UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

TAMER SALAMEH, et al.,

Plaintiffs,

vs.

TARSADIA HOTELS, et al.,

Defendants.

CASE NO. 09CV2739 DMS (CAB)

ORDER GRANTING PLAYGROUND DESTINATION PROPERTIES' MOTION TO DISMISS PLAINTIFFS' FIRST AMENDED COMPLAINT

[Doc. 50]

Pending before the Court is Defendant Playground Destination Properties' ("Playground") motion to dismiss. The matter came on for hearing on August 13, 2010. Michael Aguirre and Maria Severson appeared on behalf of Plaintiffs. Daniel Benjamin and Logan Smith appeared on behalf of Playground. Frederick Kranz appeared on behalf of the Tarsadia Hotel Defendants. Edward Rosenfeld appeared on behalf of Defendant Bank of America. For the reasons set forth below, Defendant's motion is granted.

I.

BACKGROUND

The Hard Rock Hotel San Diego ("HRHSD") is located in downtown San Diego's Gaslamp Quarter, near the baseball stadium. (FAC ¶ 67.) It is a 12-story building containing 420 guest rooms, 244 studios, 176 suites, and meeting and event space. (*Id.* at ¶ 68.) The public was offered the

opportunity to purchase ownership interests in individual HRHSD studios or suites through press releases and public marketing programs, including television commercials. (*Id.* at ¶ 82.) Plaintiffs bring suit on behalf of all persons who purchased such ownership interests. (*Id.* at ¶ 60.)

Plaintiffs purchased ownership interests in individual HRHSD studios or suites at prices ranging from $350,000 to more than $2 million. (*Id.* at ¶¶ 82, 85.) They purchased their ownership units through what Plaintiffs have titled "HRHSD Investment Contracts." (*Id.* at ¶ 82.) The HRHSD Investment Contract consisted of three documents: 1) Purchase Contract and Escrow Instructions, 2) Unit Maintenance and Operating Agreement, and 3) HRHSD Rental Management Agreement ("RMA"). (*Id.* at ¶ 86.)

Plaintiffs allege that once they purchased their units at HRHSD, they had no control over the rental management of the studios and suites. (*Id.* at ¶ 79.) Although they were told the HRHSD Rental Management Agreement was voluntary, it was in fact mandatory. (*Id.* at ¶¶ 76-78.) Plaintiffs were not issued keys to their units, but instead had to obtain keys from the hotel when staying in their units. (*Id.* at ¶ 89.) Plaintiffs were permitted to stay in their units for up to 28 days per year, and if they sold the unit, the unit was subject to the 28-day limitation. (*Id.* at ¶ 88.) HRHSD was managed by Defendant 5th Rock, LLC, and Plaintiffs had to pay 5th Rock a service and management fee when they stayed in their units. (*Id.* at ¶¶ 87, 90.) 5th Rock had a right of first refusal if Plaintiffs chose to sell their interests. (*Id.* at ¶ 94.)

Plaintiffs contend the units were marketed as real estate transactions, and indeed, as part of those real estate transactions Plaintiffs were obligated to pay tens of thousands of dollars in nonrefundable deposits. (*Id.* at ¶ 74.) Plaintiffs allege, however, that the units were actually "securities" and should have been sold pursuant to the laws regulating the sale of securities. (*Id.* at ¶ 74, 95-101.) Defendant Playground was the third-party real estate brokerage company hired by the developer to list and market the condominium units to be developed. Plaintiffs assert four claims against Playground: 1) violation of § 12(a)(2) of the Securities Act of 1933 for misrepresentation or omission, 2) violation of Cal. Corp. Code §§ 25110, 25503 and 25504.1 for sale of unqualified security, 3) violation of Cal. Corp. Code §§ 25401, 25501 and 25504.1 for misrepresentation or omission, and 4) violation of Cal. Corp. Code 25501.5 for sale by unlicensed broker-seller.

Plaintiffs filed the original complaint on December 8, 2009, and the FAC on March 15, 2010. (Docs. 1 & 8.) Playground filed its motion to dismiss on June 9, 2010. Plaintiffs filed an opposition and Defendant filed a reply. (Docs. 77 & 79.) On July 20, 2010, this Court granted without prejudice four motions to dismiss filed by the Bank Defendants. (Doc. 72.)

II.

LEGAL STANDARD

In two recent opinions, the Supreme Court established a more stringent standard of review for 12(b)(6) motions. *See Ashcroft v. Iqbal*, ___ U.S. ___, 129 S.Ct. 1937 (2009); *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007). To survive a motion to dismiss under this new standard, "a complaint must contain sufficient factual matter, accepted as true, to 'state a claim for relief that is plausible on its face.'" *Iqbal*, 129 S.Ct. at 1949 (citing *Twombly*, 550 U.S. at 570). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* (citing *Twombly*, 550 U.S. at 556). "Determining whether a complaint states a plausible claim for relief will ... be a context-specific task that requires the reviewing court to draw on its judicial experience and common sense." *Id.* at 1950 (citing *Iqbal v. Hasty*, 490 F.3d 143, 157-58 (2d Cir. 2007)). The reviewing court must therefore "identify the allegations in the complaint that are not entitled to the assumption of truth" and evaluate "the factual allegations in [the] complaint to determine if they plausibly suggest an entitlement to relief." *Id.* at 1951.

III.

DISCUSSION

Playground moves to dismiss the FAC on the grounds that the condominium units were not "securities" under the securities laws and Plaintiffs' claims are barred by the relevant statutes of limitations.

A. Sale of Security

Plaintiffs contend the sale of HRHSD condominium units was an "Investment Contract" subject to state and federal securities laws. "[A]n 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." *SEC v. W. J. Howey Co.*, 328 U.S. 293, 298-299 (1946). There is a three-part test to determine whether or not a transaction is an investment contract: "(1) an investment of money (2) in a common enterprise (3) with an expectation of profits produced by the efforts of others." *Warfield v. Alaniz*, 569 F.3d 1015, 1020 (9th Cir. 2009) (quotations omitted).

In California, an investment may be a security if it meets the federal test under *Howey*, or if meets the "risk capital" test. *Consolidated Management Group, LLC v. Department of Corporations*, 162 Cal. App. 4th 598, 610 (2008). Four factors are considered in the "risk capital" test: "(1) whether funds are being raised for a business venture or enterprise; (2) whether the transaction is offered indiscriminately to the public at large; (3) whether the investors are substantially powerless to effect the success of the enterprise; and (4) whether the investors' money is substantially at risk because it is inadequately secured." *Reiswig v. Department of Corporations*, 144 Cal. App. 4th 327, 334 (2006) (citations omitted).

Defendant argues the transaction was not an "investment contract" because of the plain language of the contracts. In the Purchase Contract and Escrow Instructions, Plaintiffs were obligated to initial a clause stating:

> Purchase not an investment. By placing his, her, their initials in the space provided herein below, Buyer expressly acknowledges that: (a) Buyer is purchasing the units for their real estate value and not as an investment; (b) neither seller nor any of its employees or agents have represented or offered the property as an investment opportunity for appreciation of value or as a means of obtaining income from the rental thereof; and (c) neither seller nor any of its employees or agents have made any statements or representations as to rental or other income that may be derived from the units or as to any other economic benefit, including possible advantages under federal or state tax laws, to be derived from the purchase and/or ownership of the units.

Defendant argues that given this language Plaintiffs could not have reasonably relied on any representations that the transaction was an investment. Plaintiffs, however, argue the economic realities of the transaction make it an investment contract. In *Hocking v. Dubois*, 885 F.2d 1449, 1461 (9th Cir. 1989), the court held there were triable issues of fact as to whether the purchase of a condominium unit in Hawaii was an investment contract, in part because the resort operated like a

hotel and it would have been impractical, if not impossible, for the investor to manage his one condominium separate from the rental agent at the resort and still receive significant rental income.

Here, the units were in a hotel, and Plaintiffs were only permitted to stay in the unit for up to 28 days a year. Thus, any benefit derived from owning the unit largely would come from its rental value, not from Plaintiffs' use of the unit. While Plaintiffs concede they were not obligated to sign the RMA to have Tarsadia manage the rental of the units, they argue that for all practical purposes, the RMA was necessary if they desired any rental income from their units. The economic realities of the transaction, according to Plaintiffs, indicate the transaction is an investment contract, despite the plain language of the Purchase Contracts. Nonetheless, Plaintiffs have failed to allege a common enterprise, and their allegations as to their expectation of profits produced by the efforts of others are conclusory. Accordingly, Plaintiffs' claims are dismissed without prejudice.

B. Statutes of Limitations

1. Claims 1 and 2 - Violation of § 12(a)(2) and Cal. Corp. Code § 25110

Section 12(a)(2) claims are governed by a three year statute of limitations and Cal. Corp. Code § 25110 claims have a two year statute of limitations. The Court has previously held that the date the Purchase Contract and Escrow Instructions were executed is the date on which the statutes of limitations began to run. Thus, the claims of many Plaintiffs are time-barred. Plaintiffs did not move for reconsideration of this ruling. Rather, Plaintiffs contend they were not bound at the time the signed the Purchase Contract and Escrow Instructions because of a provision in the contract which provided for termination in certain circumstances. Plaintiffs provide no authority for their position, nor do they contend they attempted to terminate the contract in accordance with the termination provisions. Accordingly, the Court's previous ruling on this issue stands.

2. Claim 3 - Violation of Cal. Corp. Code § 25501

Claim 3 is governed by the following statute of limitations:

> (b) For proceedings commencing on or after January 1, 2005, no action shall be maintained to enforce any liability created under Section 25500, 25501, or 25502 (or Section 25504 or Section 25504.1 insofar as they related to those sections) unless brought before the expiration of five years after the act or transaction constituting the violation or the expiration of two years after the discovery by the plaintiff of the facts constituting the violation, whichever shall first expire.

Cal. Corp. Code § 25506(b).

The two year statute of limitations is triggered when Plaintiffs have inquiry notice of their claims. *Deveny v. Entropin, Inc.,* 139 Cal. App. 4th 408, 422-423 (2006). Defendant contends Plaintiffs were put on inquiry notice at the time of signing the Purchase Contract and Escrow Instructions because registration of securities is a matter of public record; therefore, Plaintiffs should have discovered in 2006 that the units were not registered. Defendant further argues that if, as alleged, oral representations were made to Plaintiffs that the units *were* investments, such representations would have been contrary to the explicit terms of the Purchase Contracts, and Plaintiffs would have been on inquiry notice of the discrepancy at the time they signed the contracts.

The current record is incomplete as to whether Plaintiffs were put on inquiry notice at the time they executed the Purchase Contracts. Plaintiffs argue they were not put on inquiry notice until after the contracts were signed because later events revealed Defendant's fraud. Plaintiffs, however, do not explain those events. Plaintiffs also asserted at oral argument that a fiduciary relationship existed between Plaintiffs and Playground, and that such a relationship blunts Plaintiffs' duty of inquiry, but there are no such allegations in the FAC. Accordingly, Plaintiffs are granted leave to amend.

3. Claim 4 - Violation of Cal. Corp. Code § 25501.5.

California Corporations Code section 25501.5 provides for rescission of the purchase of a security from an unlicensed broker-dealer. There is no specific statute of limitations addressing this claim. Defendant argues the same statute that applies to Claim 3 applies to Claim 4. Alternatively, Defendant contends the catch-all statute of limitations in California should apply. Plaintiffs agree. Under that provision, there is a three-year statute of limitations for:"(a) an action upon a liability created by statute, other than a penalty or forfeiture," and "(d) an action for relief on the ground of fraud or mistake. The cause of action in that case is not deemed to have accrued until the discovery, by the aggrieved party, of the facts constituting the fraud or mistake." Cal. Code Civ. Proc. § 338(a) & (d).

Defendant argues § 338(a) applies and that the limitations period began when the Purchase Contracts were executed. Plaintiffs argue § 338(d) should applies because the action involves fraudulent misrepresentation. Plaintiffs argue that regardless of which section applies, less than three

years have elapsed since Plaintiffs discovered the basis for this legal action. Again, however, Plaintiffs have not pled facts to support their proffered date of discovery. Neither party has fully briefed the issue of which statute should apply and when it would begin to run. Because Plaintiffs are granted leave to amend, as set forth above, they also may amend this claim to address the date of discovery.

IV.

CONCLUSION

For the reasons set forth above, Defendant's motion is granted.[1] Plaintiffs may file a Second Amended Complaint on or before September 10, 2010.

IT IS SO ORDERED.

DATED: August 24, 2010

HON. DANA M. SABRAW
United States District Judge

[1] Additionally, Plaintiffs filed an "Amendment to Complaint To Substitute True Names for 'Doe' Defendants," which the Court construed as a motion for leave to amend. (Doc. 62.) The motion is granted.