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CARDONE CAPITAL, LLC and
GRANT CARDONE

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

WESTERN DIVISION

LUIS PINO, on behalf of himself and all others similarly situated,

Plaintiffs,

v.

CARDONE CAPITAL, LLC and GRANT CARDONE,

Defendants.

Case No. 2:20-cv-08499-JFW (KS)

CLASS ACTION

DEFENDANTS' NOTICE OF MOTION AND MOTION TO DISMISS CLASS ACTION COMPLAINT

[Filed Concurrently with Declaration of Lisa Bugni; and [Proposed] Order]

Date: March 1, 2021
Time: 1:30 p.m.

Complaint Filed: September 16, 2020
Trial Date: None Set

TO ALL PARTIES AND THEIR COUNSEL OF RECORD:

PLEASE TAKE NOTICE that, on March 1, 2021 at 1:30 p.m., or as soon thereafter as the matter may be heard, in Courtroom 7A of the above-entitled court, located at 350 W. 1st Street, Los Angeles, CA 90012, Defendants will, and hereby do, move the Court, pursuant to Federal Rule of Civil Procedure 12(b)(6) and the Private Securities Litigation Reform Act, for an order dismissing the Consolidated Class Action Complaint (Dkt. No. 53) filed in this action.

The motion is based on this Notice of Motion and Motion, the attached Memorandum of Points and Authorities, the Declaration of Lisa Bugni[1] submitted herewith, the pleadings, papers and records on file in this case, all matters of which this Court may take judicial notice, and such other documents and oral argument as may be presented at any hearing.

This Motion is made following the conference of counsel pursuant to L.R. 7-3, which took place on January 8, 2021, with a further conference of counsel of January 15, 2021, followed by additional email correspondence and exchange of information between counsel for the parties that concluded on January 22, 2021.

PLEASE TAKE FURTHER NOTICE that important information concerning the Court's conduct of hearing during the Covid-19 Pandemic may be found at https://www.cacd.uscourts.gov/honorable-john-f-walter.

Dated: January 29, 2021

Respectfully Submitted,

KING & SPALDING LLP
/s/ Joseph N. Akrotirianakis
JOSEPH N. AKROTIRIANAKIS
Counsel for Defendants
CARDONE CAPITAL, LLC and
GRANT CARDONE

[1] The citations to the Bugni Declaration in the Motion to Dismiss are to the added consecutive page numbers, not to the existing internal pagination of each exhibit.

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I. INTRODUCTION

The federal securities laws are not a system of insurance meant to protect investors from their losses. *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 345, 125 S. Ct. 1627, 1633, 161 L. Ed. 2d 577 (2005). It is a bedrock principle of the Securities Act of 1933 (the "Securities Act") that investors are responsible for bearing the risks of investments for which they are adequately warned. Plaintiff seeks in this case to recover alleged losses resulting from the realization of risks that were explicitly disclosed to him at the time he invested in late 2019. Because Plaintiff fails to allege adequately any false or misleading statement or omission of a material fact by Defendants, this case should be dismissed.

This lawsuit stems from Plaintiff's investment in Cardone Equity Fund V, LLC ("Fund V") and Cardone Equity Fund VI, LLC ("Fund VI," and collectively with Fund V, "the Funds"), which are companies managed by Defendant Cardone Capital LLC ("Cardone Capital"). These Funds acquire various real estate assets, specifically income-producing multi-family properties. Plaintiff's Complaint for Violation of the Federal Securities Laws alleges that Cardone Capital violated Section 12(a)(2) of the Securities Act by making materially false or misleading statements concerning three categories of information related to the Funds' operations and the potential financial benefits they offered to investors.

As an initial matter, Plaintiff's claim under Section 12(a)(2) fails because Cardone Capital is not a "seller" as defined by the statute and interpreted by the Supreme Court in *Pinter v. Dahl*, 486 U.S. 622, 643 (1988). The securities Plaintiff purchased were issued by the Funds, not by Cardone Capital. And Plaintiff has not alleged any facts establishing that Cardone Capital directly or actively solicited investments from Plaintiff.

But regardless of whether Cardone Capital classifies as a seller under Section 12(a)(2), the Complaint should be dismissed because Plaintiff has failed to allege adequately any material misstatement or omission. Plaintiff alleges three categories of

misstatements, none of which states a claim.

First, Plaintiff alleges that Defendants baselessly claimed that investors could expect an internal rate of return ("IRR") of 15%. Compl. at ¶¶ 40-44. The "bespeaks caution" doctrine renders this claim untenable because the forward-looking statements were accompanied by meaningful cautionary language detailing the risks of investment. The Funds' offering documents made it clear that no rates of return were guaranteed. They warned, for example, that the Funds may never become profitable or generate revenues, and that prior performance does not guarantee any future result. *See, e.g.,* Bugni Decl. Ex. 1, Fund V Offering Circular, at pg. 13; *see* *In re Infonet Services Corp. Sec. Litig.*, 310 F. Supp. 2d 1080, 1088 (C.D. Cal. 2003) ("On a motion to dismiss the securities law claims asserted in this case … the court may consider the full text of the relevant documents to determine whether the plaintiffs have alleged material misrepresentations or omissions.").

Second, Plaintiff alleges that Defendants misleadingly represented that investors could expect to receive annual cashflow distributions equal to 5% of their investment. Compl. at ¶¶ 45-48 ($50,000 in annual distributions on a $1,000,000 investment is 5% annually). Again, the bespeaks caution doctrine requires dismissal of this forward-looking statement. Plaintiff alleges the statement was false or misleading because dividend payments were suspended in April 2020 for a total of two months due to the COVID pandemic. *Id.* at ¶ 49. But neither the Defendants nor the Funds ever guaranteed any cash distributions to investors. Instead, the Funds' Offering Circulars included more than ten different risk factors that specifically warned that the Funds might not be able to make cash distributions, and that the decision whether or not to make them was entirely within the discretion of the Funds' Manager. *See, e.g.,* Bugni Decl. Ex. 1, Fund V Offering Circular, at pgs. 14-16 and 18-20. Moreover, Plaintiff's investment portal, which is referred to in paragraph 25 of the Complaint, shows that Plaintiff received $494.18 on his $10,000 investment in 2020. *See id.*, Bugni Decl. Ex. 9, Pino Investment Portal Screenshot. That is, of course, a distribution of 4.9%, entirely

consistent with the alleged representation of an expected 5% annual distribution.

Third, Plaintiff alleges that investors were not told that the Funds would be responsible for the payment of debt service related to the financings used to acquire real estate properties for the Funds. Compl. ¶¶ 50-63. This is directly contradicted by the plain language of the public offering documents, which disclosed that the Funds would need to secure additional financing, would be responsible for paying mortgages, and would leverage the acquired real estate assets up to 80% of their value. *See, e.g.*, Bugni Decl. Ex. 1, Fund V Offering Circular, at 5, 8, 9 and 44. Moreover, the Funds disclosed the amount of cash that had been used by previous investment funds for financing payments. *Id*. at 64. Given these detailed disclosures, it is impossible that any reasonable investor could have been unaware that the Funds would finance the properties, and that the Funds' investors would be responsible for debt service on those mortgages.

For all of these reasons, Plaintiff's Complaint is inadequate and self-defeating. It ignores the reality of what was publicly disclosed by the Funds in their Offering Circulars, Supplements, and Subscription Agreements filed with the U.S. Securities and Exchange Commission ("SEC"). Plaintiff's alleged losses relate to risks that were repeatedly and clearly disclosed by the Funds to all investors prior to their investment decision. Accordingly, Plaintiff cannot hijack the federal securities laws for use as insurance to protect against the consequences of risks that he knowingly accepted when choosing to invest in an emerging growth company.

II. BACKGROUND FACTS

Defendant Grant Cardone is a real estate entrepreneur, author, sales trainer and speaker who manages over $800 million in multi-family real property assets. Bugni Decl. Ex. 2, Fund VI Offering Circular, at 74. He is the owner and executive of Cardone Capital, a real estate property management company. *Id*. at 120.

In May 2018, a new Delaware corporation was formed named Cardone Equity Fund V, LLC. Bugni Decl. Ex. 1, Fund V Offering Circular, at 13. The stated purpose

of this entity was to "acquire various real estate assets throughout the United States." *Id*. at 5. In December 2018, Cardone Equity Fund VI, LLC was formed with the same stated purpose. Bugni Decl. Ex. 2, Fund VI Offering Circular, at 69. Both entities were managed by Cardone Capital and focused on investments in multi-family residential properties that were income-producing and could provide both attractive cash flow and long-term asset appreciation for investors. *Id*. at 100.

Investments in both Funds were made through offerings pursuant to Regulation A of the Securities Act. *See* Compl. ¶ 2. Both Funds were categorized as "emerging growth companies" under the 2015 U.S. JOBS Act, a law that reduced reporting and accounting requirements for emerging companies and enabled the sale of securities using crowd-funding techniques. *See* Bugni Decl. Ex. 1 Fund V Offering Circular, at 5, Ex. 2, Fund VI Offering Circular, at 69. Shares in both Funds were sold to accredited and non-accredited investors in compliance with the federal securities laws and SEC regulations. *See* Compl. ¶ 5.

As part of the process for publicly offering these securities, preliminary offering documents were filed by the Funds for comment and qualification from the SEC. *See* Bugni Decl. Ex. 3, Fund V Preliminary Offering Circular. After correspondence with the SEC and revisions by the Funds, the offering documents for Fund V became final on December 11, 2018, and the offering documents for Fund VI became final on September 26, 2019. *See* Bugni Decl. Ex. 1, Fund V Offering Circular, at 1, Ex. 4, Fund VI Offering Circular, at 68. These offering documents, which were filed with the SEC and available to the public, contained detailed information concerning the Funds' business plan, financial projections, and, most importantly, the risks of investing. *Id*. Both Funds also filed as exhibits to these offering documents form Subscription Agreements by which investors could purchase Class A shares in these Funds. *See* Bugni Decl. Exs. 4 and 5, Fund V and Fund VI Subscription Agreements, respectively. These Subscription Agreements contained additional detailed information related to the Funds, including a provision whereby purchasers acknowledged that they were not

relying on any information outside the scope of the Subscription Agreement and offering documents when making their investment decision. *Id.* at § 5.3.

Plaintiff Luis Pino invested in Fund V on September 23, 2019, and in Fund VI on November 15, 2019, by means of the respective Subscription Agreements for those Funds. *See* Compl., Ex. A, at pg. 2. Under the terms of those Agreements, as disclosed in the Funds' Offering Circulars, the Manager of the Funds could, in the Manager's complete discretion, choose to make cash distributions to investors using revenue generated by its residential real property assets. *See, e.g.,* Bugni Decl. Ex. 1, Fund V Offering Circular, at 20, Ex. 2, Fund VI Offering Circular, at 84. In April 2020, near the beginning of the worldwide COVID-19 pandemic, Mr. Cardone held a conference call with investors and stated that although rental payments remained stable, cash distributions would be temporarily suspended out of an abundance of caution. Compl. ¶ 49. These distributions were subsequently resumed, with payments made in June 2020 to make up for the temporary suspension. *Id.*; Bugni Decl. Ex. 9, Pino Investor Portal Screenshot.

On September 16, 2020, Plaintiff filed this lawsuit asserting a claim against Cardone Capital under Section 12(a)(2) of the Securities Act (Count I) and a control person claim against Mr. Cardone under Section 15 of the Securities Act (Count II). Compl. at ¶ 1. As explained below, both Counts should be dismissed.

III. LEGAL STANDARD

To survive a motion to dismiss under Rule 12(b)(6), a complaint must "contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). Although the court must accept all well-pleaded facts as true, "[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice." *Id.* Accordingly, "for a complaint to survive a motion to dismiss, the non-conclusory factual content, and reasonable inferences from that content, must be plausibly suggestive of a claim entitling the

plaintiff to relief." *Moss v. U.S. Secret Serv.*, 572 F.3d 962, 969 (9th Cir. 2009) (internal quotation marks omitted).

IV. ARGUMENT

To plead a claim under Section 12(a)(2) of the Securities Act, a plaintiff must allege that the defendant is (i) a statutory seller; (ii) that the sale was effected by means of a prospectus or oral communication; and (iii) that the communication contained a material misstatement or omission. *In re STEC Inc., Sec. Litig.*, No. SACV 09-1304, 2011 WL 4442822, at *9 (C.D. Cal. Jan. 10, 2011). Here, the Complaint should be dismissed in its entirety because (1) Plaintiff has failed to allege adequately that Cardone Capital made any material statement or omission; (2) Cardone Capital does not qualify as a statutory seller; and (3) Plaintiff has failed to allege adequately a predicate violation that can form the basis for its control person claim against Mr. Cardone.

A. Plaintiff has not alleged any actionable misstatement or omission of material fact.

Plaintiff alleges three categories of misstatements or omissions: (1) the projected IRR for the Funds; (2) the likelihood and amount of cash distributions for investors; and (3) the responsibility of investors in the Funds for debt financing obligations. As explained below, all three categories should be dismissed.

1. Internal Rate of Return

The IRR is a financial metric that measures the overall return on an investment, taking into account the amount invested and the amount and timing of any distributions to investors. *See* Bugni Decl. Ex. 1, Fund V Offering Circular, at pg. 60. Plaintiff alleges that the Defendants repeatedly touted a 15% IRR for investments in the Funds on a series of social media posts. *See, e.g.,* Compl. ¶¶ 42-45. He further alleges that Defendants had no basis for predicting this IRR. *Id.* The IRR statements should be dismissed for three reasons.

First, Plaintiff offers no facts supporting his allegation that the 15% IRR was not

a good-faith estimate, or even that investors in the Funds have failed to achieve a 15% IRR over the life of the investment. Nor could he. The Offering specifically advised investors they should expect to remain in the Funds for ten years, which means 2029 for Plaintiff's investment. *See* Bugni Decl. Ex. 1, Fund V Offering Circular, at 5, Ex. 2, Fund VI Offering Circular, at 69.

Instead, Plaintiff alleges only that the Funds' projected 15% IRR was "acknowledged by the SEC" to have no basis. Compl. ¶ 42. This is a gross mischaracterization of the SEC's position. Prior to the offering, the SEC conducted no investigation into whether the Funds had a reasonable basis for projecting a 15% IRR for their investors. Nor did the SEC reach any factual conclusions or judgments. Instead, Plaintiff relies entirely on one SEC comment letter that questioned the inclusion of the 15% IRR projection because Fund V had not yet commenced operations and therefore had no proven history of profitability. *See* Bugni Decl. Ex. 6, July 30, 2018 SEC Letter, at 230-231. But any possible misimpression raised by the original language of the draft Offering Circular was addressed when the Fund revised its Offering Circular prior to the actual offerings. *Cf.* Bugni Decl. Ex. 7, August 1, 2018 Response Letter, at 237 (noting that the reference was removed); *see also generally* Bugni Decl. Ex. 1, Fund V Offering Circular.

Second, the IRR statements are not actionable because they are projections that are protected by the common law bespeaks caution doctrine. *See In re Infonet Services Corp. Sec. Litig.*, 310 F. Supp. 2d 1080, 1102 (C.D. Cal. 2003) (holding bespeaks caution doctrine applies to 12(a)(2) claims). "The bespeaks caution doctrine protects affirmative, forward-looking statements from becoming the basis for a securities fraud claim when they are accompanied by cautionary language or risk disclosure." *Id.* at 1088. "The bespeaks caution doctrine 'was developed to address situations in which optimistic projections are coupled with cautionary language—in particular relevant specific facts or assumptions—affecting the reasonableness of reliance on and the materiality of those projections.'" *Id.* at 1089.

The performance of an investment over time is a classic example of a forward-looking statement. *See Police Ret. Sys. of St. Louis v. Intuitive Surgical, Inc.*, 759 F.3d 1051 (9th Cir. 2014) (explaining that forward-looking statements include "(1) financial projections, (2) plans and objectives of management for future operations, (3) future economic performance, or (4) the assumptions underlying or related to any of these issues.").

In the Offering Circulars filed with the SEC—which became effective prior to the Funds selling any Class A shares to investors and which were incorporated by reference into the Subscription Agreements signed by every Fund investor—the Funds provided detailed risk warnings informing investors that these estimated returns may not be realized. For example, the Offering Circular for Fund V disclosed that:

> We are an emerging growth company organized in May 2018 and have not yet commenced operations, which makes an evaluation of us extremely difficult. At this stage of our business operations, even with our good faith efforts, ***we may never become profitable or generate any significant amount of revenues***, thus potential investors have a possibility of losing their investments.

Bugni Decl. Ex. 1, Fund V Offering Circular, at 13 (emphasis added), Ex. 2, Fund VI Offering Circular, at 77. This disclosure warned investors that they could potentially realize an IRR that was not only less than 15%, but potentially zero.

The Funds' Offering Circulars also warned of a laundry list of risks that could negatively impact the returns achievable by investors, including potential management changes, the nature of blind pool offerings, changes in the real estate market, lack of investment diversification, and competition from third-parties. *See* Bugni Decl. Ex. 1, Fund V Offering Circular, at 13-15, Ex. 2, Fund VI Offering Circular, at 77-79. And, in the Subscription Agreement that Plaintiff executed to invest in the Funds, Plaintiff expressly agreed that "[t]he Subscriber acknowledges that any estimates or forward-looking statements or projections included in the Offering Circular were prepared by

the management of the Issuer in good faith, but that the attainment of any such projections, estimates or forward-looking statements cannot be guaranteed by the Issuer, its management or its affiliates and should not be relied upon." *See* Bugni Decl. Exs. 4 and 5, at § 1.8.

This detailed cautionary language renders the projection of a 15% IRR inactionable under the bespeaks caution doctrine. *See In re Infonet Services*, 310 F. Supp. 2d at 1102 (dismissing securities claims under Section 12(a)(2) based on the bespeaks caution doctrine).

Third, projections of future rates of return are also immaterial puffery. Courts recognize that general predictions of future performance or growth are immaterial as a matter of law because investors recognize that such predictions are inherently unreliable and subject to self-promotional inflation. *See Pirani v. Slack Techs., Inc.*, 445 F. Supp. 3d 367, 389 (N.D. Cal. 2020) (dismissing 12(a)(2) claims premised on "inactionable puffery"); *see also Raab v. Gen. Physics Corp.*, 4 F.3d 286, 289 (4th Cir. 1993) (statements in Annual Report that company expected '10% to 30% growth rate over the next several years' and was 'poised to carry the growth and success of 1991 well into the future' held to be immaterial 'soft puffing statements'"). Thus, in addition to being protected forward-looking statements, the Funds' projections of 15% IRR are also immaterial puffery.

2. Cash Distributions

The Offering Circulars for the Funds call for certain cash distributions to be made to investors from the revenue generated by the Funds' income-producing properties. *See, e.g.,* Bugni Decl. Ex. 1, Fund V Offering Circular, at 50. Plaintiff alleges that Defendants misrepresented the amount and likelihood of these distributions. Compl. ¶ 45. According to Plaintiff, Defendants made various social media posts touting the potential for cash distributions amounting to approximately 5% of their total investment annually. *Id.* at ¶¶ 45-47. Plaintiff alleges these statements were misleading because in April 2020, cash distributions were temporarily suspended due to the COVID-19

pandemic. *Id*. at ¶ 49. The cash distribution statement should be dismissed for two reasons.

First, Plaintiff's claim fails because all Defendants' statements concerning cash distributions are protected by the common law bespeaks caution doctrine. *See In re Infonet Services*, 310 F. Supp. 2d at 1088. Projections of future cash distributions are classic forward-looking statements because they refer solely to future events and contain inherent uncertainties. *See Police Ret. Syst. Of St. Louis*, 759 F.3d at 1058 (stating that "growth and revenue projections… are forward-looking on their face").

The future likelihood and amounts of cash distributions were heavily caveated in the Funds' offering documents. Both Funds disclosed the following risk factor:

> In the event of downturns in our operating results, unanticipated capital improvements to our properties, or other factors***, we may be unable, or may decide not to pay distributions to our Members***. The timing and amount of distributions are the sole discretion of our Manager who will consider, among other factors, our financial performance, any debt service obligations, any debt covenants, and capital expenditure requirements. We cannot assure you that we will generate sufficient cash in order to pay distributions.

Bugni Decl. Exs. 1 and 2, Fund V Offering Circular, at pg. 20; Fund VI Offering Circular at pg. 84 (emphasis added). This disclosure not only warned investors of the risk of stoppages in the cash distributions, but also placed the decision entirely within the discretion of the Manager. The fact that the Manager opted to suspend cash distributions temporarily during the largest pandemic in a century is a realization of this disclosed risk, not evidence that Defendants made a misrepresentation regarding distributions.

The Offering Circulars contained other cautionary language related to the cash distributions, including the risk disclosure that such distributions could be impacted by poor economic conditions, rising expenses, lack of liquidity, debt service obligations,

or third-party competition. *See* Bugni Decl. Bugni Decl. Ex. 1, Fund V Offering Circular, at 13-15, Ex. 2, Fund VI Offering Circular, at 77-79, Exs. 4 and 5, Subscription Agreements, at § 1.8. These detailed warnings render the forward-looking statements of expected cash distributions inactionable under the bespeaks caution doctrine. *See In re Infonet Services*, 310 F. Supp. 2d at 1102.

Second, Plaintiff's allegation that the 5% annual distribution prediction lacks a reasonable basis (Compl. ¶ 46) is wholly conclusory and contradicted by the documents incorporated into the Complaint. As a threshold matter, the Supplement to the Offering Circular for Fund V, which is expressly incorporated into the Offering Circular, specifically disclosed that distributions were being made to investors at a rate of 4.5% annually. *See* Bugni Decl. Ex. 8, Supplement to Offering, at pg. 248. So, specific to Fund V, the distribution rate Plaintiff could expect was 4.5%, and the Complaint does not, and cannot, plead that distribution amount was not paid. Plaintiff's investment portal shows that Plaintiff was paid $494.18 in distributions in 2020 on his $10,000 investment in the Funds. *Id.*; Bugni Decl. Ex. 9, Pino Investment Portal Screenshot. In other words, Plaintiff received 4.9% in annual distributions. Plaintiff cannot allege that the expected distribution amount lacked a reasonable basis when that projection was more than met in 2020. A prediction that turns out to be accurate, of course, cannot be misleading. *See St. Lucie Cty. v. Motorola, Inc.*, No. 10C-427, 2011 WL 814932, at *6 (N.D. Ill. Feb. 28, 2011). The expected distribution statements should be dismissed from the Complaint.

3. Responsibility for Debt Payments

Plaintiff alleges that Defendants misrepresented or omitted to disclose to investors information regarding financing and acquisition of the properties. Plaintiff cites to three social media posts and the Offering documents in support, but, as explained, no misstatements or omissions of material information are adequately alleged, and thus, this category of misstatements should be dismissed.

/ /

a. Social Media Posts

First, Plaintiff alleges that it was misleading for Cardone Capital to post that Mr. Cardone was "responsible for the debt." Compl. ¶ 52. But the surrounding context of the post makes it clear that this is not referring to debt service payments—the post focuses on the fact that, in past investments, Mr. Cardone has invested a significant amount of his own money, thus making him "responsible for the debt" on those properties. *Id.* As the Offering documents make clear for the Funds, Mr. Cardone was a joint owner of the Funds and thus was jointly responsible for the debt – as stated in the post. *See* Bugni Decl. Ex. 2, Fund VI Offering Circular, at 94. The post says nothing about Mr. Cardone paying 100% of the interest payment on investment properties.

Second, Plaintiff cites a post in which investments in real estate are categorized as "assets." Compl. ¶ 52. Plaintiff argues that because the properties were purchased with loans they should be considered liabilities. *Id.* This argument ignores the actual content of the post. The post contains only a general definition of assets, a comparison picture of lavish lifestyle expenses and income-producing properties, and the exhortation to "surround yourselves by assets, not liabilities." *Id.* It does not address the issue of the Funds' financing, much less misrepresent whether investors would be responsible for mortgage payments. *Id.*

Third, Plaintiff challenges a social media post comparing investments in stock with investments in real estate. *Id.* Far from stating that investors will have no debt obligations, this infographic actually highlights the potential benefits of investing in leveraged assets, *i.e.*, that it increases the relative gains on assets if the market value increases. *Id.* No reasonable investor could interpret this as an assurance that investors will bear no responsibility for making debt service payments.

Conversely, the leveraged nature of the Funds' business model and the risks this posed to investors was amply disclosed in the Funds' Offering Circulars. For example, the Offering Circular for Fund V warned that "[w]e will require additional financing, such as bank loans, outside of this offering in order for the operations to be successful."

Bugni Decl. Ex. 1, Fund V Offering Circular, at 5; *see also* Bugni Decl. Ex. 2, Fund VI Offering Circular, at 69. The Offering Circular further explained:

> ***We have broad authority to incur debt and high debt levels could hinder our ability to make distributions and decrease the value of our investors' investments.***
>
> Our policies do not limit us from incurring debt until our total liabilities would be at 80% of the value of the assets of the Company. Although we intend to borrow typically no more than 70% of a property's value, we may borrow as much as 80% of the value of our properties. We do not currently own any properties. ***High debt levels would cause us to incur higher interest charges and higher debt service payments*** and may also be accompanied by restrictive covenants. These factors could limit the amount of cash we have available to distribute and could result in a decline in the value of our investors' investments.

Bugni Decl. Ex. 1 at 18 (emphasis added); *see also* Bugni Decl. Ex. 2, Fund VI Offering Circular at 82. The Offering Circular also includes a section entitled "Financing Strategy," which explains that financing between 60% and 80% of its real estate investments is part of its fundamental business strategy. *See* Bugni Decl. Ex. 1, Fund V Offering Circular, at 44; Bugni Decl. Ex. 2, Fund VI Offering Circular at 108. Potential investors were also informed about the expenditures of earlier Cardone Equity Funds (i.e., Funds I-III) on debt service payments. *Id*. at 128.

Thus, the very facts that Plaintiff alleges were misstated or omitted were, in reality, disclosed repeatedly and in detail to investors. But even if the social media posts were misleading (which they were not), Plaintiff's claim would still fail because they are immaterial as a matter of law in light of the disclosures in the Offering Circulars. *See In re Velti PLC Sec. Litig.*, No. 13-CV-03889-WHO, 2015 WL 5736589, at *22 (N.D. Cal. Oct. 1, 2015) (finding no material omission where "[e]ach of the [allegedly omitted] circumstances—and the risks they entailed—was

disclosed in the registration statements"); *Primo v. Pacific Biosciences of California, Inc.*, 940 F.Supp. 2d 1105, 1116 (N.D. Cal. 2013) (finding alleged omission immaterial in light of other disclosures).

b. Offering Documents

Plaintiff also alleges that the Offering Documents (i) misrepresented that the properties could be acquired from a related party; (ii) misrepresented that appraisals would be obtained; and (iii) failed to disclose that 10x Living at Delray would be included in Fund V. Compl. ¶¶ 56, 61. Once again, Plaintiff's claim ignores the actual language of the Offering Circulars—all these facts were unambiguously disclosed.

First, as to related party transactions, the Funds disclosed to investors that the Funds could enter into related-party transactions with Mr. Cardone, that such transactions were not arms-length, and that this presented an inherent potential for conflicts of interest. *See* Bugni Decl. Ex. 1, Fund V Offering Circular, at 18; Bugni Decl. Ex. 2, Fund VI Offering Circular, at 82. They also disclosed that management may pre-fund a property, and that funds from the offering might be used to replace the pre-funding. *See* Bugni Decl. Ex. 1, Fund V Offering Circular, at 11; Bugni Decl. Ex. 2, Fund VI Offering Circular at 75.

Second, Plaintiff alleges that although the Funds disclosed that they would obtain fair-market appraisals for each of its properties and purchase them for less than market value, they have not complied with this requirement. *See* Compl. ¶¶ 56, 62. These allegations are purely speculative, and are unsupported by any factual allegation. Accordingly, these allegations fail the base pleading requirements of Rule 8. *See Iqbal*, 556 U.S. at 678 (requiring that factual assertions must be facially plausible). A plaintiff cannot state a securities claim by quoting a statement in an offering followed by a conclusory allegation that the statement was false. *See Fodor v. Blakey*, No. CV 11-08496 MMM, 2012 WL 12893985, at *4, 6 (C.D. Cal. February 21, 2012) (dismissing Securities Act claims because "conclusory

allegations are insufficient" to meet pleading standard and plaintiff did not "state why the representations were false.") Facts supporting the alleged falsity must be included, and Plaintiff's Complaint is devoid of any.

Third, with respect to the alleged failure to disclose that 10x Living at Delray would be part of Fund V, Plaintiff simply ignores the documents that comprise the Offering. Supplement No. 1 to Fund V, which was filed with the SEC on July 5, 2019, and incorporated into the offering documents before Plaintiff ever invested in the Funds, specifically disclosed that 10x Living at Delray would be included, along with other specified properties. *See* Bugni Decl. Ex. 8, Fund V Supplement No. 1, at 247. Plaintiff's allegation that Defendants did not disclose that 10x Living at Delray would be part of Fund V is entirely contradicted by the offering documents and should be dismissed. *See Turocy v. El Pollo Loco Holdings, Inc.*, No. 15-cv-1343, 2016 WL 4056209, at *8-10 (C.D. Cal. July 25, 2016) (holding that statements were not misleading where "allegedly omitted facts rendering the statements false were actually disclosed").

B. Plaintiff has failed to allege adequately that Cardone Capital is a "seller" within the meaning of Section 12(a)(2).

Section 12(a)(2) may be alleged against only a defendant who "offers or sells a security." 15 U.S.C. § 77l. The Supreme Court held in *Pinter v. Dahl*, 486 U.S. 622, 643 (1988), that there is a two-pronged test for determining whether a defendant qualifies as a statutory seller. Under the first prong, an individual is deemed to be the "seller" of a security if they directly pass title to the security in question to the buyer. *Vignola v. FAT Brands, Inc.*, No. 18-7469 PSG (PLAx), 2019 WL 6888051, at *4 (C.D. Cal. Dec. 17, 2019). Because Plaintiff has not alleged that Cardone Capital passed title to securities to Plaintiff for either of the Funds, Cardone Capital is not a "seller" under the first prong of *Pinter*.

Under the second prong of *Pinter*, a defendant may qualify as a seller if it solicited the purchase from the plaintiff and was motivated by financial gain. *See*

Vignola, 2019 WL 6888051, at *4. To solicit a purchase, a defendant must do more than merely assist in a solicitation or publicly recommend a security; they must actively and directly solicit the plaintiff's investment. *See Steed Fin. LDC v. Nomura Sec. Int'l, Inc.*, No. 00 CIV. 8058 (NRB), 2001 WL 1111508, at *7 (S.D.N.Y. Sept. 20, 2001) (dismissing claims because "Plaintiff . . . has failed to allege that plaintiff in fact purchased the Certificates as a result of [defendant's] solicitation.")

A defendant does not qualify as a seller under this prong, for example, when making a public presentation describing and recommending an investment. *See Hudson v. Sherwood Sec. Corp.*, No. C-86-20344-WAI, 1989 WL 108797, at *1 (N.D. Cal. July 27, 1989) (allegation that defendant "made a presentation at a meeting of prospective investors" insufficient to establish § 12 liability), *aff'd*, 951 F.2d 360 (9th Cir. 1991). Plaintiff alleges that Cardone Capital made statements on social media touting the benefits of investment in the Funds. Compl. ¶¶ 8-12. He does not allege that Cardone Capital was directly and actively involved in soliciting the Plaintiff's investment, or that Plaintiff relied on such a solicitation when investing. *See Steed Fin. LDC*, 2001 WL 1111508, at *7.

Cardone Capital's social media postings are no different than a public presentation to prospective investors. Plaintiff does not allege, for example, that Cardone Capital contacted Plaintiff directly to solicit him to invest, or that Plaintiff relied on any statement by Cardone Capital when choosing to invest in the Funds. Accordingly, Cardone Capital does not meet the second-prong of the *Pinter* test and cannot be held liable as a "seller" under Section 12(a)(2).

C. Plaintiff's control person claim under Section 15 fails to state a predicate violation.

Plaintiff alleges that Mr. Cardone is liable for any federal securities violation of Cardone Capital because he is the owner and executive of this corporation. Compl. ¶¶ 76-79. Control persons are only liable under Section 15 of the Securities Act if plaintiffs can establish a predicate securities violation by the controlled entity. *See* 15 U.S.C. §

77o. For all of the foregoing reasons, Plaintiff has failed to allege adequately any primary violation of Section 12(a)(2) by Cardone Capital. Accordingly, Plaintiff has failed to state a control person claim against Mr. Cardone. *See Primo*, 940 F. Supp. 2d at 1131.

V. CONCLUSION

For the foregoing reasons, Defendants' Motion to Dismiss Plaintiff's Complaint should be granted.

Dated: January 29, 2021

Respectfully Submitted,

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