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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

WESTERN DIVISION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. CITY OF VICTORVILLE, et al., Defendants,	Case No. 13-cv-0776 JAK (DTBx) **DEFENDANTS CITY OF VICTORVILLE AND SOUTHERN CALIFORNIA LOGISTICS AIRPORT AUTHORITY'S NOTICE OF MOTION AND MOTION TO DISMISS FIRST, SECOND, AND SEVENTH CLAIMS FOR RELIEF, AND TO STRIKE THE PRAYER FOR DISGORGEMENT** Date: September 16, 2013 Time: 8:30 a.m. Judge: Hon. John A. Kronstadt Courtroom: 750

NOTICE OF MOTION

PLEASE TAKE NOTICE that at 8:30 a.m. on Monday, September 16, 2013, before the Honorable John A. Kronstadt, in Courtroom 750-Roybal, 255 E. Temple Street, Los Angeles, California 90012, City of Victorville and Southern California Logistics Airport Authority, by their undersigned attorneys, will and hereby do move to dismiss (1) the First Claim for Relief for Fraud in Connection with the Purchase or Sale of Securities; (2) the Second Claim for Relief for Fraud in the Offer or Sale of Securities; and (3) the Seventh Claim for Relief for Aiding and Abetting Violations of Section 10(b) of the Exchange Act and Rule 10b-5, as alleged in the Complaint ("Complaint") filed by the SEC, pursuant to Federal Rules of Civil Procedure 12(b)(6) on the grounds that the Complaint fails to state a claim for violations of Section 10(b) and Rule 10b-5 and Section 17(a), and fails to state a claim for aiding and abetting such alleged violations. The City also moves to strike the SEC's request for disgorgement of profits under Fed. R. Civ. Proc. 12(f).

This motion is based on this written notice, the accompanying memorandum of points and authorities, the Request for Judicial Notice filed herewith, the Motion to Dismiss concurrently filed by defendant Keith Metzler, the Court's files and records in this proceeding, and on such other evidence and argument as may properly come before the Court at the hearing of this matter.

This motion is made following the conference of counsel pursuant to L.R. 7-3, which took place on June 5, 2013.

Dated: June 12, 2013

ARENT FOX LLP

By: */s/ Terree A. Bowers*
TERREE A. BOWERS
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City of Victorville and Southern California Logistics Airport Authority

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MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION

This case involves four airport hangars (the "Hangars") that were originally appraised at $65 million, but that the county assessor later assessed at $27.7 million. The SEC contends that the Defendants Southern California Logistics Airport Authority (the "Authority") and the City of Victorville (the "City") used an incorrect assessment for the Hangars in the Official Statement of an April 2008 bond offering.

The SEC's theory of securities fraud against the Authority and the City may make for flashy news headlines, but when measured against the law—indeed, when measured against the SEC's own standards—it falls far short of a cognizable claim. The amount at issue is far too small to be material and the difference in the assessments for the Hangars does not change the more important debt service ratio, upon which an investor might rely. The SEC claims that the Authority's misstatements were made in the context of what the SEC calls an "ill-conceived" (Compl. ¶¶ 3, 38) attempt to redevelop an area of California financially devastated 20 years ago by the closure of a former Air Force base. To the contrary, the Authority's redevelopment project supports a legislative mandate to restore financial sustainability to the High Desert area of California after years of economic difficulty. To this day, the success of the Authority's redevelopment efforts remains the High Desert's primary hope for future economic health and fiscal solvency.

The SEC alleges that the Authority used an inflated estimate of value for the Hangars, then used that allegedly inflated estimate to mislead investors by overestimating the amount of "tax increment" revenue available as security for the outstanding bonds. According to the SEC, the Hangars were overvalued by $37.3 million.

Fatally, the SEC's analysis stops there. Had the SEC completed its analysis,

even assuming its allegations were true, the alleged $37.3 million inflated value ultimately boils down to only a $200,000 differential in tax increment, less than 1% of the $22.6 million tax increment used as security for the bonds. The <1% is established two ways: 1) the tax increment of the Authority was less than 1% of the estimated property values of the Authority; and 2) in this case, the Authority's individual tax increment was only part of a much bigger "pool" of aggregated tax increments received from many areas, including the City, the Authority, the County of San Bernardino, and other nearby municipalities.

The SEC's Complaint ignores this crucial, comprehensive analysis. Irrespective of whether the Hangars were worth $27.7 million or $65 million, the eventual pooled tax increment still represents more than 125% of security for the total bonds outstanding—a benchmark hailed by the SEC itself as the legal threshold for determining materiality. As a result, the SEC alleges no "material" misstatement, even under its own definition of materiality.

The SEC blames the City for the alleged "misstatement" and contends that Defendant Keith C. Metzler ("Metzler"), a City employee, assisted the Authority in using the inflated value of the Hangars. The City is thus implicated only through Metzler. But, as argued by Metzler in his concurrently filed motion to dismiss, which is joined and incorporated by reference herein, the SEC cannot state a claim against him. If Metzler is not liable, neither is the City. Furthermore, because the Authority is not liable for a material misstatement in the first instance, Metzler and the City cannot be liable for aiding and abetting.

For the reasons articulated below, the City and the Authority respectfully request that the Court dismiss the SEC's First, Second, and Seventh Claims for Relief, without leave to amend.

II. SUMMARY OF ARGUMENT

Unlike a typical securities fraud action, where the alleged misstatement is on the face of the public disclosure, here, the Hangars' allegedly inflated value of $65

million is nowhere disclosed in the Official Statement. Rather, the $65 million was one assumption among many that eventually resulted in a 1.25 debt service ratio, which was publicly disclosed. The SEC mistakenly focuses on the undisclosed $65 million because it is a big number; instead, reasonable investors focused—as should the Court—on the publicly disclosed number, 1.25, and whether the Authority's alleged misstatement materially change that number; it does not. The allegedly correct Hangar value of $27.7 million—instead of $65 million—does not materially change the disclosed 1.25 ratio, as the publicly disclosed numbers show.

Therefore, this case is about math. From a bird's-eye view, the Authority disclosed that it would receive tax increment payments of $22.6 million, whereas the SEC asserts those payments would total $22.4 million. Under either scenario, the debt service ratio remains above 1.25—the benchmark that the SEC argues is "material" to the reasonable investor. Visually, the argument can be presented as follows:

Total Tax Increment		Debt Service Ratio
~~22,606,356~~		~~1.26~~
22,401,537	=	**1.25669**
÷		
Total Debt Outstanding		
17,825,734		

Thus, even assuming the truth of the SEC's allegations in the Complaint, no reasonable investor would consider the Authority's alleged "misstatement" to be material, and the SEC therefore fails to state a cause of action that survives a motion to dismiss. The facts and argument that follow "show the math" and provide the detail that supports this argument.

III. BACKGROUND AND RELEVANT FACTUAL ALLEGATIONS

Victor Valley Economic Development Authority and Project Area. On January 5, 1989, the Secretary of Defense announced the planned closure of former

George Air Force Base—now known as the Southern California Logistics Airport ("Airport")—pursuant to the Base Closure and Realignment Act. *See* Request for Judicial Notice ("RJN") Ex. 1 at 10, 98; Compl. at ¶ 20. Concerned about the potential negative economic implications of the closure, elected officials of the surrounding area established a joint powers authority, the Victor Valley Economic Development Authority ("VVEDA"), to set in motion a joint reuse planning effort. RJN Ex. 1 at 98; Compl. at ¶¶ 20-21.

After the enactment of special legislation—the amendment of the California Community Redevelopment Law (Health and Safety Code Section 33000 *et seq.*)—to address the immense financial impact of the base closure to the surrounding area, VVEDA was granted special authority to secure a redevelopment project for the properties within or near the Airport. RJN Ex. 1 at 98. The redevelopment project area ("Project Area") includes the Airport and certain surrounding areas. *Id.* at 10; Compl. ¶ 21.

Since 1993, the VVEDA Project Area has grown to include the Airport and surrounding land, totaling approximately 85,128 acres. RJN Ex. 1 at 11. The land of the Project Area originates from the various members of VVEDA, which include the City, the County of San Bernardino, the Cities of Hesperia and Adelanto, and the Town of Apple Valley (collectively, "VVEDA Members"). *Id.* at 10.

The Authority. In 1997, VVEDA authorized the formation of the Southern California International Airport Authority, whose name was eventually changed to the Authority. RJN Ex. 1 at 10-11. The Authority is governed by a five-member commission, consisting of all members of the Victorville city council. Compl. ¶ 13. The City Manager serves as the Authority's Executive Director. *Id.* Although Metzler, as the City's Director of Economic Development, worked with the Authority's Executive Director during the relevant time, Metzler was never employed by the Authority. Compl. ¶¶ 18, 82.

VVEDA delegated its redevelopment authority with respect to the Airport to

the Authority. RJN Ex. 1 at 11; Compl. ¶ 21. As part of its charter to redevelop the Project Area, the Authority embarked on a number of specific projects, including constructing a power plant, developing an inter-modal rail facility, and constructing the Hangars to support the Airport. Compl. ¶ 38. To raise funds for these projects, the Authority was empowered to issue bonds secured by tax increment revenues generated by the VVEDA Members in the VVEDA Project Area. RJN Ex. 1 at 11; Compl. ¶ 23.

Tax Increment Financing. Pursuant to California redevelopment law, redevelopment agencies may finance their projects by securing bonds with a pledged "incremental" increase in property tax revenues. RJN Ex. 1 at 11; Compl. ¶ 24. The Authority's total tax increment available to pledge is calculated first by (1) aggregating the assessed value of property in the Authority as improved; and (2) deducting from that the Authority's portion of VVEDA's "base-year" value before bond-funded improvements. Compl. ¶¶ 24-26. Then, the Authority's tax increment is typically estimated to be 1% of the remaining incremental assessed value, less certain deductions. RJN Ex. 1 at 103, 134; Compl. ¶ 26. Visually:

$$\left(\begin{array}{c}\text{Assessed Value}\\ \text{of Property}\end{array}\right) - \left(\begin{array}{c}\text{Base Year}\\ \text{Value}\end{array}\right) \times 1\% - \left(\begin{array}{c}\text{Certain}\\ \text{Deductions}\end{array}\right) = \begin{array}{c}\text{Tax Increment}\\ \text{Available to Pledge}\end{array}$$

That the Authority's tax increment available to pledge is less than 1% of the Authority's assessed property value is important because, as will be shown below, even if a property value within the Authority is misstated (such as the alleged $65 million Hangar value), the resulting misstated tax increment available to pledge is necessarily less than 1% of the misstated property value.

Also significant, as the SEC explains, is the fact that a redevelopment agency (such as the Authority) does not typically pledge tax increment to repay a specific bond issuance. Compl. at ¶ 27. "Instead, the aggregate amount of the tax increment in a project area is often 'pooled' and pledged to repay all of the

associated tax increment bonds issued by the agency." *Id.* (emphasis added). Thus, as will be shown below, the Authority pledges the total pooled amount of tax increment from all VVEDA Members as security for its bond obligations, not just the Authority's own, individual tax increment. *See, e.g.*, RJN Ex. 1 at 132-140 (Exhibit 10A to RJN Ex. 1 shows the "Total Pledge Revenue" for the April 2008 Bond Offering, which is the total pooled amount of the individual VVEDA Members' tax increments, as broken down in Exhibits 10B-10I).

The Authority's individual contribution of tax increment is but a small fraction of the total pooled amount from all VVEDA Members; indeed, for the relevant time period, the Authority's individual contribution of tax increment was stated as $3.9 million, (RJN Ex. 1 at 134, Exhibit 10C) whereas the total pooled amount from all VVEDA Members was stated as $22.6 million (RJN Ex. 1 at 132, Exhibit 10A). The Authority's individual tax increment contribution therefore made up only 17.6% of the total pooled tax increment amount from all VVEDA Members. As discussed further below, this is important because the alleged misstatement regarding the $65 million Hangar value will be shown to affect only the Authority's individual tax increment contribution, a small piece of a much bigger pie.

The Debt Service Ratio. The debt service ratio is simply the total, pooled tax increment pledged for a given year (as discussed above) over the total debt owed on all outstanding bonds. Compl. ¶ 28. Visually:

$$\left(\begin{array}{c}\text{Total Tax}\\ \text{Increment}\\ \div\\ \text{Total Debt}\\ \text{Outstanding}\end{array}\right) = \text{Debt Service Ratio}$$

As alleged in the Complaint, the debt service ratio of 1.25 for a given year means that the tax increment of that year is 125% of the total debt owed on all outstanding bonds, or that the tax increment has a 25% "cushion" above the debt owed. *Id.*

The Authority's Pre-April 2008 Efforts to Obtain Financing. To finance the construction of the power plant, the inter-modal rail facility, and the Hangars at the Airport, the Authority first issued bonds in 2005 and 2006, and once again in December 2007 ("December 2007 Offering"). Compl. ¶¶ 39-40. Pursuant to the "additional bonds" covenant under the governing indenture of the December 2007 Offering, the Authority agreed that for future tax increment bond issuances, the annual debt service ratio for each year the bonds were outstanding would be at least 1.25. *Id.* ¶ 44. A fiscal consultant ("Fiscal Consultant") to the Authority prepared a fiscal report ("2007 Report") for the December 2007 Offering that showed the total tax increment available to pledge as security for the bonds of the VVEDA Project Area. Compl. ¶ 42.

In February 2008, to raise additional financing, the Authority borrowed $35 million in a private placement offering to a commercial bank. Compl. ¶¶ 45-48. One condition of this placement was that the Authority enter into an agreement obligating it to offer additional tax increment bonds, at the time of the bank's choosing, to repay all or part of the bank's $35 million investment. *Id.* ¶ 48.

Tax Increment Disclosure in the April 2008 Offering (the Subject of the Complaint). In April 2008, the bank exercised its option to require the Authority to issue public bonds to repay part of the $35 million from the private placement. Compl. ¶ 62. The Official Statement accompanying the April 2008 Offering, and the disclosures therein, form the basis of this action. Compl. ¶¶ 72-79. Attached as Appendix D to the Official Statement was the Fiscal Consultant's 2007 Report, amended with an April 2008 Supplement (collectively, the "April 2008 Report"), which included updated information regarding growth in the Project Area that had occurred since the December 2007 Offering. Compl. ¶ 64; RJN Ex. 1 at 94-140. Understanding the following aspects of the April 2008 Report is crucial to understanding the SEC's materiality allegations in this case.

"Exhibit 10A" of the April 2008 Report. First, Exhibit 10A of the April 2008 Report shows the total, pooled amount of tax increment available to the Authority to pledge for the April 2008 Offering, as $22,606,358. RJN Ex. 1 at 132. The most important columns of Exhibit 10A are the four columns on the right, as represented below:

Net Revenue to Victorville	Non-Housing Revenue to SCLA	Revenue at Risk Due to Appeals	Total Pledge Revenue (Victorville + SCLA)
8,083,270	14,873,761	(350,674)	22,606,358

Here, the "Total Pledge Revenue" of $22.6 million is derived by adding the amount of tax increment available to Victorville ($8.08 million) with the amount of tax increment available to the Authority ($14.87 million), less an estimated amount at risk by certain pending tax appeals ($350 thousand). RJN Ex. 1 at 132. Specifically, the "Non-Housing Revenue to SCLA" value of $14,873,761 represents the sum of each VVEDA Member's individual tax increment contribution, which is broken out in Exhibits 10B-10I. *See* RJN Ex. 1 at 133-140. Thus:

VVEDA Member	Net Tax Increment to Authority
Victorville Area (Exhibit 10B)	$8,074,665
Authority (Exhibit 10C)	$3,994,164
San Bernardino County (Exhibit 10D)	$530,206
Apple Valley (Exhibit 10E)	$1,616,969
Hesperia (Exhibit 10F)	$439,480
Adelante Amendment IV (Exhibit G)	$166,611
San Bernardino County Amendment IV (Exhibit 10H)	$43,061

Victorville Amendment IV (Exhibit 10I)	$8,604
Total Tax Increment to Authority:	**$14,873,760**

Of the tax increment contributions of each individual VVEDA Member, the pertinent tax increment contribution for this case is the Authority's contribution of $3,994,164, whose data is found on "Exhibit 10C." *Id.* at 134.

Exhibit 10C of the April 2008 Report. Exhibit 10C shows that for 2007-08, the Authority's total tax increment that it can contribute is $3,994,164. RJN Ex. 1 at 134. The pertinent columns of this chart are represented below:

Total Secured & Unsecured Property Values	Increased Value Due to New Development	Total Assessed Value	Incremental Assessed Value	Gross Tax Increment 1%	Certain Deductions (20%) + (25.0885%)	Net Revenue to Authority
623,927,033	111,309,322	735,236,355	727,382,055	7,273,821	(1,454,764) + (1,824,893)	3,994,164

Here, the total assessed value of $735,236,355 is the result of adding $111,309,322 of new value to the Authority area's total secured and unsecured property values for the year. *See* RJN Ex. 1 at 134. The Incremental Assessed Value is the Total Assessed Value, less the base year value ($7,854,300). *Id.*

The $111.3 million increase was "due to new development" that was not accounted for in the December 2007 Offering. RJN Ex. 1 at 131. The new development was primarily at the Airport, and included, importantly, the construction and expected income from the Hangars. Compl. ¶ 66. As alleged by the SEC, $65 million of the $111.3 million was attributed specifically to the value of the Hangars. *Id.* The heart of the SEC's fraud allegations revolve around this $111.3 million amount, but, as will be shown below, even if this amount is reduced, as the SEC claims it should have been, the ultimate difference in tax increment would have been immaterial to any reasonable investor.

Given the Authority's total assessed value of $735,236,355, Exhibit 10C

shows the breakdown of the tax increment available to pledge. Recalling the formula from page 4:

(Total Assessed Value of Property **($735,236,355)**) - (Base Year Value **($7,854,300)**) x 1% - (Certain Deductions **($1,454,764)** + **($1,824,893)**) = Tax Increment Available to Pledge to Authority **($3,994,164)**

Thus, the Authority area's individual total assessed value for 2007-08 was $735 million, which translated to $3.99 million of tax increment to be pledged. RJN Ex. 1 at 134. As shown above, when this $3.99 million is added to the individual tax increments to be pledged by all the other VVEDA members, the ultimate total pooled amount of tax increment is $22.6 million, the amount that would be pledged by the Authority as security to cover its bond obligations. RJN Ex. 1 at 132.

Debt Service Ratio Disclosure in the April 2008 Offering. Using the $22.6 million tax increment value provided by the Fiscal Consultant, the Authority then disclosed the all-important debt service ratio in the "Debt Service Schedule" on page 24 of the Official Statement. RJN Ex. 1 at 32-33; Compl. ¶ 72. As with Exhibit 10A and Exhibit 10C of the April 2008 Report, the Debt Service Schedule is crucial to understanding the materiality issue in this case. Compl. ¶¶ 76-78.

The pertinent columns of the Debt Service Schedule are represented below:

Fiscal Year	Total Non-Housing Increment	Total Existing Bonds and Bonds Debt Service	All-In Coverage Growth	All-In Coverage No Growth
2008	$22,606,356	$17,825,734	1.26	1.26
2009	23,793,899	18,082,153	1.32	1.25
2010	24,882,880	18,083,310	1.38	1.25

The Debt Service Schedule shows that for 2008, the "Total Non-Housing Increment" is $22,606,356—the same $22.6 million that was derived from Exhibit

10A of the April 2008 Report, the total pooled tax increment available to pledge by the VVEDA Members. RJN Ex. 1 at 33; Compl. ¶ 73. Also shown is the total debt owed on all outstanding bonds, which for 2008 is $17,825,734, but for every year thereafter is approximately $18,081,000. RJN Ex. 1 at 33. The "All-In Coverage" is the debt service ratio; recalling the formula above:

$$\left(\begin{array}{c}\text{Total}\\ \text{Tax Increment}\\ \textbf{(22,606,356)}\\ \div\\ \text{Total Debt}\\ \text{Outstanding}\\ \textbf{(17,825,734)}\end{array}\right) = \begin{array}{c}\text{Debt Service Ratio}\\ \textbf{1.26}\end{array}$$

The difference between the debt service ratio in the final two columns is "Growth" vs. "No Growth." RJN Ex. 1 at 33. As clearly stated in the Debt Service Schedule, the Growth column assumes that the tax increment will increase due to:

> "5% value of High-Desert power plant and maximum cashflow impact of all pending appeals and lawsuits, plus increased assessed value due to sales from January 2007 to August 2007 and new development from January 2007 to December 2007." RJN Ex. 1 at 33.

Accordingly, each year the tax increment is shown to increase, assuming this growth stipulated by the Fiscal Consultant. RJN Ex. 1 at 33. For example, the estimated tax increment for 2009 ($23.7 million) is approximately 5% greater than that of 2008. *Id.*

The reasons for this assumed growth are set forth in detail in the Fiscal Consultant's April 2008 Report. RJN Ex. 1 at 100-121; 131-132. Because the estimated tax increment grows while the total debt owed on outstanding bonds remains fairly constant, the debt service ratio continues to grow as well. Thus,

assuming growth, the debt service ratio only goes up, beyond 1.26 after 2008. *Id.* at 33.

The No Growth column, on the other hand, assumes no estimated tax increment growth, despite the assumptions and reasons given by the fiscal consultant. RJN Ex. 1 at 33. Thus, only under the assumption that the total tax increment does not grow from year to year does the debt service ratio drop from 1.26 to 1.25 after 2008 and remain at 1.25 every year thereafter. *Id.* It is only as to this No Growth column, despite the Fiscal Consultant's assumptions to the contrary, that the SEC alleges the Authority made a misstatement. Compl. ¶ 72.

The SEC's Allegations. As referenced above, the SEC alleges that the $111.3 million of new value added to the Authority area in 2007, as reported in Exhibit 10C, is inflated. Compl. ¶ 66. The reason it is inflated, claims the SEC, is because $65 million of that $111.3 million is attributed to an inflated estimated value of the Hangars of the Airport. *Id.* The SEC alleges that in reality, the true value of the Hangars was $27.7 million in 2007-2008 and $27.9 million in 2008-2009; values allegedly known to Metzler at the time of the April 2008 Offering. Compl. ¶¶ 69-70.

Thus, according to the SEC, "[t]he minimum 1.25 annual debt service ratio for the April 2008 Bond offering was only achieved because the approximate $111.3 million valuation of the new development at the Airport included the inflated $65 million valuation of the four Hangars." Compl. ¶ 71. Presumably, the SEC believes that, had the alleged "true value" of either $27.7 million or $27.9 million been used instead of the "false" $65 million, the debt service ratio would not have been reached. *Id.*

The SEC is wrong. As demonstrated below, even if the $27.7 million value were used instead of $65 million, the minimum 1.25 debt service ratio would have still been met, and the difference in expected tax increment would not have materially mattered to any reasonable investor.

IV. LEGAL STANDARD

On a motion under Rule 12(b)(6) for failure to state a claim, dismissal is appropriate when the complaint fails to give the defendant fair notice of a legally cognizable claim and the grounds on which it rests. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007). A complaint must state a "plausible" claim for relief, requiring a reviewing court to "draw on its judicial experience and common sense" to determine whether the plausibility standard has been reached. *Ashcroft v. Iqbal*, 556 U.S. 662, 679 (2009). Although the court is to take all material allegations as true and construe them in the light most favorable to the plaintiff, "[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements," are not taken as true. *Id.* at 678 (citing *Twombly*, 550 U.S. at 555).

Section 17(a) of the 1933 Securities Act, Section 10(b) of the 1934 Exchange Act, and Rule 10b-5 require the SEC to specify facts showing that the defendant made "(1) a material misstatement or omission (2) in connection with the offer or sale of a security (3) by means of interstate commerce…Section 10(b) and Rule 10b-5 require scienter….Violations of Section[ ] 17(a)(2)…require[s] a showing of negligence." *SEC v. Phan*, 500 F.3d 895, 907-08 (9th Cir. 2007) (quoting *SEC v. Dain Rauscher, Inc.*, 254 F.3d 852, 856 (9th Cir. 2001)). As the Supreme Court recently emphasized, no relief is available under Section 10(b) beyond the "narrow dimensions" of the claim's rigorous and demanding elements. *See Stoneridge Inv. Partners , LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 167 (2008).

Because claims alleging violation of Section 17(a) and Section 10(b)/Rule 10b-5 "sound in fraud" they are subject to the heightened pleading requirements of Federal Rule of Civil Procedure 9(b). *In re Stac Elecs. Sec. Litig.*, 89 F.3d 1399, 1403-04 (9th Cir. 1996). Rule 9(b) mandates that "[i]n alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake." The allegations "must include statements regarding the time, place, and *nature* of the alleged fraudulent activities … [M]ere conclusory allegations of fraud are

insufficient." *In re GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541, 1548 (9th Cir. 1994) (*en banc*).

V. ARGUMENT

A. The SEC Cannot State a Claim for Fraud Against the Authority.

1. The Authority's Alleged Misstatement Was Not Material.

To state a claim for fraud under Section 10b/Rule 10b-5 and Section 17(a)(2), the SEC must allege facts showing that the Authority's misstatement was "material." *Phan*, 500 F.3d at 907-08; *Dain Rauscher*, 254 F.3d at 856. "[A] misrepresentation … is material if there is a substantial likelihood that a reasonable investor would have acted differently if the misrepresentation had not been made or the truth had been disclosed." *Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 946 (9th Cir. 2005).

While the SEC is not required to plead that investors relied on a misrepresentation, it must "allege that a *reasonable investor* would consider the fact important in making an investment decision." *S.E.C. v. Trabulse*, 526 F. Supp. 2d 1001, 1005-06 (N.D. Cal. 2007) (emphasis in the original). Materiality "will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." *Basic, Inc. v. Levinson*, 485 U.S. 224, 238 (1988).

The SEC alleges that the key standard for determining materiality in this action is the 1.25 minimum debt service ratio, as represented in the Debt Service Schedule in the April 2008 Official Statement. Compl. at ¶¶ 41-44, 64, 71-78, 123, and 127. The debt service ratio, as it is commonly understood by the SEC and investors, represents the total tax increment (i.e., tax funds) available to pledge against a bond offering, compared to the total outstanding obligations on bonds that are issued. To illustrate what a 1.25 minimum debt service ratio represents, assume that bonds totaling $100,000 have been issued. If there are tax funds totaling $125,000 available to cover the bonds, the debt service ratio would be 1.25.

Here, it can (and will) be shown that even assuming the truth of all of the SEC's allegations, the bonds issued by the Authority would have still been protected by a 1.25 debt service ratio. Therefore, the SEC cannot coherently maintain that the alleged misstatement was material under its own defined standard.

2. Even Assuming the Truth of the SEC's Allegations, the Debt Service Ratio Remains above 1.25

As set forth above, the SEC contends that the true value of the Airport Hangars in 2007-08 was $27.7 million, not $65 million. Compl. ¶ 70. Stopping there in the analysis, the SEC apparently thinks that the $37.3 million difference is alone material. What the SEC fails to consider, however, is the fact that the expected tax increment is less than 1% of the total values. After running the math set forth above, it is clear that that the alleged misstatement amounts to only about $200,000 difference in tax increment—not enough to dip below the debt service ratio of 1.25, and not enough to be material to a reasonable investor. Consider the following:

First, the SEC alleges that $65 million of the $111,309,322 million of increased value due to Airport development is attributable to the allegedly inflated Airport Hangars. If the $65 million is substituted for what the SEC claims is the correct value, $27.7 million, then the $111,309,322 amount should be reduced by $37.3 million (65,000,000 - 27,700,000), resulting in $74,009,322 (111,309,322 - 37,300,000). When the $74 million amount is inserted into the chart from page 9, the following results:

Total Secured & Unsecured Property Values	Increased Value Due to New Development	Total Assessed Value	Incremental Assessed Value	Gross Tax Increment 1%	Certain Deductions (20%) + (25.0885%)	Net Revenue to Authority
623,927,033	~~111,309,322~~ **74,009,322**	735,236,355	727,382,055	7,273,821	(1,454,764) + (1,824,893)	3,994,164

When the rest of the numbers in the chart are updated to reflect the $74

million assumed by the SEC, the result is as follows:

Total Secured & Unsecured Property Values	Increased Value Due to New Development	Total Assessed Value	Incremental Assessed Value	Gross Tax Increment 1%	Certain Deductions (20%) + (25.0885%)	Net Revenue to Authority
623,927,033	~~111,309,322~~ **74,009,322**	~~735,236,355~~ **697,936,355**	~~727,382,055~~ **690,082,055**	~~7,273,821~~ **6,900,821**	(~~1,454,764~~) **(1,380,164)** + (~~1,824,893~~) **(1,731,312)**	~~3,994,164~~ **3,789,345**

As can be seen above, assuming that the Hangars were worth only $27.7 million instead of $65 million, they still would have contributed to a total of $74,009,322 new development growth, which still would have resulted in $3,789,345 net incremental tax to the Authority instead of $3,994,164—a difference of only $204,819.

This fractional difference is dwarfed further when one considers that it is only the difference attributable to the individual contribution of the Authority. When it is added, or "pooled," with the individual contributions of the other VVEDA Members, its insignificance on the total tax increment available to pledge is clear. Below, the chart from pages 8-9 is updated to insert the $3,789,345 calculated from the Complaint in place of $3,994,164:

VVEDA Member	Net Tax Increment to Authority
Victorville Area (Exhibit 10B)	$8,074,665
Authority (Exhibit 10C)	~~$3,994,164~~ **$3,789,345**
San Bernardino County (Exhibit 10D)	$530,206
Apple Valley (Exhibit 10E)	$1,616,969
Hesperia (Exhibit 10F)	$439,480

Adelante Amendment IV (Exhibit G)	$166,611
San Bernardino County Amendment IV (Exhibit 10H)	$43,061
Victorville Amendment IV (Exhibit 10I)	$8,604
Total Tax Increment to Authority:	**$~~14,873,760~~** **$14,668,941**

When the updated $14,668,941 amount is then added to the chart in Exhibit 10A, the resulting pledge revenue is re-calculated as set forth below:

Net Revenue to Victorville	Non-Housing Revenue to SCLA	Revenue at Risk Due to Appeals	Total Pledge Revenue (Victorville + SCLA)
8,083,270	~~14,873,761~~ **$14,668,941**	(350,674)	~~22,606,358~~ **$22,401,537**

Thus, instead of being able to pledge $22.6 million, the SEC is alleging that the Authority should have disclosed an ability to pledge $22.4 million—a difference of less than 1%. And when the correct $22.4 million amount is applied to the debt service ratio, which the SEC alleges is the factual basis for its allegation of materiality in this action, the result is:

Total Tax Increment		Debt Service Ratio
~~22,606,356~~ **22,401,537** ÷ Total Debt Outstanding 17,825,734	=	~~1.26~~ **1.25669**

Not only is the debt service ratio still above 1.25, it is well above 1.25. This is fatal to the SEC's claim: even if the SEC is correct in alleging that the Hangars' value was $27.7 million instead of $65 million, the all-important debt service ratio

remains well above 1.25. The $200,000 difference in expected tax increment, calculated from the Complaint's allegations, would not be material to any reasonable investor even by the SEC's own standard of materiality.

3. The SEC Has Not Alleged That a Reasonable Investor Would Expect a No-Growth Scenario.

Assuming that the SEC's allegations are correct—as this Court must do on a motion to dismiss—the debt service ratio remains above the SEC's materiality standard of 1.25 for the projected year 2008. Accordingly, the debt service ratio also would remain above 1.25 for every year after 2008, assuming the approximately 5% growth rates[1] estimated by the Fiscal Consultant. Recall a portion of the Debt Service Schedule from page 10:

Fiscal Year	Total Non-Housing Increment	Total Existing Bonds and Bonds Debt Service	All-In Coverage Growth
2008	~~$22,606,356~~ **$22,401,537**	$17,825,734	~~1.26~~ **1.25669**
2009	~~23,793,899~~ **23,578,321**	18,082,153	~~1.32~~ **1.3**
2010	~~24,882,880~~ **24,657,436**	18,083,310	~~1.38~~ **1.36**

Indeed, for every year shown on the Debt Service Schedule, the debt service ratio progressively increases each year, assuming growth. RJN Ex. 1 at 33.

The only way the SEC could maintain that the allegedly correct $22.4 million tax increment causes the debt service ratio to fall below 1.25 after 2008 is if it assumes a "No-Growth" scenario, meaning the VVEDA Members would not

[1] Technically, the difference in growth between the Fiscal Consultant's 2008-09 year is 5.25% and 4.57% for 2009-10.

experience any growth for the years after 2008. Even the SEC recognizes that a no-growth scenario is unreasonable and absurd, for no contrary position is asserted in the Complaint. Nowhere in the Complaint does the SEC allege that a reasonable investor would rely only on a no-growth assumption. The SEC deliberately chose not to allege an exclusive no-growth assumption because it strains credulity: no reasonable investor would only assume that the VVEDA Members would experience no growth after 2008.

Nor does the SEC allege that a no-growth assumption was required to be disclosed by the covenant in the indenture that calls for the 1.25 minimum. Nor does the SEC allege that the Fiscal Consultant's approximate 5% growth assumption was unreasonable or false at the time, or that a reasonable investor would have any reason not to rely on it.

In short, the SEC has failed for good reason to allege any of these improbable scenarios. Without them, the SEC must agree that, even if the value of the Airport Hangars were $37.3 million less than disclosed, that difference resulted in a negligible tax increment difference ($200,000), and non-material change in the debt service ratio (< 1%). But in the SEC's case against the Authority, the City, and Metzler, the materiality of the debt service ratio is the foundation; without it, the case collapses.

B. The SEC Cannot State a Claim of Aiding and Abetting Against the City.

1. The SEC Does Not Satisfy the Pleading Requirements of Any Element of Aiding and Abetting.

The SEC does not allege that the City violated Section 10(b) or Rule 10b-5. Instead, its only claim for relief against the City is for aiding and abetting the Authority's alleged violation of Section 10(b) and Rule 10b-5. The elements of aiding and abetting a violation of Section 10(b)/Rule 10b-5 are: (1) the existence of an independent primary violation; (2) actual knowledge by the alleged aider and

abettor of the primary violation and of his or her own role in furthering it; (3) "substantial assistance" by the defendant in the commission of the primary violation. *S.E.C. v. Fehn*, 97 F.3d 1276, 1288 (9th Cir. 1996); *see also Ponce v. S.E.C.*, 345 F.3d 722, 737 (9th Cir. 2003).

These elements must be pled with particularity, under the heightened pleading standard of Fed. R. Civ. P. 9(b): "[i]t is well established that claims brought under Rule 10b-5 and Section 10(b) must meet the particularity requirements of Fed.R.Civ.P. 9(b)." *Stac*, 89 F.3d at 1404 (citing *Wool v. Tandem Computers, Inc.,* 818 F.2d 1433, 1439 (9th Cir. 1987)). "This means that substantial assistance must be pleaded with particularity. . . ." *Allstate Ins. Co. v. Countrywide Fin. Corp.*, 824 F. Supp. 2d 1164, 1188 (C.D. Cal. 2011). "Actual knowledge, which may be pleaded generally, is still subject to the requirement that claimants state 'factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.'" *Id.*; *see Iqbal*, 556 U.S. at 678.

2. The SEC Cannot Allege the Existence of a Primary Violation.

The first element of a Section 10(b) or Rule 10b-5 aiding and abetting claim is "the existence of an independent primary violation." *Fehn*, 97 F.3d at 1288; *see also Ponce*, 345 F.3d at 737. It is axiomatic that "[t]here can be no liability for aiding and abetting without a primary violation." *S.E.C. v. Daifotis*, 874 F. Supp. 2d 870, 887 (N.D. Cal. 2012).

Here, the SEC assumes that the primary violation is the Authority's alleged misstatements in the Official Statement regarding the tax increment and the debt service ratio. *See, e.g.*, Compl. ¶ 153. But, for the reasons set forth above, the SEC cannot state a claim against the Authority because it has not alleged that the Authority's alleged misstatements were material. Thus, because the SEC cannot allege that the Authority committed a "primary violation," the entirety of the SEC's

aiding and abetting claim against the City must also fail. *See Fehn*, 97 F.3d at 1288.

3. The SEC Does Not Allege How the City Substantially Assisted the Authority.

The SEC's claim against the City also fails because it does not—and cannot—allege with particularity how the City provided "substantial assistance" to the Authority. "Where aiding and abetting is the gravamen of the claim, Rule 9(b) requires that the complaint … inform [the] defendant … what he did that constituted … 'substantial assistance.'" *Neilson v. Union Bank of California, N.A.*, 290 F. Supp. 2d 1101, 1131 (C.D. Cal. 2003).

Of all the Complaint's 167 paragraphs, the City's alleged role in assisting the Authority gets only two passing, conclusory references: first, that "Metzler and his employer, the City, substantially assisted in the making of the misstatements and omissions…" (Compl. at ¶ 83); and second, that the "Defendant[ ] City … knowingly provided substantial assistance to the Authority… .(Compl. ¶ 154). In neither case does the SEC even attempt to identify what specific actions the City took that allegedly provided substantial assistance to the primary violation, falling far short of the particularity standards of Fed. R. Civ. P. 9(b).

Apparently, the SEC hopes to pin its theory of liability against the City *entirely* on Metzler, assuming that if Metzler, as the City's employee, provided substantial assistance to the Authority, then the City did as well. That Metzler is the only means by which the City is alleged to have provided assistance to the Authority is clear on the face of the Complaint: no allegations regarding the City, other than those involving Metzler (Compl. ¶¶ 83 and 154) suggest that the City provided any assistance to the Authority. If Metzler's employment by the City is not the SEC's theory behind the City's liability, the SEC does not clearly allege this, and for that reason alone, the SEC's claim should fail.

But even more problematic for the SEC is the fact that, for the reasons set

forth in Metzler's Motion to Dismiss, joined and incorporated here, the SEC has not and cannot allege with any particularity how Metzler supposedly provided substantial assistance to the Authority in its "violation." Because the SEC fails to sufficiently allege that Metzler provided substantial assistance to the Authority—and because Metzler is apparently the *only* way by which the City could have provided assistance to the Authority—the claims against Metzler and the City fall together.

4. The SEC Cannot Allege That the City Had Actual Knowledge of the Authority's Alleged Misstatements.

An aiding and abetting claim requires "actual knowledge by the [City] of the primary violation and of [its] own role in furthering it." *Fehn*, 97 F.3d at 1288. As with the substantial assistance prong above, the SEC hopes to pin the City's liability entirely on Metzler's alleged "actual knowledge." *See* Compl. at ¶ 84 (claiming that because Metzler "was an employee of the City, and reported to the City Manager, the City had actual knowledge of, or was reckless in not knowing, the falsity and misleading nature of these misstatements."). No one associated with the City, other than Metzler, is alleged to have the necessary scienter on behalf of the City, and the City *itself* cannot have scienter without the knowledge of a natural person. *See Daifotis*, 874 F. Supp. 2d at 886 ("[A] corporation can only act through its agents, so the corporation itself, cannot have scienter."). Thus, as with the substantial assistance prong, the Complaint's claim for relief against the City depends entirely on Metzler.

As before, for the reasons set forth in Metzler's Motion to Dismiss, joined and incorporated here, the SEC has not and cannot allege with any particularity how Metzler allegedly had the requisite, actual knowledge of the Authority's alleged misstatements. Because the SEC fails to sufficiently allege that Metzler had actual knowledge—and because Metzler is apparently the *only* way by which the City could have had the requisite knowledge—the claims against Metzler and the

City fall together.

C. The Court Should Strike the SEC's Request for Disgorgement Because the Complaint Does Not Allege that the City Received Ill-Gotten Gains.

The Court may "order stricken from any pleading … any redundant, immaterial, impertinent, or scandalous matter." Fed. R. Civ. Proc. 12(f). "Improper prayers for relief are proper subjects for a motion to strike." *Santa Clara Valley Water District v. Olin Corp.*, No. C-07-03756 RMW, 2007 WL 2890390, at *5 (N.D. Cal. Sept. 28, 2007). Courts frequently strike demands for monetary relief where the complaint fails to allege facts supporting the plaintiff's entitlement to the requested relief. *See Nichia v. Seoul Semiconductor Ltd.*, No. C-06-0162 MMC, 2006 WL 1233148, at *2 (N.D. Cal. May 9, 2006) (striking prayer for treble damages where the complaint failed to include "any…allegation that, if proven, might support an award of treble damages"); *David v. Giurbino*, 488 F. Supp. 2d 1048, 1060 (S.D. Cal. 2007) (granting motion to strike claim for punitive damages where "Plaintiff has not alleged any facts" to substantiate such relief).

Here, the SEC seeks disgorgement of the City's alleged "ill-gotten gains." Compl. at page 42. In meet-and-confer discussions, the SEC did not identify any allegation in the Complaint suggesting that the City had actually received any ill-gotten gains resulting from the conduct alleged in the Complaint.

Absent any allegations that, if proven, would establish ill-gotten gains, the Court must strike the SEC's request for disgorgement from the City. *See S.E.C. v. Berry*, 2008 WL 4065865, No. C-07-04431 RMW, at *10 (N.D. Cal. Aug. 27, 2008) (striking request for disgorgement where "the defendant has not been unjustly enriched and there is nothing for her to disgorge").

VI. CONCLUSION

The flaws in the SEC's Complaint are fatal, and cannot be remedied by amendment. Therefore, the City and the Authority respectfully request that the

Court dismiss the First, Second, and Seventh Claims for Relief in the Complaint, without leave to amend. In the alternative, the Court should strike the SEC's request for disgorgement from the City.

Dated: June 12, 2013

ARENT FOX LLP

By: */s/ Terree A. Bowers*
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PROOF OF SERVICE

I am a citizen of the United States. My business address is Arent Fox LLP, 555 West Fifth Street, 48th Floor, Los Angeles, California 90013. I am employed in the County of Los Angeles where this service occurs. I am over the age of 18 years, and not a party to the within cause.

On the date set forth below, according to ordinary business practice, I served the foregoing document(s) described as:

DEFENDANTS CITY OF VICTORVILLE AND SOUTHERN CALIFORNIA LOGISTICS AIRPORT AUTHORITY'S NOTICE OF MOTION AND MOTION TO DISMISS FIRST, SECOND, AND SEVENTH CLAIMS FOR RELIEF, AND TO STRIKE THE PRAYER FOR DISGORGEMENT

☐ (BY FAX) By transmitting via facsimile, from facsimile number (213) 629-7401, the document(s) to the person(s) on the attached service list at the fax number(s) set forth therein, on this date before 5:00 p.m.

☐ (BY E-MAIL) On this date, I caused the above documents to be delivered electronically to the e-mail address(es) of the person(s) on the attached service list.

☒ (BY MAIL) I am readily familiar with my employer's business practice for collection and processing of correspondence for mailing with the U.S. Postal Service, and that practice is that correspondence is deposited with the U.S. Postal Service the same day as the day of collection in the ordinary course of business. On this date, I placed the document(s) in envelopes addressed to the person(s) on the attached service list and sealed and placed the envelopes for collection and mailing following ordinary business practices.

☐ (BY PERSONAL SERVICE) On this date, I caused the above documents to be delivered by hand delivery to the person(s) below.

☐ (BY OVERNIGHT DELIVERY) On this date, I placed the documents in envelope(s) addressed to the person(s) on the attached service list, and caused those envelopes to be delivered to an overnight delivery carrier, with delivery fees provided for, for next-business-day delivery to whom it is to be served.

"SEE ATTACHED SERVICE LIST"

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed on June 12, 2013 at Los Angeles, California.

Marsha Stockard

SEC v. CITY OF VICTORVILLE, et al.
Case No. 13-cv-0776-JAK (DTBx)

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