

**IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

KRAVCO INC., et al.,	:	
Plaintiffs	:	CIVIL ACTION
vs.	:	
	:	NO. 00-0272
RODAMCO NORTH AMERICA, N.V., et al.,	:	
Defendants.	:	

MEMORANDUM-O R D E R

GREEN, S.J.

December _____, 2000

Presently before the Court is Defendants’¹ Motion to Dismiss the First Amended Complaint, Plaintiffs’² Response, and Defendants’ Reply thereto. After careful consideration of

¹ The moving “defendants” for the sake of this motion were: Rodamco North America, N.V.; Rodamco North America, B.V.; RoProperty Investment Management, N.V.; Hexalon Real Estate, Inc.; HRE KI Partners, L.P.; HRE KI Inc.; HRE Pennsylvania, Inc.; HRE Kravco II, Inc.; RNA-Kravco III, Inc.; CGR Advisors; Cecil D. Conlee; and David S. Golden. In a separate motion, Robeco Groep, N.V., joined the Motion to Dismiss of the aforementioned Defendants, and had filed a separate motion based on personal jurisdiction grounds. The other two named defendants, KI-Kravco Associates and Kravco Company, are captioned in the First Amended Complaint as “Nominal Defendants”. Neither of the latter two defendants has either retained counsel or answered the First Amended Complaint. Because I find subject matter jurisdiction lacking for the entire matter sub judice, Plaintiffs’ First Amended Complaint will be dismissed as to all defendants in this action.

² The Plaintiffs in this action are: Kravco, Inc.; Powell Schaeffer Associates Limited Partnership, individually and derivatively on behalf of Kravco Investments, L.P.; Robert Schaeffer, Adele K. Schaeffer, Anthony Schaeffer, and James Schaeffer, individually and as trustees of the Amended and Restated Indenture of trust of Harold G. Schaeffer dated December 5, 1979; H.G. Schaeffer, Inc., as general partner of Schaeffer Associates, a partnership; Harold G. Schaeffer, individually and as a managing partner of Schaeffer Family Holdings; Arthur L. Powell, individually; Lea R. Powell, Jon R. Powell, Richard S. Powell, Nancy E. Powell, and Carol P. Heller, individually and as Trustees of the Amended and Restated Indenture of Trust of Arthur L. Powell dated November 14, 1979; Lea R. Powell as a general partner and as Trustee of the Powell Grandchildren Associates, a partnership; Jon R. Powell as a partner and as Trustee of Powell Grandchildren Associates II, a partnership; A.L. Powell, Inc., as general partner of Powell Associates, a partnership; and Richard S. Powell, Carol P. Heller, Nancy E. Powell and Jon R. Powell as Trustees of the 1994 Trust for Powell Grandchildren.

the issues involved, I find that Plaintiffs have failed to state a cause of action, and thus, under Rule 12(b)(6) of the Federal Rules of Civil Procedure, Plaintiffs' federal cause of action must be dismissed.

I. Factual Background

This action arises out of a multi-transactional joining of two well-funded groups.³ In November of 1998, after a year and a half of discussions, negotiations and agreements, the closing of this deal occurred, bringing together assets approaching three hundred million dollars. In essence, the concluded deal combined the Plaintiffs' impressive catalog of commercial real estate holdings with a substantial monetary input from the Defendants, forming a partnership intended to manage the existing properties, and, expand the land portfolio. Since the closing, however, the relationship has soured, and the Plaintiffs look to be reimbursed damages for their losses, or to rescind the agreements. The Defendants, on the other hand, wish to enforce the existing agreements, and continue along in the partnership as currently formed.

The Plaintiffs' group is comprised of numerous individuals, partnerships and trusts, all of whom have interests in commercial real estate located in the United States. The particular holdings relevant in this matter are various shopping malls, in which the Plaintiffs either own an interest or manage. The accumulation of these assets began over 25 years ago, with efforts led primarily by Arthur Powell and Harold Schaeffer. Due to the realities of the real estate market in the 1990's, Plaintiffs realized that if they were to continue to expand their enterprise, they would need the assistance of a partner that had access to the large amount of capital necessary to survive and excel in the competitive real estate marketplace. The Plaintiffs decided that a single, large

³ All facts are taken from Plaintiffs' First Amended Complaint, unless otherwise noted.

institutional partner, with access to financing from worldwide sources, best fit their plans. After exploratory discussions with several other parties, Plaintiffs were approached by the Defendants, and the delicate courtship process commenced. By the summer of 1997, the general framework of the partnership was created, and after more serious discussions, negotiations and agreements, the final contracts were signed in November of 1998.

The Plaintiffs place great importance on the objectives they sought to achieve. Primarily, the Plaintiffs were looking for a single partner that was able to infuse the partnership with the kind of money needed to purchase, develop and maintain the large commercial properties which the Plaintiffs envisioned. They wanted the partnership to be a long-term commitment, and went to pains in the contracts to make certain that the Defendants could not simply form the partnership and then depart. Chief among these protections were clauses requiring the Defendants to remain in the partnership for at least seven years. The Plaintiffs allege that the Defendants misrepresented their commitment to the enterprise. Even though the Defendants knew of Plaintiffs' desires for a long term commitment, the Defendants purportedly planned to consummate the deal, then immediately divest their interests in the partnership after the closing. The motive: a thirty million dollar "windfall."

It is alleged that the "windfall" was possible as a result of the contribution agreements, which basically involved distinct infusions of funding for the new partnership: the Plaintiffs placed certain of their shopping mall-related interests into the partnership; the Defendants were to purchase certain minority limited partnership interests from third parties for approximately \$120 million in cash; and, finally, the Plaintiffs agreed that the Defendants were to be credited with \$150 million in contributions. Thus, with expenditures of only \$120 million in cash, the

Defendants stood to gain an immediate realization on their investment due to the \$150 million credit allowed to them by the Plaintiffs. Since Defendants' interest was not liquid -- there were significant restrictions on how and when the Defendants could divest themselves from the partnership -- the Plaintiffs felt secure in granting the Defendants this credit, and on embarking on what the Plaintiffs hoped to be a long, profitable relationship for all concerned.

In January 1999, the Plaintiffs were, for the first time, informed by one of the Defendants that the Defendants were looking to pull out of all the partnerships. Since that point, the Plaintiffs allege that they have made attempts to continue the business of the partnerships, but have been thwarted in their efforts. Plaintiffs have allegedly lost not only prospective business opportunities, but also have been forced to move on at least one acquisition without the participation of the Defendants. The Plaintiffs allege that, because of the promises and assurances of the Defendants, the Plaintiffs have lost control of a number of their most lucrative properties, and are continuing to sustain immeasurable damages as a result of the Defendants' inaction and failure to live up to both the terms and the spirit of the partnership arrangements.

As part of the establishment of the partnerships, Plaintiffs allege that certain securities were created in the form of limited partnership interests. Plaintiffs contend that they "would neither have caused nor accepted issuance of the securities had they been told the truth about defendant[s'] . . . intent to immediately divest itself of its partnership interests." See Pltfs. First Amended Compl., ¶ 92. Plaintiffs specifically allege the Defendants have committed fraud in connection with the purchase or sale of securities, in violation of §10(b)(5) of the Securities Exchange Act of 1934 ("the Act").⁴ Critical to Plaintiffs' case, and to this Court's jurisdiction, is

⁴ 15 U.S.C. §78(j)(b).

whether the transactions at issue involved “securities,” as that term is defined in the Act.⁵

Plaintiffs allege that the transactions at issue involve “securities” because they are either “roll-up limited partnership interests” or “investment contracts.” See Pltfs.’ Mem. of Law in Opposition to Motion to Dismiss at 13-14. The Defendants argue that none of the transactions at issue involved a “security”, as that term is understood under the Act or the relevant case law. See Defs.’ Mem. of Law at 13-15.

The litigation at bar revolves around Kravco Investments, L.P. (“KI”). KI is “a Pennsylvania limited partnership, the sole general partner of which is KI-Kravco [Associates]” (“KI-Kravco”). See Pltfs. First Amended Compl. at 6. KI-Kravco owns a .5% general partnership interest in KI. See Pltfs. First Amended Compl. at 12.⁶ KI-Kravco is equally

⁵ “Security” is defined in the Act as:

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

15 U.S.C. § 78c(a)(10).

⁶ The percentages of partnership involvement, while taken from Plaintiffs’ First Amended Complaint, is also listed in “Appendix to Memorandum of Law in Support of Defendants’ Motion to Dismiss: Agreements Placed at Issue in Plaintiffs’ First Amended Complaint”; specifically, the list is found in the Appendix in the “Amended and Restated Limited Partnership Agreement of Kravco Investments, L.P.” at Exhibit A, page 81, of the agreement.

controlled by Kravco, Inc. (“KINC”) and HRE Kravco II, Inc. (“HRE II”). See **Pltfs. First Amended Compl.** at 12. KINC is a Plaintiff in this action, and is controlled by Plaintiffs. See **Pltfs. First Amended Compl.** at 4, 12. HRE II is a Defendant here, and is controlled by Defendants. See **Pltfs. First Amended Compl.** at 10, 15. So, KI-Kravco, the general partner of KI, is equally controlled by Plaintiffs and Defendants.

There are three limited partners in KI. Powell Schaeffer Associates Limited Partnership (“PSLP”) is controlled by Plaintiffs, and owns a 37.9% limited partnership interest in KI. See **Pltfs. First Amended Compl.** at 4. HRE KI Partners, L.P. (“HRE I”) is controlled by Defendants and owns a 58.9% limited partnership interest in KI. See **Pltfs. First Amended Compl.** at 9. Kravco Company (“KC”), one of the “nominal defendants” in the action, is jointly controlled by Plaintiffs and Defendants, and owns the remaining 3.7% limited partnership interest in KI. See **Pltfs. First Amended Compl.** at 11-12. KC is owned equally by KINC and HRE II. See **Pltfs. First Amended Compl.** at 12.

In April, 2000, Plaintiffs filed a First Amended Complaint, listing one federal question and seven state law causes of action. In the First Prayer for Relief, Plaintiffs invoked this Court’s subject matter jurisdiction pursuant to 28 U.S.C. § 1331, as well as pursuant to §27 of the Securities Exchange Act of 1934, 15 U.S.C. § 75aa, which confers on the district courts exclusive jurisdiction over violations of the Securities Exchange Act of 1934. Then, pursuant to 28 U.S.C. § 1367(a)⁷, the Plaintiffs asked this Court to invoke its supplemental jurisdiction over

⁷ Plaintiffs’ seven state law causes of action are: 1) Fraud in Violation of Pennsylvania Securities Statutes [70 Pa. Stat. Ann. § 1-401, et seq.]; 2) Fraud in the Inducement; 3) Negligent Misrepresentation; 4) Breach of Partnership Disclosure Duties; 5) Breach of Partnership Fiduciary Duties; 6) Breach of Contract; and, 7) Unjust Enrichment. Plaintiffs pray in their

the remaining state law Prayers for Relief.

II. Discussion

Pursuant to Fed.R.Civ.P. 12(b)(6), a court should dismiss a claim for failure to state a cause of action only if it appears to a certainty that no relief could be granted under any set of facts which could be proved. See Hishon v. King & Spalding, 467 U.S. 69, 73, 104 S.Ct. 2229, 2232-33 (1984). Because granting such a motion results in a determination on the merits at an early stage of a plaintiff's case, the district court "must take all the well pleaded allegations as true, construe the complaint in the light most favorable to the plaintiff, and determine whether, under any reasonable reading of the pleadings, the plaintiff may be entitled to relief." Colburn v. Upper Darby Twp., 838 F.2d 663, 664-65 (3d Cir.1988), *cert.denied*, 489 U.S. 1065 (1989).⁸ "In considering a motion under Rule 12(b)(6), 'a court may consider an undisputably authentic document that [Defendants attach] as an exhibit to a motion to dismiss if the [Plaintiffs'] claims are based on the document.'" See Steinhardt Group Inc. v. Citicorp, 126 F.3d 144, 145 (3d Cir. 1997) (quoting Pension Benefit Guaranty Corp. v. White Consolidated Industries, Inc., 998 F.2d 1192, 1196 (3d Cir. 1993)). Defendants have submitted an "Appendix to Memorandum of Law in Support of Defendants' Motion to Dismiss: Agreements Placed at Issue in Plaintiffs' First

Amended Complaint for the Court to exercise supplemental jurisdiction over the state law claims, pursuant to 28 U.S.C. § 1367(a). Since I am dismissing the securities action, and since that is the only basis for this Court's jurisdiction, I decline to exercise this Court's supplemental jurisdiction over these seven state law claims, and will dismiss them for that reason, without reaching the merits of the arguments.

⁸ It must be noted, also, that this Court cannot have diversity jurisdiction under 28 U.S.C. § 1332, because two of the Defendants "reside" in Pennsylvania. See Pltfs. First Amended Compl.; 28 U.S.C. § 1332. Since the Plaintiffs "reside" in Pennsylvania as well, complete diversity is lacking, and jurisdiction under 28 U.S.C. § 1332 cannot lie. See Caterpillar, Inc., v. Lewis, 519 U.S. 61, 68 (1996) (stating long-held requirement of complete diversity).

Amended Complaint” (“Appendix”). The authenticity of the agreements was not disputed by the Plaintiffs, and, therefore, I have relied upon them in my consideration of this matter.

A. Roll-up Limited Partnership Interests

The term “roll-up limited partnership interests” does not appear in the Act. See 15 U.S.C. § 78c(a)(10), *supra* note 5. Plaintiffs argue that said interests fall under the ambit of the Act’s catch-all, which includes, “in general, any instrument[s] commonly known as ‘securit[ies].’” See 15 U.S.C. § 78c(a)(10), *supra* note 5; **Pltfs.’ Mem. of Law in Opposition to Motion to Dismiss** at 13. Plaintiffs cite several cases to support their proposition that “roll-up limited partnership interests are securities.” See **Pltfs.’ Mem. of Law in Opposition to Motion to Dismiss** at 13. Defendants argue that a “roll-up limited partnership” transaction is not necessarily a “security.” See **Defs.’ Reply Mem. of Law** at 7-8. Further, Defendants argue that controlling case law mandates that the transaction be reviewed under the same analysis employed when attempting to determine if an “investment contract” is a “security.” See *Steinhardt Group Inc. v. Citicorp*, 126 F.3d 144, 145 (3d Cir. 1997) (employing the Howey test/“installment contract” analysis to determine that a “highly structured securitization transaction negotiated between Citicorp and an investor in a limited partnership” did not constitute a “security”).⁹

⁹ Plaintiffs disagree that the Howey test should be used; instead, Plaintiffs argue that the controlling case on this point should be Landreth Timber Co. v. Landreth, 471 U.S. 681 (1985). See **Pltfs.’ Mem. of Law in Opposition to Motion to Dismiss** at 11. Plaintiffs argue that if “the instrument is what it purports to be - both from its label and characteristics - that will end the analysis.” **Pltfs.’ Mem. of Law in Opposition to Motion to Dismiss** at 11. Plaintiffs then attempt to synthesize an argument that the transaction at issue here has been labeled a “roll-up limited partnership interest,” and that the S.E.C. and Congress have both explicitly called such an interest a “security.” See **Pltfs.’ Mem. of Law in Opposition to Motion to Dismiss** at 12-14. But the label Plaintiffs utilize is entirely one of its own making, and not indicative of the documents at issue. Nowhere does Plaintiff point to any document which avers that a “security” is at issue, or that the transaction involved is a “roll-up of limited partnership interests.”

I conclude that, in order to determine whether any “roll-up limited partnership interest” is a “security”, I must employ the “investment contract” analysis used by the Third Circuit and further explained below. Because the same analysis applies regardless of the labeling of the transaction, I need not enter into two separate reviews of the matter sub judice, but will, rather, conduct one review of the matter in the following section.

B. Investment Contract

Because “[t]he term investment contract has not been defined by Congress, . . . [t]he interpretation of th[e] term has been left to the judiciary.” Steinhardt, 126 F.3d 150-51. The Supreme Court established a three part test in S.E.C. v. W.J. Howey, 328 U.S. 293, 301 (1946). In order for a transaction to be considered a “security” under the “investment contract” analysis, it is required that there be: (1) “an investment of money,” (2) “in a common enterprise,” (3) “with profits to come solely from the efforts of others.” See Howey, 328 U.S. at 301; Steinhardt, 126 F.3d at 151. To determine whether Plaintiffs were passive investors, it is necessary to “look at the transaction as a whole, considering the arrangements that parties made” with each other. See Steinhardt, 126 F.3d at 153.

While it is clear at this stage of the litigation that steps (1) and (2) are satisfied,

Landreth is readily distinguishable from the case at bar. In Landreth, the transaction at issue involved “stock”, which was not only labeled “stock” but also had characteristics necessary for it to be considered a “stock.” See Landreth, 471 U.S. at 687. Landreth required that, if a court could determine from the “label” and “characteristics” of the instrument at issue that the instrument was what it purported to be, then it was not necessary to engage in a more detailed analysis to see if, in reality, the instrument was a “security.” Landreth simply held that the analysis is short, but it still held that an analysis was required: it must be determined whether the instrument at issue had the “label” and “characteristics” of a “security.” Here, there were no labels attached which could readily lead people to conclude that “securities” were at issue, and no “labels” were attached which could assist the Landreth analysis. Therefore, a more detailed analysis is called for, and the “installment contract” analysis provides a suitable test.

Defendants take particular exception to step (3), arguing that the Plaintiffs have been left with substantial control in the ultimate entity, and that, therefore, no “securities” were involved. See Defs.’ Mem. of Law at 17-18; Defs.’ Reply Mem. of Law at 9-10. To understand the amount of control the Plaintiffs have, it is necessary to review the composition of the final entity, and determine who is participating in the operation of the ultimate “investment” vehicle.

1. Standing of the various Plaintiffs.

Defendants argue that, of all the Plaintiffs listed in the First Amended Complaint, only the Powell Schaeffer Associates Limited Partnership (“PSLP”) can argue a purchase of a “security” because only PSLP actually stated such a claim in the First Amended Complaint. See Defs.’ Mem. of Law at 15-17; Defs.’ Reply Mem. of Law at 6. I will first examine whether PSLP has shown the existence of a “security”, then determine the extent to which the individual, trust and partnership Plaintiffs are bound by their relationship to PSLP.

2. PSLP’s federal securities claim.

“PSLP is the entity into which the individual, trust and partnership plaintiffs first contributed their partnership interests before they were contributed to KI, the roll-up entity jointly owned with defendants.” Pltfs. First Amended Compl. at 4. The sole general partner of PSLP is KINC. See Pltfs. First Amended Compl. at 4. And, as stated previously, KINC is controlled by Plaintiffs and owns a 50% general partnership interest in KI-Kravco, the entity which, as will be shown, controls KI. See Pltfs. First Amended Compl. at 4.

Plaintiffs argue that they do not have the requisite “control” here, and therefore, the entire transaction should be considered a security. Plaintiffs correctly state that step (3) of the Howey test does not require that anticipated profits come “solely” from the efforts of others, but, rather,

the profits need only be generated from the “entrepreneurial or managerial efforts of others.” United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 852 (1975); Lino v. City Investing Co., 487 F.2d 689, 692 (holding “that an investment contract can exist where the investor is required to perform some duties, as long as they are nominal or limited and would have ‘little direct effect upon receipt by the participant of the benefits promised by the promoters’”).

Plaintiffs contend that their participation here is insufficient to make them co-venturers with Defendants, instead asking the Court to find that the Plaintiffs are innocent investors unaware of how the Defendants would act, and unable to protect themselves from Defendants’ nefarious undertakings. An examination of the transaction undercuts Plaintiffs’ claims.

In reviewing the “Amended and Restated Limited Partnership Agreement of Kravco Investments, L.P.” (“Agreement”), it is clear that KI is controlled by its general partner. In particular, the Agreement’s provision for Additional Capital Contributions serves to illustrate the general partner’s control of KI. See Agreement, § 4.2 Additional Capital Contributions, at pg. 4. In this section, it is spelled out how only the general partner can determine and call for additional capital contributions. Since part of the main purpose for the partnership is to “acquire, hold, own, develop, redevelop, construct, improve, [or] maintain” commercial real estate, it is clear that, from time to time, additional capital will be required of the partners. See Agreement, § 2.3 Character of the Business, at page 2. Therefore, because only the general partner has authority to direct such an important dynamic of the partnership, it is clear that the general partner has pervasive control of the partnership. This is important, because of the composition of the general partner.

As state above, KI-Kravco is the general partner of KI. KI-Kravco is equally controlled

by the Plaintiffs and Defendants. There are 6 members of KI-Kravco's Board of Directors. See Amended and Restated General Partnership Agreement of KI-Kravco Associates ("KI-Kravco Agreement") at § 8.1(a), page 12. The Plaintiffs and the Defendants each appoint 3 members of the Board. See KI-Kravco Agreement at § 8.1(a), page 12. Because of the equal split of the Board, both Plaintiffs and Defendants have the ability to block all day-to-day operational and major decisions. See KI-Kravco Agreement at §9.2, pages 14-19. Neither Plaintiffs nor Defendants may primarily control KI.

As in Steinhardt, it is imperative to "look at the transaction as a whole, considering the arrangements the parties made for the operation of the investment vehicle in order to determine who exercised control in generating profits for the vehicle." Steinhardt, 126 F.3d at 153. It is clear, from the contractual arrangements, that Plaintiffs do not expect to realize investment benefits primarily from the efforts of another. Plaintiffs have an active role in the direction and management of KI. Plaintiffs have engaged in a highly sophisticated and structured transaction with the Defendants, and it is clear that one of the main goals of the detailed negotiations was to ensure that both sides were equally vested with the managerial control of KI. Since Plaintiffs have negotiated for, and obtained, more than a passive role in KI, it is clear that step (3) of the Howey test is not satisfied, and the transaction sub judice does not involve a "security."

3. The individual, trust and partnership Plaintiffs.

It is not claimed in the First Amended Complaint that the individual, trust and partnership Plaintiffs have any interest separate and apart from PSLP. The interests of the individual, trust and partnership Plaintiffs are one and the same with PSLP's. Since I have concluded that PSLP has not engaged in a transaction involving a "security," I must also conclude that none of the

individual, trust and partnership Plaintiffs have either. Therefore, the federal securities claim of the individual, trust and partnership Plaintiffs must be dismissed along with PSLP's.

III. Conclusion

Every contract is not a security. Here, where Plaintiffs have entered into a detailed and sophisticated operating agreement with the Defendants, it is impossible to conclude that Plaintiffs were just passive investors subject to Defendants' efforts alone. Plaintiffs are heavily involved in the management, direction and control of KI. Though there may be merit in Plaintiffs' state-law claims against Defendants, those claims sound mainly in contract, and there is no federal dispute extant. The Supreme Court is "satisfied that Congress, in enacting the securities laws, did not intend to provide a broad federal remedy for all fraud." Marine Bank v. Weaver, 455 U.S. 551, 556 (1982). I conclude that Plaintiffs have not stated a federal question under the Act, and therefore, the First Plaintiffs' First Amended Complaint must be dismissed. Additionally, I decline to exercise supplemental jurisdiction over the state law claims, and will dismiss them without prejudice. An appropriate order follows: