. It has **the hottest location in all of San Diego** and this is one of the most desirable **markets** in the world. That's it-short and sweet. There's nothing more important in real estate than **the location** and this one, no doubt, is the most coveted in San Diego. ER49:23-28

Q. Normally in the world of condo-hotels, you'd sell first, then build. But you're already building and have about $40m in the ground. What's the story there?

A. **We've been working on this project for three years and at the end of the day we have a fantastic project that works all day long**. When you get a site like this one and the right team with the right ideas, there's nothing holding you back. ER50:1-6

Q. You've talked about San Diego as being one of the hottest spots for a condo-hotel. Why do you feel this way?

A. With the millions of people visiting San Diego every year, this is the perfect spot for a condo-hotel. They work really well at **the upper end of the market**-at the 4-Diamond luxury level-and that's exactly what we're delivering. Then there's the idea of a loyal base of Owners that become the hotel's greatest fans and connectors. That priceless for us as the operator for the Owners. ER50:7-12

Another document used to sell the Hard Rock Hotel investment to appellants was the California DRE public report. ER38-39 ¶¶ 83-87. 5th Rock promoters did not file the RMA with the DRE, so the DRE report did not disclose the terms of the RMA. ER86. The Rental Management Agreement was not provided to appellants until eight months after appellants signed the unit purchase agreement. ER13:5-6.

The RMA represented a material change in the terms of the agreement because the Covenants, Conditions, Easements and Restrictions for the 5th & K Master Association (CC&Rs) suggested to the DRE that the appellants could rent their rooms out directly or through an approved Transient Occupancy Agent under a service fee arrangement. ER44¶ 98; Master Association CC&Rs (Exhibit A to Request for Judicial Notice.) All material changes were required to be disclosed to the DRE. *Cal Bus & Prof Code* § 11012; Title 10 *Cal Admin Code §* 2800. However, appellees did not disclose to appellants that they failed to report the material RMA change to the DRE. ER86:15-19.

The DRE report made no mention of the RMA. In fact, after the RMA was brought to the attention of the DRE, the man who approved the transaction stated he never would have approved of it had he known of the actual facts:

> **MR. AGUIRRE**: Yes, your honor, I will. What we have discovered first of all, is as to the relationship with the Department of Real Estate, we have secured all of the DRE filings by Tarsadia. We have reviewed extensively the questionnaire. And we have made extensive interview with the man who approved the transaction. And I will proffer to your honor that he now is of the opinion, as he has expressed to us, that had he known what we have brought to his attention he never would have approve this transaction. ER106:17 - 107:1.

B. Playground's Role in the Investment Scheme

Playground Destination Properties, Inc. is a Washington state corporation doing business in California whose sales brokers sold the Hard Rock Hotel

investment contracts to appellants. ER33:24-26; ER34-35 ¶ 60; ER138. The Playground sales force materially and substantially assisted in the unlawful sale of unregistered and unqualified Hard Rock Hotel investment contracts. ER34-35 ¶ 60; ER67:21. Playground was required to be registered as a broker-dealer and, at the time of the sale, had not applied for and secured from the commissioner a required broker-dealer certificate. ER67:25-26; ER71-72 ¶ 206.

Playground's efforts, led by BJ Turner, Jason Dolker (its Director of Sales) and their fellow Playground agents, participated directly in the sale of Hard Rock Hotel investment contracts. ER54:18-19; ER54 ¶ 130. These Playground agents negotiated the contracts, provided the terms, helped prepare the paper work, coordinated with bank sales representatives, provided comparable sales and rent information, and issued a constant stream of upbeat emails touting the attributes of the Hard Rock condo investment contracts. ER54:19-22.

These Playground representatives knew the Hard Rock Hotel project had been shifted from a hotel project to a commercial non-residential condominium project and that investors were not receiving the information needed about projected performance underlying the investment contracts. ER54:23-26. These Playground agents knew the Hard Rock Hotel investment contracts they sold were required to be registered with the SEC and qualified by the DOC from their training as real estate brokers and agents. ER54:26-28; ER60:26-27. These

Playground agents also knew they were required to be registered as broker dealers before they could lawfully sell the Hard Rock Hotel investment contracts. ER54:28-55:3. These Playground agents were highly compensated and were motivated by the lure of financial gain to violate their legal duties. ER55:2-3. Playground materially aided in the transaction constituting the violations and is also liable, jointly and severally, with and to the same extent as the remaining defendants-appellees. ER71 ¶ 205.

C. Erskine Group Assists with the Scheme

Defendant Erskine Corp. operated under the name Erskine Group (Erskine) and was a part of the promoter group acting on behalf of Professional Mortgage Partners who sold Hard Rock Hotel interests to some appellants. ER36:4-6. Erskine is a California corporation run by two brothers, Joshua Erskine and Shane Erskine. ER36:7-8.

Erskine provided mortgage and financing services and arranged financing with Professional Mortgage Partners, Inc. (PMP) and assisted, participated in, and funded the sale to and purchase by appellants of the Hard Rock Hotel investment contracts. ER33:26-34:1; ER36:7-11. Erskine materially assisted in the unlawful sale of the unregistered and unqualified Hard Rock Hotel investment contracts to appellants. ER36:4-6. PMP provided financing for the sale and purchase of $38,536,730 of Hard Rock Hotel investment contracts. ER36 ¶ 71. PMP

underwriting standards for loans like those made to appellants deteriorated and led to PMP's financial collapse. ER63:22-25.

Erskine personnel knew the Hard Rock Hotel units were commercial non-residential units that could not be sold as second homes, but were in fact investment properties. ER63:27-64:1. Erskine knew the appraisals supporting the loans for the hotel room sales were improper because they were not based on room rental revenue that was to go to the appellants. ER64:1-4. Erskine knew the sales appraisals for the Hard Rock Hotel investment contracts sold to appellants exceeded what actual rent-based appraisals would support. ER64:4-6.

Erskine knew the Hard Rock Hotel investment contracts were required to be but were not registered with the SEC and qualified by the DOC. ER64:6-7. Erskine's agents possessed this knowledge based on their experience and training in the mortgage banking and real estate brokerage business. They obtained this training and knowledge from their preparation for the licensing exams they were required to successfully complete. ER64:8-10.

Erskine agents knew appellants were not informed of material facts needed to make those stated not misleading. Erskine agents knew that wrong appraisals were being used and that had proper room revenue-based appraisals been used, they would not support the price at Hard Rock Hotel investment contacts were sold to appellants. ER64:11-14.

The Erskine agents acted knowingly and intentionally. It was a business practice of PMP to engage in violations of underwriting standards in connection with the origination of mortgage loans, and PMP's issuance of unlawful loans in connection with HRHSD investment contracts assisted by Erskine was a continuation of those unlawful practices. ER64:16-19.

III. PROCEEDINGS BELOW

A. Security Issue

The district court erred in finding that appellants did not adequately allege the elements of a security. ER9-17. Appellants' investment in the hotel room and rental management agreement was a security because it was (1) an investment of money, (2) in a common enterprise, (3) with an expectation of profits produced by the efforts of others. *Hocking v. Dubois*, 885 F. 2d 1449, 1455 (9th Cir. 1989); *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). The district court found appellants had not adequately alleged the third element. ER14:7-9.

B. Statute of Limitations Issue

The district court did not accept as true the allegations in the operative complaint when reviewing the motions to dismiss under Federal Rule of Civil Procedure 12(b)(6), nor did it determine whether the running of the statute was apparent on the face of the complaint. *Huynh v. Chase Manhattan Bank*, 465 F. 3d 992, 997 (9th Cir. 2006).

Instead, the district court improperly interpreted the various writings, resolved factual questions that were for the trier of fact to decide, and dismissed the complaint without finding it did not appear "beyond doubt that the plaintiff can prove no set of facts that would establish the timeliness of the claim." *Huynh v. Chase Manhattan Bank*, 465 F. 3d 992, 997 (9th Cir. 2006); ER17:5-19:2.

Moreover, the district court did not consider whether the fiduciary relationship between appellants and their real estate agent Playground tolled the statute of limitation under *E-FAB, Inc., v. Accountants Inc., Services* (2007) 153 Cal. App. 4 1308, 1318 (fiduciary relationship tolls statute of limitations).

C. Specificity Issue

The district court erroneously found that appellants did not adequately allege common law fraud, relying on Federal Rule of Civil Procedure 9(b) and *Vess v. Ciba-Geigy Corp. USA*, 317 F.3d 1097 (9th Cir. 2003). ER21:4-22:7.

D. Justifiable Reliance Issue

The district court also committed error finding appellants could not show justifiable reliance on Tarsadia and affiliates' alleged fraudulent statements because plaintiffs were signatories to representations and warranties that contradicted the alleged misstatements. ER22:8-24. As will be shown below, disclaimers in form agreements are not controlling. *Manderville v. PCG & S Group* (2007) 146 Cal. App. 4th 1486, 1500-1501; *Timmreck v. Munn* 433 F. Supp.

396, 401 (N.D. Ill. 1977) *Civ. Code* § 1856(g); see also, Macklin, Alicia W., *The Fraud Exception to the Parol Evidence Rule: Necessary Protection for Fraud Victims or Loophole for Clever Parties*?, 82 S. Cal. L. Rev 809 (2009).

E. Leave to Amend Issue

Finally, the district court erred when it dismissed the operative complaint without leave to amend. ER 22:28-29:2. *Eminence Capital, LLC v. Aspeon, Inc.*, 316 F.3d 1048, 1052 (9th Cir. 2003). The Court rested its decision to deny leave to amend the complaint on the incorrect grounds that "Plaintiffs have had ample opportunity to properly plead a case and have failed to do so," instead of determining whether no amendment would cure. ER23.

SUMMARY OF ARGUMENT

1. The sale of hotel rooms and suites in the San Diego Hard Rock hotel with rental management agreements was a security because the unit seller and hotel operator are commonly owned by affiliated companies and persons, and because the purchasers invested money in a common enterprise with the expectation of profits produced by the efforts of the hotel operator and manager.

The investment contract consisted of one transaction involving several agreements: a unit purchase agreement, a unit maintenance and operation agreement, and a rental management agreement. To camouflage the transaction as something other than a security, the hotel promoters intentionally distributed the

agreements over time. To further masquerade the transaction, promoters unlawfully included disclaimers aimed at waiving compliance with provisions of the Securities Act.

Affirming a finding that no security was sold in this case would only serve as a blueprint "for variable schemes devised by those who seek the use of the money of others on the promise of profits." *Hocking v. Dubois*, 885 F. 2d at 1455, (citing *Howey Co.*, 328 U.S. at 299 (1946)).

2. The legal action was brought within the time permitted by the applicable state and federal statutes of limitations, especially when investors were represented by a fiduciary in the underlying transaction. Because investors were subjected to a barrage of false and misleading statements designed to keep them from discovering facts supporting the need to bring claims, investors did not discover the group effort to shift the investment risks of the Hard Rock Hotel to investors so as to disguise the true nature of the transaction as an unregistered security.

3. The operative complaint's allegations regarding the fraud are pled with sufficient specificity. The Patels, through their owned and controlled entities and persons, misrepresented the nature of the transaction and concealed the fact that (1) investors were purchasing a security that was required to be registered and qualified and (2) that the rental management agreement was mandatory due to their

ownership and control over the units and the agreements.

Playground's representatives knew material information was not being provided to investors and that the investment was required to be but was not registered or qualified with federal and state securities regulators. Investors purchased their investment contracts from Playground who knew it was required to be but was not registered as a broker-dealer.

4. The operative complaint alleges justifiable reliance on the seller and rental management operator's misrepresentations and omission of facts needed to make those stated not misleading. The misrepresentations and omissions made are those that investors would have assumed significant in deciding whether to invest in the hotel. Any disclaimer provisions in the form agreements do not preclude, as a matter of law, buyers' showing of justifiable reliance. Further, weighing facts and interpreting judicially noticed documents are improper at the pleading stage.

5. Leave to amend following the granting of the motions to dismiss should have been granted because it is not clear that the complaint could not be saved by amendment, especially when there is no prejudice to appellees.

STANDARD OF REVIEW

A dismissal pursuant to Federal Rule of Civil Procedure 12(b)(6) is reviewed de novo. *Pareto v. Federal Deposit Insurance Corp*, 139 F.3d 696, 699 (9th Cir. 1998). The Court limits its review to the allegations of material facts set forth in

the complaint, which it reads in the light most favorable to the non-moving party and which, together with all reasonable inferences therefrom, it takes to be true. *Id*.

Dismissal of a complaint without leave to amend is improper unless it is clear, upon de novo review that the complaint could not be saved by any amendment. *Thinket Ink Info. Res., Inc. v. Sun Microsystems, Inc.*, 368 F.3d 1053, 1061 (9th Cir. 2004). The court reviews *de novo* the district court's determination whether a transaction is a security. *Hocking v. Dubois*, 885 F. 2d 1449, 1454 (9th Cir. 1989).

ARGUMENT

I. THE INTERESTS APPELLANTS PURCHASED IN THE HARD ROCK HOTEL WERE SECURITIES

To make a claim under the securities laws, appellants must show that the promoters' alleged misrepresentations were made in connection with the purchase or sale of a security. A security includes an investment contract. 15 U.S.C. § 77b(1); 15 U.S.C. § 78c (a)(10); *Hocking v. Dubois* 885 F. 2d at 1463.

The term "investment contract" has been interpreted to reach "novel, uncommon, or irregular devices, whatever they appear to be . . ." *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943). It embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946).

In *Howey*, the Supreme Court found that the combined sale of land and a land service contract, under which the purchaser relinquished all control over the land for a 10-year period, was an investment contract. The Court there put forward the classic definition of an investment contract:

> An investment contract for purposes of the Securities Act 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.

Howey rejected the suggestion "that an investment contract is necessarily missing . . . where the tangible interest which is sold has intrinsic value independent of the success of the enterprise as a whole." *Id.* at 301. The sale of real estate constitutes the sale of a security when related management services are provided either by the real estate promoter or by an affiliate. *Hocking v. Dubois* 885 F. 2d at 1463.

A. The Patels Devised a Scheme to Sell Investments in a Common Enterprise: The Hard Rock Hotel San Diego

Here, the promoters devised a sophisticated scheme in its search for the use of investors' money based on the promise of Hard Rock Hotel profits. 5th Rock was the developer of the Hard Rock Hotel, seller of the hotel units, and contracted with a separate entity to license for its exclusive use the Hard Rock brand. ER28:21-22; ER359; ER34:4-6; ER378:9; ER438-439 ¶ 5.1(c). Tarsadia was the

operator of the Hard Rock Hotel San Diego (ER34:15-16; ER43:15) and the operator of the rental management and reservation program. ER43:15-16; ER454. Under the Tarsadia Hotels Rental Management Agreement, appellants appointed Tarsadia to be their exclusive rental agent. ER41:20; ER43:16-17; ER454, ER456.

Affiliate Gaslamp owned the land on which the hotel stood (ER47 ¶ 111) and, according to the CC&Rs of the Patel-conceived Master Association, was authorized, along with 5th Rock to operate the unit rental program. ER44¶ 98, RJN Ex. A. MKP One controlled 5th Rock and executed the unit purchase agreements. ER34¶ 55.

Tarsadia, 5th Rock, Gaslamp and MKP One (5th Promoters) were all affiliates and under the common control of the Patels and Casserly. ER51:2-3, 8-10; ER53 ¶ 126. The Patels were the owners of 5th Rock and Tarsadia, while Casserly was Tarsadia's President. ER53 ¶ 126; ER56 ¶ 138.

As in *Hocking*, the close link between the seller of the Hard Rock Hotel real estate (5th Rock) and the manager of the related rental agreement (Tarsadia Hotels) supports the contention a security was sold. *Hocking v. Dubois*, 885 F. 2d at 1464.

B. The Hard Rock Condo Investors Expected Profits Solely From the Efforts of the Promoters

Investors purchased hotel rooms at the Hard Rock, but their right to call their unit a "Hard Rock Hotel" room or rent it as such was dependent upon the relinquishment of their rental rights. ER438; ER456. The developer (5th Rock)

obtained a license to operate the hotel as a Hard Rock Hotel, and investors had to agree to 5th Rock's efforts to operate the hotel in accordance with the Hard Rock Hotel license, Project Standards and the Hotel System. ER438-439 ¶ 5.1(c). Appellants had "no right to use the 'Hard Rock' trademarks or logos." ER377 ¶ 9; ER438-439 ¶ 5.1(c).

Investors relied on the hotel operator's efforts in promoting, pricing, and renting the rooms to make them profits. Investors' rooms had to be managed as part of a hotel. ER39-40 ¶ 89. Investors could not reside in the rooms they purchased, which had no kitchens; they could only stay there 28 days per year as the rooms were commercial units of the hotel. ER45:3-5; ER46 ¶ 104. Investors' rooms could only be rented out under a program operated by the hotel owner (5th Rock or Gaslamp) or a third party approved by the hotel owner. ER44:3-7. Investors were even required to pay the hotel owner a "service fee" at initial rates of $90 to $150 for each day they rented their own rooms. ER44:8-11. Thus, as a practical matter, appellants could not rent out their own room units because under these restrictions, the units had to be operated as part of the management of the hotel. ER45:14-16; ER46 ¶ 104.

The district court also erroneously determined there was a material difference between the rental pooling agreement in *Hocking* and the Rental Management Agreement sold to appellants. ER13:5. Here, the investors and

promoters shared in the Hard Rock Hotel's costs and profits. ER41-42 ¶ 93; ER42 ¶ 94. There was an operation cost pool; the costs of operating the common areas were combined, and the individual owners were charged a ratable share of the costs without regard to whether investors' units were actually rented. ER44:21-27.

The economic reality was that investors gave the use of their money to a common enterprise formed by the Patels and their affiliates. The investors relied on the Patel companies' hotel expertise and know-how to return a profit. The reality was that the promoters did not sell, and the investors did not purchase, a "Hard Rock Condo" because the Hard Rock trademark could only be used if investors designated Tarsadia as the exclusive rental management agent. ER45-46 ¶¶ 100-105. Without a signed RMA that permitted use of the Hard Rock trademark to advertise and price room rentals, investors merely owned downtown generic airspace without a kitchen in which they could not live but could rent nightly.

C. The Promoters Offered the Security as One Transaction

The district court erred in finding the transaction in this case was not a security under the test of *Hocking v. Dubois*, 885 F.2d at 1464. The court further erred when finding that the unit sale and the Rental Management Agreements were two transactions (ER13:5-14:6), even though the seller of the unit and the operator of the management agreement were affiliated and had the same owners (ER51:2-3, 8-10), and the closing date for the unit sales agreement (estimated as 31 August

2007 and no later than 29 December 2007), the effective date of the unit maintenance (when appellants obtained fee title) and the rental agreements (the date the hotel opened) were interdependently linked. ER360 ¶ J; ER 433 ¶ 1; ER468 ¶ 8.1.

The Rental Management Agreements acknowledged investors were buying rooms through the unit purchase agreements. ER465 ¶ VII(a). Title to the units did not pass to investors until *after* the hotel was completed in December 2007. ER87:9-13; ER360 ¶ J. The rooms and suites had to be operated as part of the hotel (ER 40:1) under the Hard Rock Hotel license agreement. ER377 ¶ 9; ER438-439 ¶ 5.1(c).

Investors were told from the beginning they could rent their units under a program operated by the hotel owner. ER44:5-6. Tarsadia represented to appellants that reservations would be allocated by Tarsadia through its "Our Property Management System" known as "OPERA." ER45: 24-25. The fact that 5th Rock Promoters withheld disclosure of the financial terms of the Rental Management Agreement for eight months did not convert that single transaction to two. ER13:5-6.

Moreover, the district court made conflicting findings about the RMA. On the one hand, the court found the RMA was a separate transaction because it occurred eight months after the unit purchase agreement. ER13:5-6. On the other,

the district court found appellants knew the factors that made the RMA mandatory when they signed the unit purchase agreement. ER13:21-14:6. However, all agreements came into effect at the same time and were in effect when the hotel opened. ER254:2-14.

From the Master CC&Rs, appellants learned they could only rent their unit under a program operated or approved by the hotel owner. ER44:1-7; ER46:2-4; Request for Judicial Notice Exhibit A, p. 48(i). The unit purchase agreement included a receipt for the CC&Rs. ER384. The details of the Rental Management Agreement were contained in the rental agreement's Frequently Asked Questions. ER45 ¶ 100; ER45-46 ¶ 103: ER53 ¶126; ER54 ¶ 129. These documents were presented to appellants before they signed the rental management agreement. ER45-46; ER 352; ER 384. However, Tarsadia and 5th Rock's plan was always to operate the hotel as a Hard Rock Hotel, and Tarsadia was always going to manage the room rentals. ER40:1; ER377 ¶ 9. ER44:1-7; ER46:2-4.

The district court cited two No-Action letters issued by the staff of the SEC stating that "the S.E.C. has previously issued a no-action letter stating that zoning requirements will not transform a condominium into a security." ER11:24-28. The SEC issued no such letter. The cited letters expressed the Enforcement Division's position on enforcement action only, and they did not purport to express any legal conclusion on the questions presented. S.E.C. No-Action Letter to Marco Polo

Hotel, Inc., 1987 WL 108553*1 (Sept. 30, 1987); No-Action Letter to Intrawest Corp., 2002 WL * 31626919 (Nov. 8, 2002).

The no-action letters are not precedent or even binding on the parties to the no-action letter. *Amalgamated Clothing & Textile Workers Union v. SEC*, 15 F.3d 254, 257 (2d Cir. 1994); see, Nagy, Donna M., *Judicial Reliance on Regulatory Interpretations in SEC No-Action Letters: Current Problem and a Proposed Framework*, 83 Cornell L. Rev. 921 (1998). Moreover, the fact patterns in both letters were materially different than the ones in this case. In the no-action matters, roomowners could stay in their rooms as long as they wished; room owners were free to use whatever rental management company they desired, and the rental management decision was separate from the unit purchase decision. S.E.C. No-Action Letter to Marco Polo Hotel, Inc., 1987 WL 108553*1 (Sept. 30, 1987); No-Action Letter to Intrawest Corp., 2002 WL 31626919 (Nov. 8, 2002).

Side tracked by the no-action letters, the district court ignored the fact that a security was found in *Hocking*, even though the *Hocking* plaintiff did not buy from the developer, was not required to enter into the rental agreement as part of the purchase, the previous owner of the unit had not entered into an rental pooling agreement, and the rental agreement he entered into was not part of the sale. *Hocking v. Dubois* 885 F. 2d at 1457.

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The district court ignored the economic reality of the transaction [*Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967)] in which investors spent several hundred thousand dollars to purchase airspace in a Hard Rock Hotel they could neither reside nor stay in more than 28 days per year. The only source of income for investors was that generated from rental of their rooms. Tarsadia, as exclusive rental agent, shared with investors a percentage of the income from the rental of the rooms. Investors relied on the efforts of Tarsadia to generate rental income of the rooms. The advertising, room rates, décor, promotions, reservation system, and accounting system were all under Tarsadia's control. ER41-46. The economic reality renders it a security.

1. Investor Protection Laws Prohibit the Hard Rock Hotel Scheme

As a matter of policy, if the court were to affirm the district court's finding of two transactions, it would provide a blueprint "for variable schemes devised by those who seek the use of the money of others on the promise of profits." *Hocking v. Dubois*, 885 F. 2d at 1455, (citing *Howey Co.*, 328 U.S. at 299 (1946)). Those seeking to avoid securities laws could take their single security transaction and merely distribute the transaction documents on two different dates. That is not what the investor protection laws of the 1933 Security Act were designed to permit.

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2. Disclaimer Language by a Promoter of a Security Did Not Change its Economic Reality

Instead of crediting the economic reality of the transaction, the district court focused on boilerplate disclaimer language in the unit purchase contract. ER14:7-15:21. The court concluded that in light of the representations and disclaimers set out in the parties' contracts, it was not persuaded that the appellants had an expectation of profits from the efforts of others when they entered into the purchase contracts. ER15:17-27. However, this finding contradicts the court's earlier finding that investors knew at the time they signed the unit purchase agreements that the rental management agreement was mandatory. ER13:21-24.

The proper focus in determining a security is not on boilerplate disclaimers (ER45 ¶100) but rather on the economic reality of the transaction. *Hocking v. Dubois*, 885 F. 2d 1449 at 1457. In attempting to determine whether a scheme involved a security, the inquiry was not supposed to be limited to the contract or other written instruments. *Id.* Characterization of the inducement cannot be accomplished without a thorough examination of the representations made by the defendants as the basis of the sale. Promotional materials, merchandising approaches, oral assurances and contractual agreements should all be considered in testing the nature of the product in virtually every relevant investment contract case. *Aldrich v. McCulloch Properties, Inc.*, 627 F.2d 1036, 1039-40 (10th Cir. 1980).

The court below also relied on two out-of-circuit cases: *Garcia v. Santa Monica Resorts Inc.*, 528 F. Supp. 1283 (S.D. Fla. 2007) and *Demarco v. La Pay*, 2009 U.S. Dist. LEXIS 107282. Both cases are distinguishable from the facts in this case. In *Garcia v. Santa Monica Resorts Inc.*, there was no written rental management agreement. The *Santa Monica* plaintiffs signed purchase agreements for condominium units they never needed to close because the developer would 'flip' the plaintiffs' contracts for them after all of the units were under contract and construction commenced, thereby making plaintiffs a profit of several hundred thousand dollars. *Garcia v. Santa Monica Resorts Inc.*, 528 F. Supp. 1283 (S.D. Fla. 2007).

The court in *Santa Monica Resorts* analyzed the question of whether a security existed by following a strict contract analysis disavowed in *Hocking v. Dubois*, 885 F. 2d 1449 at 1457.

The facts in *Demarco v. Lapay* are also distinguishable from those here. In *Demarco*, condominiums were available for individual owners to rent out. *Demarco v. La Pay*, 2009 U.S. Dist. LEXIS 10782 *23. The defendant was not a rental agent and there was no collateral rental agreement alleged. *Id.* at 24-25. The *Demarco* court did not employ the security test of *Hocking* because it adopted a strict contract analysis, and its analysis on the disclaimers therein was mere obiter dictum. *Id.* at 26-27. Moreover, provisions in a form agreement are not controlling

in fraud cases. *Manderville v. PCG & S Group* (2007) 146 Cal. App. 4th 1486, 1500-1501; *Timmreck v. Munn*, 433 F. Supp. 396, 401 (N.D. Ill. 1977); Civ. Code § 1856(g); see also, Macklin, Alicia W., *The Fraud Exception to the Parol Evidence Rule: Necessary Protection for Fraud Victims or Loophole for Clever Parties*?, 82 S. Cal. L. Rev 809 (2009).

As a threshold matter, while it may have been appropriate for the court to take judicial notice of the agreements referenced in the complaint, it was not appropriate for the court to weigh a party's assertion of what the contents mean. *Wilshire Westwood Assocs. V. Atlantic Richfield Corp.*, 881 F.2d 801, 803 (9th Cir. 1988).

The district court should not have accepted appellees' interpretation of the contract disclaimers using discredited contract interpretation principles. The complaint alleged the interests appellants purchased were defined by several documents. ER13-14 ¶ 91; ER162:16-163:6. Thus, it is error to adopt appellees' interpretation of the transaction based only on the disclaimer in one of the relevant documents, especially at the motion to dismiss stage. For the purposes of a 12(b)(6) motion - to ensure that they focus only on matters of law - courts must accept as true all reasonable allegations of fact in the complaint. See *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957).

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However, to properly interpret a contract, a party must be able to present evidence in support of their interpretation that the agreements when read together constituted an investment contract. ER162:16-163:6 (R.T. 84:16-85:6); See, *Wolf v. Superior Court* (2004) 114 Cal. App. 4th 1343, 1346, 1350-1351; *Civ. Code §* 1636; see also, Patterson, Edwin W., *The Interpretation and Construction of Contracts,* 64 *Colum L. Rev*. 833, 855-856 (1964).

Moreover, the numerous writings defining the relationship (ER13-14 ¶ 91) should have been read by the court, but were not, so as to fall "within the reasonable expectations of (appellants) the weaker or 'adhering' party." *Fischer v. First Internat. Bank* (2003) 109 Cal.App.4th 1433, 1446; See *Armendariz v. Foundation Health Psychcare Services, Inc*., supra, 24 Cal.4th at p. 113; *Bruni v. Didion* (2008) 160 Cal. App. 4th 1272, 1289-1290. The rule that any ambiguities caused by the draftsman of the contract must be resolved against that party applies with peculiar force in the case of the contract of adhesion. *Neal v. State Farm Insurance Co.* (1961) 188 Cal. App. 2d 690, 695.

Because the contract interpretation urged by appellees is inappropriate at this stage of the proceedings, the Court should look to the controlling law of *Hocking* wherein the majority and dissenters agreed on a fact pattern in which there would be no doubt that a security was sold. The facts in this Hard Rock case fit within the fact pattern for which all Honorable justices agreed would constitute a security:

> There is no doubt that, had Hocking purchased the condominium and the rental pool directly from the developer and an affiliated rental pool operator, and had the rental pool been for a long term without any provision for early termination, Hocking would have purchased a security. If that were the case, we would merely substitute Hocking's Hawaiian condominium for Howey's Floridian citrus grove. *Hocking v. Dubois*, 885 F. 2d at 1456.
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> It is not disputed that a sale of a condominium by a developer who also provides [a Rental Pool Agreement] normally constitutes the sale of a security. *Hocking v. Dubois*, 885 F. 2d at 1456 (dissent).

In applying the *Howey* test to the facts of this case, the Court must determine what exactly was offered to appellants. *Hocking* at 885 F. 2d at 1457. In searching for the meaning and scope of the word 'security', form should be disregarded for substance and the emphasis should be on economic reality. *Tcherepnin v. Knight*, 389 U.S. 332, (1967). In looking at the nature of the inducement used as the basis of the sale, and in considering the promotional materials, merchandising approaches, oral assurances and contractual agreements in testing the nature of the product, the Hard Rock Hotel condo offering must be deemed a security. *Hocking v. Dubois* 885 F. 2d 1449, 1457 (9th Cir. 1989). Any disclaimers attempting to waive compliance with provisions of the Securities Act are void. 15 U.S.C. § 77n; Cal. Corp. Code 25701. ER52:123-54:5.

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There is no doubt that appellants purchased hotel rooms and the rental pool[2] directly from the developer (5th Rock) and an affiliated rental operator (Tarsadia Hotels). ER39:4-6; ER359; ER454; ER56. The rental pool operator was designated for a long term (3 years with automatic 5-year renewal terms) without any provision for early termination unless the unit was sold or the rental agreement changed. ER468 ¶8.1. Thus, appellants purchased a security. *Hocking v. Dubois*, 885 F. 2d at 1456 (dissent).

In *Howey*, as here, the investors purchased real estate and at the same time relinquished much of the right to use or enter the property. *S.E.C. v. W.J.Howey Co.*, 328 U.S. at 296. In *Howey*, as here, the investors were not on paper obligated to purchase the service contracts. *Id. at 295*. As with the lemon grove in *Howey*, appellants here lacked the skill, knowledge and equipment necessary to manage the hotel investment. *Id*. at 296.

Even the sophisticated securities legal counsel representing certain bank defendants conceded that any contention the transaction was not a security was a "difficult argument:" [3]

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[2] The costs of operation were pooled. The rooms were put into a pool of rooms available for which Tarsadia Hotels distributed reservations. Advertising costs for the pool of rooms were shared.

[3] The district court acknowledged that other defendants in the case conceded the Hard Rock Hotel interests sold to appellants were securities: "Bank Defendants

> **Mr. Christopher Murphy**: We haven't –in our papers have not addressed that issue as to whether there is a security or not. We did not make that argument. But the sale of the condominium—
> **The Court**: Why don't you make that argument?
> **Mr. Murphy**: Because I thought we –I think we have some strong arguments without making that argument, and **I think that argument is a difficult argument**, and I thought we had some easier arguments to make. But that is just a matter of strategy, your honor.
> **The Court**: Thank You. 11 February 2011 R.T. 66:20-67:4 at ER 144-145

II. THE CLAIMS WERE NOT TIME-BARRED

Appellants brought their claims approximately two years from the date the Hard Rock Hotel opened in December 2007. ER254.

A. Untrue Statements of Material Fact in Connection with Sale of Securities § 12(2)(a)

Under federal securities laws that prohibit the making of false statements in connection with the sale of securities, the statute of limitations is 1-year from date of discovery of facts upon which claims are based or 3-years from the date of sale, whichever occurs first. 15 U.S.C. § 77. Under §12(a)(2), claims are subject to a 3-year absolute statute of limitations that begins to run from the date of sale, which is when the parties entered into a binding contract for the sale of a security. ER17:11-13.

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largely assume for the purpose of their motions to dismiss the transactions constituted securities." ER9.

The date of sale of the Hard Rock Hotel securities was at the earliest the date Rental Management Agreement was signed, not the date the unit purchase agreement was signed as found by the district court. ER17:7-11; ER352. If appellants could only claim an expectation of profits from the efforts of others, that expectation did not materialize until the Rental Management Agreement, which was offered eight months after the unit purchase agreement. ER13:5-6; ER15:21-24. Under that logic, the date of sale of the security would be the date the Rental Management Agreement was signed as the terms of the investment, e.g. the division of revenues, was not even in place until then. ER 463.

B. Securities Fraud Claims

The complaint was filed on 8 December 2009 -- approximately two years after the hotel opened in December 2007. ER254. Investors were required to bring their federal securities fraud claims under Section 10 and Rule 10(b)5 of the Securities & Exchange Act and their state securities fraud claims under Cal. Corp. Code §§ 25401, 25501, 25504.1, and 25504 before the expiration of two years after the discovery by the investors of the facts constituting the violation. 28 U.S.C. 1658(b); Cal. Corp. Code § 25006. The question of when an investor discovers facts constituting the fraud is a question for the trier of fact to resolve. *Betz v. Trainer Wortham & Co.*, 610 F.3d 1169, 1170 (9th Cir. 2010).

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The operative complaint alleges the 5th Rock promoters determined their original plan to develop a 388 Hard Rock Hotel did not work. ER40 ¶ 90; ER49:9-14, 23-28; ER50:1-13. 5th Rock promoters organized a fraudulent scheme, with the knowing direct involvement of defendant Playground (ER33:24-25; ER34-35 ¶ 60; ER54-55 ¶¶ 130-131; ER71-72 ¶ 206) and Erskine (ER33: 26-27; ER36 ¶¶ 67-68; ER63-65 ¶¶ 165-171) to shift the risk of the investment to investors without complying with the federal and state securities law. ER28-29 ¶¶ 1-10; ER48-50 ¶ 113. These defendants are alleged to have made misrepresentations and omitted facts needed to make statements made in the DRE Report, Rental Management Agreement FAQs, Hard Rock Hotel Guide and other promotional materials used to sell the Hard Rock Hotel investment contracts not misleading. ER38-39 ¶¶ 83-87; ER45-46 ¶¶ 100-103; ER48-50 ¶¶ 113.

The Ninth Circuit generally views the question of when a reasonably diligent investor should have discovered a claim as appropriate for the fact finder to determine after trial rather than one for a judge to decide. *Luksch v. Latham,* 675 F. Supp. 1198, 1201 (N.D. Cal. 1987); *Deveney v. Entropin* (2005) 139 Cal. App. 4th 408, 428.

Moreover, Appellants are entitled to rely on their confidential relationship with Playground -- their real estate agent -- to toll the statute of limitations "until some event [occurs] which would normally awaken suspicion in them. *Zola v.*

Gordon, 685 F. Supp. 354, 364-365 (S.D.N.Y 1988); *E-FAB, Inc. v. Accountants, Inc. Services* (2007) 153 Cal. App. 4th 1308, 1318 (fiduciary relationship tolls statute of limitations). Dawson, *Undiscovered Fraud and Statutes of Limitation*, 31 Mich. L. Rev. 591, 611 (1933).

In this case, there were no storm warnings to put investors on alert. First, investors enjoyed a fiduciary relationship with real estate agent Playground from whom they purchased their interests in the common fund hotel and their rental management agreement. ER54 ¶ 130. Playground negotiated appellants' investment contracts, provided the terms, helped to prepare the paper work, coordinated with bank sales representatives, provided comparable sales and rent information, and issued a constant stream of upbeat emails touting the attributes of the investment. ER34-34 ¶¶ 60; ER54-55 ¶¶ 130-131.

Second, Hard Rock is a well-respected national brand name. Tarsadia was held out as national hotel entrepreneurs. ER48-50 ¶ 113. Tarsadia, 5th Rock and related control persons and affiliates made a public offering of the opportunity to invest in the Hard Rock Hotel. ER44 ¶ 99. The project had all of the markings of an honest business transaction and did not put investors on notice of fraud. *In re Countrywide Fin. Corp. Sec. Litig.*, 588 F. Supp. 2d 1132, 1159 (2008).

Investors were subjected to a barrage of false and misleading statements by the Tarsdadia-related entities and Playground designed to keep investors from

discovering facts supporting the need to bring claims. One device used was to slowly reduce investors' room revenue while gradually increasing costs. ER55 ¶¶ 132-133. It was not until then that investors consulted with legal counsel. An investigation ensued and uncovered the fact that Tarsadia and its co-defendants were part of a group effort to shift the investment risks of the Hard Rock Hotel they were building to a group of investors so as to disguise the transaction as a sale of a condo and avoid the registration and qualification requires of state and federal securities laws. ER48-51¶¶ 113-118; ER103:24-104:12. *See*, Corp. Code § 25110 (unlawful to sell security unless qualified under Corp. Code); § 25140 (Corporation Commissioner may issue a stop order denying permit if in the public interest and business plan not fair, just, or equitable).

While investors signed documents representing they were not relying on any representations made outside of the documents themselves, were not purchasing the units for investment purposes, and that rental of the units was voluntary, they were unaware of the gravamen of the fraud claims at the time. The operative complaint does not suggest investors knew or discovered appellees acted with scienter as required under *Merck & Co. v. Reynolds*, 130 S. Ct. 1784 (2010). Any such conclusion would require a factual determination properly reserved for the trier of fact. *Betz v. Trainer Wortham & Co.*, 610 F.3d 1169, 1170 (9th Cir. 2010).

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1. Claims Were Properly Filed Within Two Years of Discovery of Fraud

The Second Claim for Relief (Rule 10b-5) and the Fourth Claim for Relief (Cal. Corp. Code § 25501) must be brought within two years of discovery of fraud. 28 U.S.C. § 1658(b); Cal. Corp. Code § 25506. Under the Second Claim for Relief – 10b-5 -- the Supreme Court has held that "facts constituting the violation include the fact of scienter a mental state embracing intent to deceive, manipulate or defraud;" the limitations period therefore does not begin to until plaintiff has "discovered any facts suggesting scienter." *Merck & Co v. Reynolds*, 130 S. Ct 1784, 1796 (2010). The question of notice of fraud is for the trier of fact and only when uncontroverted evidence irrefutably demonstrates plaintiffs discovered or should have discovered the fraudulent conduct may a 10b-5 case be summarily dismissed. *See*, *Betz v. Trainer Wortham & Co.*, 610 F.3d 1169, 1170 (9th Cir. 2010); *Deveny v. Entropin*, (2006) 139 Cal App. 4th 408, 428 (when reasonably diligent investor should have discovered question for fact finder). No such irrefutable evidence of discovery of the fraud exists here.

2. Common Law Fraud Claims

The time for bringing the common law fraud claims is three years after the time a party discovers facts constituting the fraud, as provided by Cal. Code Civ. Proc. § 338(d). *Sun'N Sand, Inc. v. United Cal. Bank* (1978) 21 Cal. 3d 671, 701; *Galusha v. Fraser* (1918) 178 Cal. 653, 656. The claims here were brought

approximately two years from the hotel opening and the transaction closed. It wasn't until then that facts surfaced to cause investors to consult legal counsel and together investigate and then discover the promoters' fraudulent masquerading of securities as condominiums to transfer risks to investors while keeping the upside of the business for themselves. ER55 ¶¶ 132-133; ER48-51¶¶ 113-118.

III. SELLING SECURITIES WITHOUT A BROKERS LICENSE

Corporations Code § 25501.5 addresses the prohibitions of inducing the purchase of a security unless licensed as a broker-dealer. The law was introduced into the legislature as Assembly Bill No. 2167 in 2004. The Legislative Counsel's Digest explained the purpose of Assembly Bill No. 2167:

> The Corporation Securities Law of 1968 prohibits a broker-dealer from effecting a transaction in, or inducing or attempting to induce the purchase or sale of, any security in this state without a certificate from the Commissioner of Corporations authorizing the person to act in that capacity. Under existing law, an unlicensed person who caused injury as a result of engaging in specified activities for which a license is required is liable for treble the amount of assessed damages. This bill would authorize a person who purchases a security from or sells a security to a broker-dealer without a certificate to bring an action for rescission of the sale or purchase, or for specified damages, and would authorize the court to award reasonable attorney's fees and costs to a plaintiff. The bill would extend the application of treble damages to these actions. Assembly Bill No. 2167 Legislative Counsel Digest (2004).

A 4-year statute of limitations for breach of fiduciary duty is the most appropriate limitations period for a § 25501.5 violation. *See, In Re Brocade Communications Systems Inc. Derivative Litigation*, 615 F. Supp. 2d 1018, 1036

(N.D. Cal. 2009). Appellants base their position on the fact that Playground was acting in the capacity of an unlicensed fiduciary and as such engaged in a serious breach of fiduciary duty prohibited by statute. The legislature found such conduct to be reprehensible enough to permit treble damage recovery and award of attorneys' fees. See Cal. Code Civ. Proc. § 1029.8.11.

IV. COMMON LAW FRAUD CLAIMS WERE STATED WITH REQUISITE SPECIFICITY

The authority controlling the requirements for pleading specificity in fraud cases is *Vess v. Ciba-Geigy Corp. USA*, 317 F. 3d 1097 (9th Cir. 2003) and *Fecht v. Price Co.*, 70 F. 3d 1078 (9th Cir. 1995). As set forth below, the operative complaint sufficiently pleads fraud.

A. Tarsadia, Affiliates 5th Rock, MKP One, Gaslamp, and Control Persons Patels and Casserly's Fraudulent Acts

A de novo review of the operative complaint reveals specific allegations of fraud. Patels, through their affiliates and control persons, formed a common enterprise to sell a condo investment contract wherein investors had an expectation that profits would be produced by the managers of the Hard Rock Hotel because, in part, they were forced to join the Tarsadia rental program with Tarsadia as their exclusive rental agent. ER38 ¶ 82; ER40 ¶ 90; ER41 ¶¶ 92-93; ER44 ¶ 95. The written assertions that the rental program was voluntary were not correct based on the way the Patels through their affiliates and control persons structured the Hard

Rock Hotel. The Master Association Declaration of Covenants, Conditions, Easements and Restrictions provided that unit investors could only rent their units through the program operated by the hotel owner (5th Rock or Gaslamp Holdings) or "any third party approved by the Hotel Owner." ER44¶ 98; Appellants' Request for Judicial Notice, Exhibit A.

The Patels and their owned and controlled entities did not disclose that after imposition of service fees, together with governing agreements that prevented unit investors from renting the room as a Hard Rock Hotel unit, the unit investors' ability to rent was infeasible. ER44 ¶ 98. Casserly – Tarsadia President and architect of the scheme to shift from a hotel to a condo investment contract moving risk to investors – was an author of the Hard Rock Guide, Rental Management FAQ and other documents provided to investors that misrepresented the transaction and concealed its true nature as that of a security. He was assisted by Tarsadia's officers, general manager, and agents. ER53-54¶¶ 126-129.

The Patels and their owned and controlled entities did not disclose that the written representations contradicted the economic reality of the investment scheme. ER46 ¶ 104; ER47 ¶¶ 110-11. The unit investors were provided the Hard Rock Guide, which omitted to state that the business model was changed by the developer/seller/promoters after they determined the risks of developing the hotel were too great and thus were being shifted to investors in a market that wouldn't

support the investment for the hotel owner. Instead they misrepresented the strength of the market when promoting and selling the investments while omitting to disclose that they would retain the substantial income and benefits of the project. ER48-50 ¶ 113.

The Patels, through their owned and controlled entities and persons, misrepresented the nature of the transaction and concealed the fact that (1) investors were purchasing a security that was required to be registered and qualified and (2) that the rental management agreement was mandatory due to the their ownership and control over the units and the agreements. These misrepresentations were made in the Hard Rock Guide, the Rental Management Agreement FAQs, and the marketing sizzle based on the Hard Rock brand. Moreover, the Patels and their owned and controlled entities and agents aided and materially assisted each other in the misrepresentations to help close the transaction with investors. ER48-51 ¶¶ 113-119; ER53-54¶¶ 126-129.

Appellant investors properly alleged a security was sold consistent with controlling authority. *Hocking v. Dubois*, 885 F. 2d 1449 (9th Cir. 1989); *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293, 298-299 (1946). However, the district court dismissed the common law fraud claims against Tarsadia reasoning that plaintiffs had not sufficiently alleged the transactions constituted a security and, therefore, their allegations of misrepresentations and omissions relating to that fact did not

support a fraud allegation. ER22:12-15. If a security is found, it would remove the basis for the district court's ruling that appellants had not alleged a common law fraud claim.

The district court misunderstood the allegations of the operative complaint. Investors did not understand that the Hard Rock promoters attempted to make a false written record that rental management of appellants units by Tarsadia Hotels was not mandatory "to conceal the fact that the HRHSD Investment Contract transaction was an unregistered, public offering of a security." ER51 ¶ 118.

These fraud allegations are sufficient under Fed. R. Civ. P. 9(b) because they identify the circumstances of the alleged fraud so that the Patels, Casserly, and the owned and controlled entities (5th Rock, Tarsadia, Gaslamp Holdings and MKP One) could prepare an adequate answer." *Fecht v. Price Co.*, 70 F.3d 1078, 1082 (9th Cir. 1995).

B. Playground's Involvement in the Fraud

The operative complaint identifies Playground as a promoter who engaged in the unlawful activities alleged in the operative complaint. ER33:24-25. Playground was a "sales broker for the HRHSD Investment Contracts." ER33:24-25; ER56:8. Playground "materially and substantially assisted in the unlawful sale of unregistered and unqualified HRHSD investment contracts." ER33: 24-25; ER34-35 ¶ 60; ER71:¶205.

The operative complaint goes on to identify the individuals at Playground who made the sales of the Hard Rock Hotel investment contracts:

> 130. Playground related defendants were led by BJ Turner, and Jason Dolker Playground's Director of Sales. Playground defendants Turner and Dolker and their fellow Playground brokers participated directly in the sale of HRHSD Investment Contracts. They negotiated the contracts, provided the terms, helped to prepare the paper work, coordinated with the bank sales representatives, provided comparable sales and rent information, and issued a constant stream of upbeat emails touting the attributes of the HRHSD investment contracts. ER 54 ¶ 130.

The operative complaint goes on to allege that Playground's representatives knew material information was not being provided to investors, and that the investment was required to be but was not registered or qualified with federal and state securities regulators:

> 131. These Playground representatives knew the HRHSD project had been shifted from a hotel project to a commercial non-residential condominium and that plaintiffs were not receiving the information they needed about the projected performance underlying the HRHSD Investment Contracts. These agents of Playground knew the HRHSD Investment Contracts were required to be registered with the SEC and qualified by the Department of Corporations from their training as real estate brokers and agents. These Playground agents knew they were required to be registered as broker dealers before they could lawfully sell the HRHSD Investment contracts. These Playground agents were highly compensated and were motivated by the lure of financial gain to violate their legal duties. ER 54-55 ¶131.

The operative complaint alleges plaintiffs purchased their HRHSD investment contracts from defendant Playground when Playground was required to be but was not registered as a broker-dealer. ER71-72 ¶ 206; ER75 ¶¶ 225-226.

Playground identified for investors lenders who Playground represented to be part of the Hard Rock Condo sales team. ER57:3; ER67:25.

After Playground's role as the sales arm for the project was detailed, the misrepresentations used to make the sales of the Hard Rock Hotel investment contracts were described in the operative complaint. ER48-50 ¶ 113; ER36-37 ¶¶ 83-87; ER44 ¶¶ 98, 99. The misrepresentations and omissions of material facts needed to make those stated not misleading were described in detail. ER48-50 ¶113. The text of the misrepresentations and omissions were described and the documents in which the misrepresentations and omissions appeared were identified. ER48-50 ¶113. An explanation of how and why the statements made were false was provided. ER48-50 ¶ 113.

The operative complaint explained that the key misrepresentation involved the Rental Management Agreement (ER50-51 ¶ 116) and that, as a matter of economic and practical reality, the rental program for the rooms had to be operated and managed by Tarsadia, as investors were later to discover. ER50-51 ¶ 116; ER 44:3-6; ER45:24-25. However, investors were not told the true reasons why Tarsadia prepared paperwork to create a written, albeit false, record that rental management by Tarsadia was voluntary. ER51 ¶ 118.

Playground is alleged to have been a party to a scheme to use a document entitled "Tarsadia's Optional Rental Management Program FAQ" to create a false

written record that the rental management was not a condition of ownership in an effort to make it less likely that the investment would be recognized for what it was -- the public offering of a security. ER51 ¶ 118. It was in this context that plaintiffs alleged Playground subjected them to a barrage of false and misleading statements designed to keep them from discovering facts supporting the need to bring these claims. ER55 ¶133.

These allegations are sufficient under Fed. R. Civ. P. 9(b) because they identify the circumstances of the alleged fraud so that the defendant Playground could prepare an adequate answer. *Fecht v. Price Co.*, 70 F.3d 1078, 1082 (9th Cir. 1995).

C. Erskine Group and Professional Mortgage Partners' Role in the Fraud

Appellants contend that their allegations against Erskine satisfy the particularity requirements because they have sufficiently pled "one coherent scheme to defraud, the entire purpose of which was to shift the investment risk of the Hard Rock Hotel to plaintiffs without disclosing" the material risks of the investment. ER28 ¶ 4; ER29 ¶ 9; ER48-50 ¶ 113; ER53 ¶ 126-127; ER54-55 ¶ 131. As an active participant in the Patel-affiliate scheme, appellants adequately alleged common law fraud against Erskine, contrary to the district court's determination. *Vess v. Ciba-Geigy Corp. USA*, 317 F.3d 1097, 1102-1103 (9th Cir. 2003).

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Erskine materially assisted in the unlawful sale of the unregistered and unqualified investment contracts to appellants. ER36:4-6. Erskine secured for PMP financing for the sale and purchase of $38,536,730 of Hard Rock Hotel investment contracts. ER36 ¶ 71. Erskine knew the appraisals supporting the loans for the hotel room sales were not based on room revenue that was to go to the appellants, and that those appraisals exceeded what actual rent-based appraisals would support. ER64:1-6.

Erskine knew from their preparation for licensing exams in the mortgage banking and real estate brokerage business that the Hard Rock Hotel investment contracts were required to be but were not registered with the SEC and qualified by the DOC. ER64:6-10. These fraud allegations are sufficient under Fed. R. Civ. P. 9(b) for Erskine to prepare an adequate answer." *Fecht v. Price Co.*, 70 F.3d 1078, 1082 (9th Cir. 1995).

V. THE COMPLAINT DEMONSTRATED INVESTORS' JUSTIFIABLE RELIANCE ON PROMOTERS' MISREPRESENTATIONS

The operative complaint sets forth the appellees' misrepresentations and omission of facts needed to make those stated not misleading and investors' reliance on them when entering into the transactions. ER73 ¶ 216; ER76 ¶¶ 230-232; ER77 ¶¶ 235-237. Investors were provided revenue comparables when making their investment decisions. ER53:54:8. Promoters heavily focused on the value of Hard Rock brand in promoting the condo investment. ER49:18-23.

Promoters organized a "Hard Rock Condo Sales Team" and held themselves out as there to help investors with the transaction experience. ER48:17-27. Investors were told that the Hard Rock rental management agreement was voluntary when they induced the sales, yet when the RMA was finally disclosed, it made clear that in order to rent as a hard Rock unit, investors had to give up approximately 57% of the room rental revenue. ER45-46 ¶¶ 100-105; ER463.

No warranties or disclaimers disprove investors' justifiable reliance as a matter of law. The record demonstrates that appellants were signatories to representations and warranties the district court erroneously determined *contradicted* the alleged misstatements. ER 22:8-10. Plaintiff investors pled that the interests they purchased were defined by specific documents. ER40-41 ¶ 91. Indeed, while disclaimer language comes from the unit purchase agreement, it was not included in the Rental Management Agreement, the DRE public report, the Rental Management FAQ or the Hard Rock Guide. ER95:17-96:22; ER453-477.

To rule as it did, the district court first had to ignore the expanse of the transaction that was alleged to be part of a fraudulent scheme and instead, limit its consideration to documents submitted pursuant to a request for judicial notice. However, a 12(b)6 motion tests the legal sufficiency of the claims in the complaint. The Court must decide whether facts alleged, if true, would entitle plaintiff to some form of legal remedy. *De La Cruz v. Tormey*, 582 F2d 45, 48 (9th Cir. 1978).

While it may have been appropriate for the Court to take judicial notice of the agreements referenced in the complaint, it was not appropriate for the court to weigh a party's assertion of what the contents mean. *Wilshire Westwood Assocs. v. Atlantic Richfield Corp.*, 881 F.2d 801, 803 (9th Cir. 1988).

Further, the provisions in a form agreement do not preclude, as a matter of law, buyers' showing of justifiable reliance on an element of their claims. *Manderville v. PCG & S Group* (2007) 146 Cal. App. 4th 1486, 1500-1501; *Timmreck v. Munn*, 433 F. Supp. 396, 401 (N.D. Ill. 1977); Civ. Code § 1856(g); *see also*, Macklin, Alicia W., *The Fraud Exception to the Parol Evidence Rule: Necessary Protection for Fraud Victims or Loophole for Clever Parties*?, 82 S. Cal. L. Rev 809 (2009).

As set forth earlier in the brief, were contract interpretation be appropriate at the pleading stage, appellants have a right to present evidence in support of its interpretation of the agreements defining their relationship with the defendants. *Wolf v. Superior Court* (2004) 114 Cal. App. 4th 1343, 1346-1351. Civ. Code § 1636; *see also*, Patterson, Edwin W., *The Interpretation and Construction of Contracts* 64 *Colum L. Rev*. 833, 855-856 (1964). Because the disclaimers were drafted by the hotel promoters, sellers and operators, they must be read to fall "within the reasonable expectations of the weaker or 'adhering' party." *Fischer v. First Internat. Bank* (2003) 109 Cal.App.4th 1433, 1446; *Armendariz v.*

Foundation Health Psychcare Services, Inc., (2000) 24 Cal.4th 83, 113. Any ambiguities caused by the draftsman of the contract must be resolved against that party applies with peculiar force in the case of the contract of adhesion. *Neal v. State Farm Insurance Co.* (1961) 188 Cal. App. 2d 690, 695.

The representations and warranties in the Purchase Contracts and Addendums that investors were not relying on any representations not contained in those agreements do not end the analysis:

> "It is no defense to an action for the rescission of a written contract that the misrepresentations complained of were oral and that they are not included in the contract itself (citation omitted). In speaking of a similar contention, the court in (citation omitted) used language which might well have been written of the case before us, as follows: 'If this contention were true, it would never be possible to avoid a written contract for fraudulent misrepresentations unless such misrepresentations were also in writing and made a part of the contract. This clearly is not the law.
>
> The Civil Code provides (sec. 1566) that a contract may be rescinded where the consent is not free, and in the following section it is provided that consent is not free when such consent is induced by fraud. Actual fraud is defined in section 1572 of the Civil Code. The plaintiffs, in attempting to show actual fraud, as defined by said last-mentioned section, were entitled to show all the matters of inducement for entering into the contract. Actual fraud is always a question of fact (Civ. Code, sec. 1574), and the trial court has made very complete findings covering numerous fraudulent misrepresentations by the defendant, any one of which is sufficient to warrant the relief granted to the plaintiffs.'
> In such an action it is proper to admit evidence of oral statements which constituted inducements to the making of the agreement (citation omitted), and even evidence of a previous verbal contract may be received (citation omitted) Not only were these misrepresentations sufficient to justify a rescission but it would be

> somewhat difficult to imagine stronger grounds therefor." *Peterson v. Wood* (1932) 119 Cal. App. 731, 733-734; Also see, *Continental Airlines, Inc., v. McDonnell Douglas Corp.*, (1989) 216 Cal. App. 3d 388; *Danzig v. Jack Grynberg & Ass.*, (1984) 161 Cal. App. 3d 1128; *Palm v. Smither* (1942) 52 Cal. App. 2d 500; *Engalla v. Permanente Medical Group, Inc.* (1997) 15 Cal 4th 951.

The disclaimers that ignore the contradictions elsewhere create an issue of fact, making dismissal at the pleadings stage improper.

A. Investors Justifiably Relied on the Misrepresentations and Omissions Regarding the Securities

Playground as a real estate agent was a fiduciary on which plaintiffs were entitled to rely without further inquiry. ER54 ¶ 130. *Michelson v. Hamada* (1994) 29 Cal. App. 4th 1566, 1579. The 5th Rock Promoters and sales agents induced trust by representing to plaintiffs "[w]e will help you through the process." ER48:20-21. These agents negotiated contracts, provided the terms, helped to prepare the paper work, coordinated with bank representatives, provided comparable sales and rent information, and issued a constant stream of upbeat emails about the project. ER54:20-28.

As for omissions of material fact, a rebuttable presumption of reliance is deemed to arise because the fraud involves material omissions. *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153–54 (1972). This is a "mixed case of misstatements and omissions," but is primarily an omissions case because the promoters concealed the fact that the promoters had determined the project did not

work and elected to shift the investment risk to investors without compliance with the federal securities laws. The promoters concealed the facts showing the offering to be a security by preparing the paper work to suggest that the rental agreement was separate from the sale of the hotel units. ER28-29; ER50:14-51:24. See, *Binder v. Gillespie*, 184 F.3d 1059, 1063, 1064 (9th Cir.1999)

Whether there was justifiable reliance is a factual question. Although there is no reported decision reflecting that a court actually instructed a jury to consider the foregoing factors, there is some authority for doing so. *See, e.g., In re Rexplore, Inc. Securities Litigation*, 671 F.Supp. 679, 684 (N.D. Cal. 1987); *Luksch v. Latham*, 675 F.Supp. 1198, 1203 (N.D. Cal. 1987) (sophistication of plaintiff relevant to determine when plaintiff knew or should have known of a securities law violation, for purposes of statute of limitations); *cf. Vucinich v. Paine, Webber, Jackson & Curtis, Inc.*, 739 F.2d 1434, 1435–36 (9th Cir.1984)

Here, the misrepresentations and omissions were material. The Supreme Court adopted the standard for materiality developed in *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (whether a reasonable shareholder would "consider it important" or whether the fact would have "assumed actual significance") as the standard for actions under 15 U.S.C. § 78j(b); *Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988).

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A factual representation concerning a security is material if there is a substantial likelihood a reasonable investor would consider the fact important in deciding whether or not to buy or sell that security. An omission concerning a security is material if a reasonable investor would have regarded what was not disclosed to the investor as having significantly altered the total mix of information the investor took into account in deciding whether to buy or sell the security. In discussing materiality, the Ninth Circuit has applied *TSC Indus.* and *Basic Inc.* in various formulations. *See, for example, Kaplan v. Rose*, 49 F.3d 1363, 1371 (9th Cir.1994) (omission or misrepresentation would have misled a reasonable investor about the nature of his or her investment), *cert. denied*, 516 U.S. 810 (1995); *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1413 n.2 (9th Cir.1994) (substantial likelihood omitted fact would have been viewed by reasonable investor as having significantly altered the "total mix" of information; reasonable investor would have felt the fact "important" in deciding whether to invest), *cert. denied*, 516 U.S. 868 (1995); *In re Stac Electronics Sec. Litig.*, 89 F.3d 1399, 1408 (9th Cir.1996) (same), *cert. denied*, 520 U.S. 1103 (1997); *McGonigle v. Combs*, 968 F.2d 810, 817 (9th Cir.) (substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in deliberations of the reasonable shareholder), *cert. dismissed*, 506 U.S. 948 (1992).

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The operative complaint alleges promoters made misrepresentations and omissions of facts that the investors would have assumed significant in deciding whether to invest in the hotel. Weighing facts would be improper at the pleading stage. Accordingly, justifiable reliance is alleged.

VI. APPELLANTS SHOULD BE GRANTED LEAVE TO AMEND

In *Foman v. Davis*, 371 U.S. 178 (1962), the Supreme Court offered the following factors a district court should consider in deciding whether to grant leave to amend: In the absence of any apparent or declared reason-- such as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc. --the leave sought should, as the rules require, be "freely given." *Eminence Capital, LLC v. Aspeon, Inc.*, 316 F.3d 1048, 1052 (9th Cir. 2003).

Dismissal with prejudice and without leave to amend is not appropriate unless it is clear on de novo review that the complaint could not be saved by amendment. *Chang v. Chen*, 80 F.3d 1293, 1296 (9th Cir. 1996). A district court's failure to consider the relevant factors and articulate why dismissal should be with prejudice instead of without prejudice may constitute an abuse of discretion. *Eminence Capital, LLC v. Aspeon, Inc.*, 316 F.3d at 1052. (Adherence to these principles is especially important in the context of the PSLRA.)

Here, the district court erred by misapplying the holding of *Eminence Capital, LLC v. Aspeon, Inc.* in denying appellants leave to amend the operative complaint citing, "Plaintiffs have had ample opportunity to properly plead a case and have failed to do so." *Id.* ER 22:28-29:2. This is not the standard. Because appellants could amend to cure insufficiencies in pleadings, if any, leave would be proper. Appellants proffer that if remanded, they could add facts developed in their continued investigation to cure insufficiencies, if any are found to exist.

CONCLUSION

For the foregoing reasons, the district court's order dismissing the action should be overruled and the case remanded to district court.

Respectfully submitted,

Dated: July 29, 2011

/s/Michael J. Aguirre
Michael J. Aguirre
Attorneys for Plaintiffs-Appellants

STATEMENT OF RELATION CASES

Pursuant to Ninth Circuit Court Rule 28-2.61, Appellants advise they are not aware of any related cases pending in the United States Court of Appeals for the Ninth Circuit.

CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 13,709 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Office Word 2007, Times New Roman, 14-point.

Respectfully submitted,

Dated: July 29, 2011

/s/Michael J. Aguirre
Michael J. Aguirre
Attorneys for Plaintiffs-Appellants

CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United State Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on July 29, 2011.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

/s/Michael J. Aguirre
Michael J. Aguirre