

**IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION**

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| SECURITIES AND EXCHANGE COMMISSION, | § | |
| | § | |
| Plaintiff, | § | |
| | § | |
| v. | § | |
| | § | |
| ROCKWELL ENERGY OF TEXAS, LLC | § | |
| ROCKWELL ENERGY MANAGEMENT, LLC | § | Civil Action No.: 4:09-cv-4080 |
| GREGORY S. SHINDLER, | § | |
| BRADLEY M. JAMES, | § | |
| W. TODD SMITH, | § | |
| STUART E. RAWITT, and | § | |
| BRIAN W. WALSH | § | |
| | § | |
| Defendants. | § | |
| | § | |
| | § | |

**DEFENDANTS’ REPLY IN SUPPORT OF THEIR MOTION TO DISMISS PURSUANT
TO FEDERAL RULES OF CIVIL PROCEDURE 12(b)(6) AND 9(b)**

Defendants Rockwell Energy of Texas, L.L.C., Rockwell Energy Management, L.L.C., Gregory S. Shindler and Bradley M. James (collectively, “Rockwell” or the “Rockwell Defendants”) file this reply in support of their motion to dismiss pursuant to Federal Rules of Civil Procedure 12(b)(6) and 9(b).

INTRODUCTION

The Securities and Exchange Commission (“SEC”) has filed a response that fails to address the points Rockwell raised in its motion to dismiss and simply restates its assertions without addressing the pleading deficiencies. For this reason, the Court should grant Rockwell’s motion and dismiss the securities fraud claims against the Rockwell Defendants. This reply will address each of the SEC’s arguments in the order presented in the SEC’s response.

I. Contrary to the SEC’s assertion, the complaint fails to plead fraud adequately.

Rather than address the specific attacks Rockwell has made on the complaint, the SEC simply restates its assertion that “the Rockwell Defendants made material misrepresentations and omitted material facts concerning the profitability of the funds, the nature and extent of the investments that the funds had made or intended to make, and the use of investor proceeds.” (SEC Response at p. 5.) The SEC then repeats various “facts” pled in its complaint without responding to Rockwell’s showing that the assertions of fraud were either belied by the Private Placement Memoranda (“PPMs”) or were based upon events that occurred after the representations had been made.

II. The Rockwell Defendants have established that the Court should dismiss the complaint pursuant to Rules 12(b)(6) and 9(b).

A. The Rockwell Defendants indeed dispute the allegations of paragraphs 38 and 48.

Contrary to the SEC’s suggestion that Rockwell has conceded certain false statements, Rockwell *has* challenged the SEC’s allegations in paragraphs 38 and 48. Specifically, the Appendix¹ at page 11 addresses paragraph 38, in which the SEC alleges that Rockwell falsely promised that the Fund II would open with “two wells in the inventory of target acquisitions” yet never acquired a single well. As Rockwell points out, the use of the term “targets” disclosed that Rockwell did not yet own the wells; and the fact that it was not able secure its “targets” cannot be evidence of fraud at the time the statement was made. Additionally, Rockwell’s Appendix provides context for the accused representations by reference to the PPM, which clearly advises

¹ Because the SEC has attacked the appendix as constituting briefing in excess of the Court’s page limits, Rockwell has filed an unopposed motion for leave to file an amended appendix or, in the alternative, to file supplemental briefing, in the form of the amended appendix, in excess of the Court’s page limits.

potential limited partners that the General Partner could in his sole discretion substitute other projects.

Similarly, Rockwell has now addressed the allegations contained in paragraph 48, in which the SEC alleges that Rockwell misrepresented the amount of sales commissions and falsely represented that it would sell only through licensed dealers. (*See* Amended Appendix at page 15.) Specifically, the PPMs contain many disclosures about the fact that fees could total up to 50% of the amount raised from limited partners. Additionally, as Rockwell’s motion points out, the SEC has pled no facts showing that Rockwell had knowledge of the alleged falsity of the statements when they were made. And, significantly, the SEC fails to allege *any* facts showing that Rockwell was aware that the salesmen who brought limited partners to Rockwell were unlicensed. As such, the SEC has failed to plead securities fraud.

B. The SEC has pled “fraud by hindsight.”

The SEC cannot escape its pleading failure with the naked assertion “there existed no reasonable basis on which [the Rockwell Defendants] could project [18% annual] returns.” The fact remains that the fraud allegations rest almost completely on the fact that Fund I and Fund II did not perform as hoped due to gas prices falling substantially from the levels that prevailed when the PPMs were drafted. Indeed, the offering materials, as discussed in Rockwell’s motion to dismiss, disclosed the substantial risks associated with such ventures, including most particularly a fall in the price of gas.

C. The Court can consider Rockwell’s arguments regarding the disclosures in the PPMs.

The SEC alleges without citing any authority that the safe harbor and bespeaks caution doctrines do not apply to enforcement actions.² Contrary to the SEC’s assertion, the bespeaks caution doctrine is not the creation of the PSLRA. Indeed, Courts have recognized this doctrine, which creates a safe harbor of sorts for “optimistic projections . . . coupled with cautionary language--in particular, relevant specific facts or assumptions--affecting the reasonableness of the reliance on and the materiality of those projections,”³ since at least 1991. *See, e.g., Moorhead v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 949 F.2d 243, 245-46 (8th Cir.1991). As the Fifth Circuit observed in *Rubenstein v. Collins*, “to put it another way, the ‘bespeaks caution’ doctrine merely reflects the unremarkable proposition that statements must be analyzed in context.” 20 F.3d 160, 168 (5th Cir. 1994). As the Rockwell Defendants have demonstrated in their motion to dismiss, analysis of the alleged misrepresentations in context leads to the conclusion that Defendants did not commit securities fraud.

The SEC attempts to avoid the force of the doctrine by asserting that the complaint adequately pleads that the Rockwell Defendants knew that their revenue projections were false.⁴ The SEC’s response fails, however, to point to a single statement in the complaint that accomplishes that task. In fact, the Amended Appendix proves to the contrary.

D. Contrary to the SEC’s assertion, the references to the PPMs provide substantial context that renders the alleged statements not misleading.

² Rockwell acknowledges that by its terms 15 U.S.C. § 78u-5(c)(1) applies to private actions but asserts that issuers should be afforded similar protection in SEC actions. While proof of forward-looking statements (“accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement[s]”) could relate to the issue of reliance in a private securities action, proof of such statements—independently of any reference to the statute—also bears on the issue of scienter, which the SEC must prove in enforcement actions. *Aaron v. SEC*, 446 U.S. 680 (1980).

³ *Rubenstein v. Collins*, 20 F.3d 160, 168 (5th Cir. 1994).

In section I.D. of its response (at pages 9-11), the SEC addresses four sets of representations from the PPMs, asserting that the Rockwell Defendants have failed to provide context that would render them not misleading. As discussed below, the SEC is incorrect.

The 20 wells: The first set of representations relates to the “inventory of 20 wells,” about which the SEC complains in paragraph 23 of the complaint. As the Rockwell Defendants explained, both in their motion and in addressing paragraphs 2.b. and 23 in the Amended Appendix, the “former business partner of Shindler” (complaint at ¶23), who owned the wells, was identified in the Fund I PPM as part of the General Partner.⁵ The Rockwell Defendants cited page 25 of the Fund I PPM for this proposition, and it is indeed on page 25 of the Fund I PPM that the information appears. Although the SEC claims that nothing in the appendix corresponds to this citation, even a passing review of the citation proves the SEC to be incorrect. To address any confusion, the Rockwell Defendants attach copies of the cited pages as Exhibit A to this reply.

The alleged “general provision” granting discretion to the general partner: The SEC next mistakenly asserts—without citation to a particular provision in the PPM—that the Rockwell Defendants have relied on a single “general provision in the PPMs” to justify various alleged improprieties asserted in paragraphs 32-34 and 42-45.⁶ To the contrary, the Rockwell

⁵ The SEC mistakenly asserts that the Rockwell Defendants have injected a disputed fact by pointing this out; to the contrary, the SEC has done so by reference to an interview that the owner of the wells had with the SEC. The record before this Court, the complaint and the PPMs, to which the complaint refers and the authenticity of which the SEC has not questioned (*see Branch v. Tunnell*, 14 F.3d 449, 453 (9th Cir. 1993), *overruled on other grounds*, *Galbraith v. Santa Clara*, 307 F.3d 1119, 1125-27 (9th Cir. 2002)), shows that “the owner” and “former business partner of Shindler” (complaint at ¶23) was part of the general partner of Fund I.

⁶ The Rockwell Defendants point out that the SEC’s discussion of these alleged improprieties does not in any way address the fact that the SEC has failed to plead how these constitute securities fraud, or how the Rockwell Defendants made material representations they knew to be false at the time they made them.

Defendants have cited several specific provisions of the PPMs that provide direct authorization for the general partner to, for example:

- (1) generate income through a commodities hedge fund (complaint at ¶ 32): Fund I PPM at page 15, LOANS AND BORROWING (Amended Appendix at p. 9);
- (2) pay the general partner's expenses (complaint at ¶ 33): Fund I PPM at page 26, REIMBURSEMENT TO THE GENERAL PARTNER (Amended Appendix at p. 9);
- (3) pay for alleged "administrative services" (complaint at ¶ 34): Limited Partnership Agreement, made part of the PPM, at page 8, which gives the general partner power to employ others in connection with the business of the partnership (Amended Appendix at p. 10);
- (4) enter into affiliate transactions (complaint at ¶¶ 42 and 43): Fund II PPM at page 11, addressing affiliate transactions and **AFFILIATE COMPENSATION** (Amended Appendix at p. 12);
- (5) enter into loan transactions⁷ (complaint at ¶¶ 44 and 45): Fund II PPM at page 10, LOANS AND BORROWING (Amended Appendix at p. 13).

Fund II's single transaction: Contrary to the SEC's next assertion—that "the Rockwell Defendants admit that [Fund II's single transaction] was, in fact, a loan" (SEC response at 10), the Rockwell Defendants have simply done what it required in urging a motion to dismiss—accepted, without admitting, the allegations in the complaint.⁸ While the Rockwell Defendants maintain that the Fund II transaction was indeed an investment to secure oil and gas leases in the Sealy prospect in Grimes County, Texas, their motion to dismiss merely pointed out that, if the transaction was a loan, it was specifically authorized by the Fund II PPM at page 10, in the section entitled "LOANS AND BORROWING." (See Amended Appendix at 13.)

Apparently having no retort to the Rockwell Defendants' demonstrating that the Fund II PPM specifically authorized the alleged loan, the SEC resorts to complaining that nothing in the

⁷ As discussed in the next section, the Rockwell Defendants do not admit that the Fund II investment constituted a mere loan; they are simply addressing the SEC's allegation that the general partner lacked the authority to make loans, a proposition emphatically belied by reference to the PPM.

⁸ See footnote 2 at page 2 of the Rockwell Defendants' motion to dismiss.

PPM “disclosed to investors that the fund[] would use loans, rather than investments in oil-and-gas properties, to fund distribution payments to investors.”⁹ This statement misses the point, as the SEC complaint makes clear that the partnerships ceased making acquisitions at the SEC’s request in February of 2009, shortly after the single initial investment.

Mitigation of risk: The SEC’s response does little to support its proposition that—in the face of repeated discussions of the risk of oil and gas investments and these partnerships in particular—the statement regarding green technology’s “mitigating risk completely” misled any potential limited partner into believing that the partnership interests were not extremely risky. Moreover, reference to the full context of the discussion of the technology demonstrates that the statement lacks materiality.¹⁰

E. The SEC has not adequately pled scienter.

The SEC has utterly failed to address the crux of the Rockwell Defendants’ argument regarding scienter. Rather than point to a single specific allegation regarding any defendant’s intent to deceive in the complaint, the SEC refers generally to vague assertions of sky-high returns, gas well interests that the funds did not own, “green” technology never meaningfully deployed, unauthorized investments, undisclosed sales commissions, etc. In addition to the fact that the Rockwell Defendants’ motion to dismiss put each of these accused representations into the full context of the two PPMs, it also established that the complaint failed to plead the Rockwell Defendants’ knowledge of the alleged falsity of the representations. In short, the complaint fails to satisfy Rule 9(b)’s requirement that the complaint “set forth specific facts that

⁹ The SEC includes in this statement the assertion that the Fund I PPM failed to adequately disclose a \$130,000 loan that Fund I made. Again, as the Rockwell Defendants have previously demonstrated, the Fund I PPM specifically authorized loans of partnership proceeds. *See* Fund I PPM at 15, LOANS AND BORROWING; *see also* Amended Appendix at p. 8.

¹⁰ *See* fourth page of Croft marketing materials, incorporated into offering materials for Funds; *see also* Amended Appendix at p. 4.

support an inference of fraud.”¹¹ See *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1068 (5th Cir. 1994).

F. The SEC cannot support its allegations of post-subscription representations.

The SEC’s response fails even to address the specifics of the post-subscription representations attacked in the complaint. Styling them omissions, the SEC fails to explain how transactions that had not yet occurred could be disclosed. And, again, the SEC’s response fails to address the fact that the PPMs authorized the transactions the SEC attacks in the complaint.

III. The Court should dismiss the claim for injunctive relief.

The Court should reject the SEC’s justification of its request for injunctive relief—that the Rockwell Defendants exercised their right to defend themselves in this action and have denied the SEC’s allegations of fraud. There is simply no indication whatsoever that the Rockwell Defendants’ cooperation is “simply a cessation of illegal activity.” Indeed, as the SEC concedes, the Rockwell Defendants voluntarily appeared for interview and produced thousands of documents in trying to assist the SEC with its investigation.

IV. The Court should accept the Rockwell Defendants’ Amended Appendix.

The Rockwell Defendants dispute the SEC’s attack on the appendix they filed with their motion to dismiss. Nevertheless, in an abundance of caution, contemporaneous with the filing of this reply, the Rockwell Defendants have filed an unopposed motion for leave to file an amended appendix or, in the alternative, to file briefing in excess of the Court’s page limits for briefing.¹²

The Rockwell Defendants believe the amended appendix will materially assist the Court in

¹¹ The Rockwell Defendants point out that the Second and Third Circuits have interpreted Rule 9(b)’s particularity requirement to require pleading facts showing a “strong inference” of scienter, and urge that this is the proper standard. See, e.g., *In re Burlington Coat Factory Sec. Litig.* 114 F.3d 1410, 1422 (3d Cir. 1997); *Shields v. Citytrust Bancorp Inc.*, 25 F.3d 1124, 1129 (2d Cir. 1994).

¹² The SEC’s counsel has advised that, while he has no objection to the motion for leave, the SEC does dispute the contents of the Amended Appendix.

evaluating plaintiff's allegations of fraud. Contrary to plaintiff's argument, the amended appendix either explains how each paragraph cannot constitute an adequately pled fraud claim, or identifies it as not alleging fraud or not applicable to the Rockwell Defendants. Although the Rockwell Defendants intended the appendix only as an aid and not an end run around this Court's procedures, the Rockwell Defendants have alternatively requested that the Court grant them leave to exceed the Court's page limit for motions to dismiss and allow the filing of the appendix as supplemental briefing.

CONCLUSION

For the foregoing reasons, the Rockwell Defendants respectfully request that the Court dismiss the SEC's securities fraud claims against the Rockwell Defendants. The SEC has had access to voluminous documents that it alleges support its claims, as well as interviews with Shindler and James; thus, it has had more than adequate time to develop its claims against Defendants, and further time or further opportunity to plead will not remedy the problems with the Complaint. The Rockwell Defendants, therefore, pray that the Court enter the order attached to their motion to dismiss, dismissing the SEC's claims under the Securities Exchange Act, the Securities Act and Rule 10b-5, pursuant to Federal Rule of Civil Procedure 12(b)(6) and 9(b).

Respectfully submitted,

By: /s/Linda Brooks

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the forgoing document was served by Electronic Case Filing and email, on the 7th day of May, 2010 to all counsel of record.

/s/ Linda Broocks
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