

**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 §  
GREGORY S. SHINDLER, §  
BRADLEY M. JAMES, §  
W. TODD SMITH, §  
STUART E. RAWITT, and §  
BRIAN W. WALSH §  
§  
Defendants. §  
§

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Civil Action No.: 4:09-cv-4080

**DEFENDANTS' MOTION TO DISMISS PURSUANT TO FEDERAL  
RULES OF CIVIL PROCEDURE 12(b)(6) AND 9(b) AND  
MEMORANDUM OF LAW IN SUPPORT**

Respectfully submitted,

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MEMORANDUM OF LAW IN SUPPORT**

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 motion to dismiss pursuant to Federal Rules of Civil Procedure 12(b)(6) and 9(b) and memorandum of law in support.

**I.  
INTRODUCTION**

The Securities and Exchange Commission ("SEC") brought this suit against the Rockwell Defendants claiming that Defendants violated the antifraud provisions of both section 17(a) of

the Securities Act and section 10(b) of the Securities Exchange Act, and Rule 10b-5.<sup>1</sup> Defendants move to dismiss the SEC's fraud claims because the SEC has failed to allege facts to show that Defendants made misrepresentations of material fact with knowledge of the falsity of those statements.

The SEC alleges that investors bought interests in the "Rockwell Energy Production & Acquisition Fund, L.P. ("Fund I") and "Rockwell Energy Acquisition Fund, L.P. ("Fund II") and that through these Funds, investors participated in purportedly high-yield oil and gas fund offerings. The SEC alleges that, through the Private Placement Memorandum ("PPM") for each fund and by other representations, investors were promised eighteen percent interest return annually, and climbing to as high as thirty percent as additional production was brought online. The SEC further alleges that, while initially many investors received 1.5% monthly returns, the Funds' gas well interests never generated sufficient production or at sufficient prices to continue paying such high returns.<sup>2</sup>

The SEC has not, however, alleged any facts that would make the Rockwell Defendants responsible for investor losses. The SEC attempts to parlay the alleged<sup>3</sup> failure of the funds—and

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<sup>1</sup> The SEC has also alleged that the Rockwell Defendants violated the registration requirements of the Securities Act. While Rockwell disputes this claim, this motion to dismiss addresses only the securities fraud claims.

<sup>2</sup> Solely for the purposes of this motion, the Rockwell Defendants have accepted the facts as stated by the SEC. Rockwell's recitation of the SEC's assertions, however, is not intended as agreement with the SEC's conclusory allegation, and Rockwell reserves the right to dispute the SEC's stated "facts" and assertions.

<sup>3</sup> Although the funds have not generated the hoped-for income, they have not "failed." Indeed, Fund I continues to generate some income, albeit at much lower rates as gas continues to hover at prices much lower than those prevailing when the fund was established. Fund II has not produced income since the SEC began its investigation and instituted a voluntary freeze of Fund II's funds. When this was done, the counterparty on the single lease transaction into which Fund II had entered ceased making payments. Rockwell and the counter-party are attempting to sell their interest in the lease. Additionally, the SEC has denied approval of all further investment opportunities Rockwell has presented; as such, the fund's performance cannot be judged as if the SEC had not intervened.

little more—into a claim for securities fraud against all of the Rockwell Defendants. The SEC uses only conclusory allegations to suggest that the alleged representations were false or that the Rockwell Defendants “knew” or had “intent” to commit any wrongdoing. The SEC simply has not satisfied the rigorous standards for pleading fraud.

## **II. BRIEF FACTUAL BACKGROUND<sup>4</sup>**

Rockwell Energy of Texas, Inc. (“REOT”) is the general partner of Fund 1, and Rockwell Energy Management, LLC (“REM”) is the general partner of Fund 2. Greg Shindler is currently the sole shareholder of REOT and REM. When the Fund 1 PPM was produced, R. J. Abercrombie was a part owner of REOT. Bradley James was a manager of REM until he resigned in December of 2008. Both limited partnerships were organized for various purposes, including generating income from oil and gas properties for their respective limited partners. The literature accompanying the offering materials also describes a green technology, known as the Croft PDS system,<sup>5</sup> which Rockwell hoped to employ on partnership properties for the purpose of increasing production and, in turn, profits.

Fund 1 began in late March 2008, was fully subscribed as of October 2008, and has 77 limited partners, who contributed a total of \$3.5 million to the partnership. Each received a copy of the PPM, which included the limited partnership agreement, subscription agreement, and accredited investor questionnaire. The PPM makes a number of important disclosures, including the substantial risks of participating in the limited partnership, potential affiliate transactions, and the fact that in excess of 50% of the limited partner contributions may be used for start up

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<sup>4</sup> The Rockwell Defendants provide this factual discussion only to give the Court context for their argument, not as a basis for any point in this motion to dismiss.

<sup>5</sup> The Croft passive dehydration system, or “PDS,” is designed to dehydrate natural gas and to dry hydrocarbon streams for the purpose of increasing gas production and decreasing toxic emissions.

costs—including commissions—of the partnership. The great majority of the Fund 1 limited partners signed and returned their accredited investor questionnaires and subscription agreements.

Fund 2 began accepting limited partners in October of 2008 and, as of February 2009, when it ceased accepting new limited partners at the request of the SEC Staff, had 58 limited partners, who contributed a total of approximately \$2.4 million to the partnership. (Like Fund 1, Fund 2 was designed to have limited partner contributions totaling \$3.5 million.) As with Fund 1, each Fund 2 limited partner received a copy of the PPM, which, again, included the limited partnership agreement, subscription agreement, and accredited investor questionnaire. The Fund 2 PPM made the same important disclosures regarding substantial risks, potential affiliate transactions, and commissions and expenses. And, again, the great majority of the Fund 2 limited partners signed and returned their accredited investor questionnaires and subscription agreements.

In February of 2009, both Funds voluntarily ceased making any further acquisitions without approval of the SEC staff; although they made requests to the SEC staff for approval to make further oil and gas investments that Rockwell believed to be advantageous to the limited partners, each was denied.

Rockwell came to the SEC's attention through an investigation the Staff was conducting of Delta Onshore, one of the dealers whose customers became limited partners in the Funds. The Rockwell Defendants cooperated with the SEC at every stage of the investigation and spent hundreds of hours in appearing for interviews with SEC staff and in producing thousands of pages of documents, including complete bank records for both funds.

**III.**  
**STAGE OF THE PROCEEDINGS**

This case is in the motions phase. The SEC filed suit in December 2009 against the Rockwell Defendants and others for violations of the Securities Exchange Act and the Securities Act. Formal discovery has not begun, but the SEC has had access to files pertinent to Fund I and Fund II, and Greg Shindler and Bradley James voluntarily appeared for interviews with the SEC staff. The SEC should, therefore, have enough documentation to state a claim should one exist. The Rockwell Defendants file this motion to dismiss because the SEC has failed to meet the strict burden for pleading securities fraud.

**IV.**  
**SUMMARY OF THE ARGUMENT**

The SEC falls far short of stating a claim and fails to meet the particularity requirements for pleading fraud. First, the SEC fails to allege actionable misrepresentations concerning Fund I or Fund II. Ignoring the well established rule against pleading fraud by hindsight, the Complaint fails to set forth facts establishing that the challenged representations were false *when made*. Rather than plead specific facts to show how the representations were false at the time, the SEC simply asserts that investors eventually suffered losses, and that prior representations regarding the degree of risk involved in the Funds must have been fraudulent. Second, the SEC fails to allege that the Rockwell Defendants had an actual intent to defraud. Instead of setting forth particularized facts sufficient to support the requisite strong inference of scienter, the SEC simply states conclusory allegations that are both unconvincing and insufficient to state a claim under the securities laws. Third, the SEC fails to establish that many of the alleged misrepresentations were made in connection with the purchase or sale of a security.

Finally the SEC has failed to allege facts that would support the issuance of an injunction against the Rockwell defendants. Indeed, the Complaint acknowledges Rockwell's cooperation with the SEC's investigation and thus, in essence, concedes that an injunction is unnecessary.

**V.  
ISSUES PRESENTED**

Has the SEC satisfied the rigorous standards for pleading securities fraud against the Rockwell Defendants, especially in alleging how the alleged representations were false or that the Rockwell Defendants "knew" or had "intent" to commit any wrongdoing, or should its complaint be dismissed by Federal Rule of Civil Procedure 12(b)(6).

**VI.  
STANDARDS OF REVIEW**

**A. Rule 12(b)(6).**

Under Rule 12(b)(6), the movant "admits the facts alleged in the complaint, but challenges plaintiff's right to relief based upon these facts." *Tel-Phonic Servs., Inc. v. TBS Int'l, Inc.*, 975 F.2d 1134, 1137 (5th Cir. 1992) (quoting *Ward v. Hudnell*, 366 F.2d 247, 249 (5th Cir. 1966)). However, it has long been the rule that, in considering a motion to dismiss a securities fraud suit, the court does not accept conclusory allegations or unwarranted deductions of fact as true. *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555, 127 S. Ct. 1955, 1964-65, 167 L. Ed. 2d 929 (2007) (stating that "[w]hile a complaint attacked by a Rule 12(b)(6) motion to dismiss does not need detailed factual allegations, ... a plaintiff's obligation to provide the grounds of his entitlement to relief requires more than labels and conclusions. ...") (citations, brackets, and quotation marks omitted); *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1067 (5th Cir.1994); *Guidry v. Bank of LaPlace*, 954 F.2d 278, 281 (5th Cir.1992). "Factual allegations must be enough to raise a right to relief above the speculative level." *Twombly*, 550 U.S. at 555. On a motion to dismiss for failure to state a claim, the Court is not required to accept as true

unwarranted inferences, *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1067 (5th Cir. 1994), conclusory allegations, *see, e.g., Lovelace v. Software Spectrum, Inc.*, 78 F.3d 1015, 1020 n.5 (5th Cir. 1996), or legal conclusions, even when cast in the form of factual allegations, *Tuchman*, 14 F.3d at 1067; *see also Papasan v. Allain*, 478 U.S. 265, 286, 106 S.Ct. 2932, 92 L.Ed.2d 209 (1986) (stating that courts “are not bound to accept as true a legal conclusion couched as a factual allegation.”).

In ruling on Rule 12(b)(6) motions, district courts generally may rely only on the complaint and its proper attachments. *Financial Acquisition Partners LP v. Blackwell*, 440 F.3d 278, 290 (5th Cir. 2006); *Travis v. Irby*, 326 F.3d 644, 648 (5th Cir. 2003); *Hal Roach Studios v. Richard Feiner & Co.*, 896 F.2d 1542, 1555 n. 19 (9th Cir. 1990). The courts are permitted, however, to rely on matters of public record. *Davis v. Bayless*, 70 F.3d 367, 372 n. 3 (5th Cir. 1995); *Mir v. Little Co. of Mary Hosp.*, 844 F.2d 646, 649 (9th Cir. 1988) (quotation marks omitted). Nevertheless, “a document is not ‘outside’ the complaint if the complaint specifically refers to the document and if its authenticity is not questioned.” *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). As such this Court may refer to the entirety of the private placement memoranda (“PPMs”) provided the limited partners in Fund I and Fund II.<sup>6</sup>

**B. Rule 9(b).**

Rule 9(b) requires that “[i]n alleging fraud . . . , a party must state with particularity the circumstances constituting fraud or mistake.” FED. R. CIV. P. 9(b). The rule has four purposes:

- (1) to provide defendants with fair notice of the plaintiff’s claims in order to prepare a defense;

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<sup>6</sup> Complete copies of the PPM’s are attached to this motion as exhibits and 1 and 2, respectively.

- (2) to protect the defendant's reputation or goodwill from unfounded accusations of fraud;
- (3) to reduce the number of strike suits; and
- (4) to prevent plaintiffs from filing baseless claims and then attempting to discover unknown wrongs.

*Tuchman*, 14 F.3d at 1067. This heightened pleading standard applies to the SEC's securities fraud claims. *See id.*

To meet the requirements of Rule 9(b), a complaint must go beyond merely reproducing a statement by the defendant and alleging its falsity. Rather, the plaintiff must set forth what is false or misleading about a statement, and why it is false. *See also Salinger v. Projectavision, Inc.*, 934 F. Supp. 1402, 1413 (S.D.N.Y. 1996) (dismissing a claim because "plaintiffs have not specified with particularity *how* each of these statements were fraudulent"). The plaintiff must plead the particulars of each false representation alleged, as well as the identity of the person making the representation, and what he gained thereby . . ." *Melder v. Morris*, 27 F.3d 1097, 1100 & n.5 (5th Cir. 1994); *see also Williams v. WMX Techs., Inc.*, 112 F.3d 175, 177 (5th Cir.1997) (explaining that a plaintiff must "specify the statements contended to be fraudulent, identify the speaker, state when and where the statements were made, and explain why the statements were fraudulent."). Moreover, a plaintiff must plead sufficient factual detail to support a reasonable inference of fraudulent intent. *Tuchman*, 14 F.3d at 1068. Courts in this circuit and elsewhere do not shrink from dismissing securities fraud claims when plaintiffs fail to plead in strict compliance with Rule 9(b). *See, e.g., Tuchman*, 14 F.3d at 1067.

**VII.**  
**ARGUMENT**

**A. The Court Should Dismiss the SEC's Securities Act and Securities Exchange Act Claims Pursuant to Federal Rules of Civil Procedure 12(b)(6) and 9(b).**

In order to state a securities fraud claim under either the Securities Act or the Securities Exchange Act, the SEC must allege that each Defendant made material misrepresentations or omissions with the requisite degree of scienter in connection with the purchase, sale or offering of a security. 15 U.S.C. § 77(q)(a); 15 U.S.C. § 78(j)(b); 17 C.F.R. § 240.10(b)-5; *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 406-07 (5th Cir. 2001). Because the SEC cannot establish these elements, this Court should dismiss the SEC's securities fraud claims against the Rockwell Defendants.

1. *The SEC cannot establish specific misrepresentations of a material fact by Defendants.*

In order to survive a motion to dismiss, the SEC's complaint must identify each statement it alleges to be false, describe when and where the statement was made, and explain why the statement was fraudulent. *In re Baker Hughes Sec. Litig.*, 136 F. Supp. 2d 630, 637 (S.D. Tex. 2001); *Tuchman*, 14 F.3d at 1067. The SEC's allegations, although voluminous, do not meet these pleading requirements. *See Williams v. WMX Techs., Inc.*, 112 F.3d 175, 178 (5th Cir. 1997) ("A complaint can be long-winded, even prolix, without pleading with particularity. Indeed, such a garrulous style is not an uncommon mask for an absence of detail.").

Indeed, besides references to the statements taken out of context from the PPMs, the SEC's only other allegations are broad and vague allegations of post-investment representations that often lump the Rockwell Defendants together and thus do not meet these pleading requirements. As a result, the Rockwell Defendants are left to guess at the SEC's allegations, particularly what the SEC contends they did that specifically violated the securities laws.

In addition, the SEC does not allege how the alleged representations are false or how the alleged misstatement must have been false when made: “It is also impermissible to allege fraud by hindsight, that is, to seize upon disclosures in later reports and allege that they should have been made in earlier ones.” *Coates v. Heartland Wireless Communications, Inc.*, 55 F. Supp. 2d 628, 635 (N.D. Tex. 1999) (“*Coates II*”). The SEC’s primary strategy for explaining why alleged misstatements were false when made amounts to no more than impermissible pleading of fraud by hindsight. For example, the SEC’s support for any Defendant’s alleged knowledge of the statement’s falsity is its conclusory allegations that after full subscription the oil and gas properties never generated sufficient production to support such high monthly returns of 1.5%. See Complaint, ¶ 28 (“in reality, Fund I’s assets never performed well enough to support 1% monthly returns, let alone the 1.5% returns originally promised”). Although fraud-by-hindsight pleading has long been discredited, the SEC appears to have nothing else to offer. *Shields v. CityTrust Bancorp, Inc.*, 25 F.3d 1124, 1129 (2d Cir. 1994) (“This technique is sufficient to allege that the defendants were wrong; but misguided optimism is not a cause of action, and does not support an inference of fraud.”); *Denny v. Barber*, 576 F.2d 465, 470 (2d Cir. 1978) (dismissing complaint that “seized upon disclosures made in later annual reports and alleged that they should have been made in earlier ones”); *In re Sec. Litig. BMC Software, Inc.*, 183 F. Supp. 2d 860, 917 (S.D. Tex. 2001) (noting that pleading fraud by hindsight is impermissible). The following representations, among others alleged by the SEC do not explain why or how they are false or that they were false when made:<sup>7</sup>

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<sup>7</sup> The Rockwell Defendants have submitted with this Motion to Dismiss Appendix A, which addresses each paragraph of the Complaint and explains why each fails to provide a basis for securities fraud claims against the Rockwell Defendants.

- “The PPM refers to the technology as a “green” technology and calls it a Passive Dehydration System or PDS. The device purportedly enhances production by removing water from unprocessed natural gas in a manner that is more efficient than traditional methods.” Complaint, ¶ 18. The SEC does not even allege that this representation is false, how it was false or that it was false when made.
- “According to offering materials, PDS technology ‘results in an immediate increase in production of 40%,’ and the ‘production and revenue increase . . . mitigat[es] risk completely.’ The statement that the device ‘mitigates’ risk ‘completely’ is either misleading or patently false.” Complaint, ¶ 19. Not only does the SEC take this statement out of context, it fails to explain how it is false or that it was false when it was made.
- “The private placement memorandum (“PPM”) and promotional materials for Fund I style the offering as an income investment that pays investors monthly distributions ‘secured’ by existing and to-be-acquired gas production.” Complaint, ¶ 20. The SEC does not even allege that this representation is false, how it was false or that it was false when made.
- “In the Fund I offering materials, Shindler told investors that the fund ‘will payout 18% annually which is paid out 1.5% monthly, from the date of investment,’ and that returns would climb as high as 30% ‘as additional production is brought online.’ Shindler never disclosed to investors that there existed no reasonable basis on which he could project such returns.” Complaint, ¶ 25. “As promised, Shindler started paying investors 1.5% monthly returns soon after they invested in Fund I. The gas well interests that Fund I owned, however, never generated

sufficient production revenue to support such high returns.” Complaint, ¶ 26. “At full subscription, the fund needed \$52,500 in monthly production revenue to meet its distribution commitments. Fund I was fully subscribed by October 2008, but was earning, on average, only about \$20,000 in monthly production revenue. Fund I never earned more than \$42,675 in production revenue in a single month, and, since September 2008, has not earned more than \$18,000 in a single month.” Complaint, ¶ 27. “Nevertheless, Shindler sent investors monthly distribution payments at the promised rate of return up until December 2008, at which time he cut the payments to roughly 1% monthly. Shindler told investors at the time that the drop was due to price declines in the market for natural gas. In reality, Fund I’s assets never performed well enough to support 1% monthly returns, let alone the 1.5% returns originally promised.” Complaint, ¶ 28. The SEC does not allege how these statements or omissions are false or that they were false when made; this failure is especially significant (1) in light of the SEC’s admission that Shindler did begin paying those monthly returns, (2) in light of the forward looking statements and cautionary language below, and (3) when viewed within the context of the entire PPM materials. The SEC is particularly relying on fraud-by-hindsight pleading and should be discredited by this Court here.

The SEC’s inability to state with particularity how the statements were fraudulent is a fatal defect requiring dismissal. Accordingly, the SEC’s Complaint fails to meet the requirements of Rule 9(b) and should be dismissed pursuant to Rule 12(b)(6).

Moreover, the SEC cannot get past the safe harbor provisions of 15 U.S.C. § 78u-5(c)(1) or the “bespeaks caution” doctrine. In order for the safe harbor to apply, a forward-looking

statement must both be “identified as a forward-looking statement, and [be] accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement.” 15 U.S.C. § 78u-5(c)(1)(A)(i). To avoid the effect of the safe harbor provision, a plaintiff must show the forward-looking statement to be material and knowingly false. See 15 U.S.C. § 78u-5(c)(1)(A)(ii),(B).

The bespeaks caution doctrine operates in a very similar fashion. This doctrine provides a mechanism by which a court can rule as a matter of law that defendants’ forward-looking representations contained enough cautionary language or risk disclosure to protect the defendant against claims of securities fraud. *Provenz v. Miller*, 102 F.3d 1478, 1493 (9th Cir.1996) (citing *In re Worlds of Wonder Securities Litigation*, 35 F.3d 1407, 1413-4 (9th Cir.1994)). Both the safe harbor and the bespeaks caution doctrine shield a defendant from liability for statements that both (1) are forward-looking and (2) include sufficient cautionary language. The Ninth Circuit has explained that the bespeaks caution doctrine merely stands for “the unremarkable proposition that statements must be analyzed in context.” *Id.*

In this case, the SEC relies on statements in the PPMs but pulls them out of context, disregarding all the forward looking aspects and sufficient cautionary language contained in them. In considering the motion to dismiss, this Court is allowed to review the quoted statements in context, by reviewing the PPMs in their entirety. For example paragraphs 25 through 28 of the Complaint, quoted above, ignore the fact that the PPMs included sufficient cautionary language including (1) the fact that its assumptions are based upon minimum prices of \$60 per barrel for oil and \$6 per mcf for gas<sup>8</sup> and, (2) that “these statements involve risks and uncertainties that may cause actual future activities and results to be materially different from

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<sup>8</sup> See page 1 of marketing materials accompanying PPMs (and quoted in part by SEC in the Complaint).

those suggested or described herein.”<sup>9</sup> The potential investor is referred several times to the discussion in the respective PPM of significant risk factors, including but not limited to: the risk that “Volatile Oil and Gas Prices Can Materially Affect the Limited Partnership: \* \* \* Oil and natural gas prices have historically been and are likely to continue to be volatile. This volatility makes it difficult to estimate with prevision the value of producing properties in acquisitions and to budget and project the return on exploration and development projects involving the Limited Partnership’s oil and gas interests . . .” Fund I PPM at 19-20. The risk of “Fluctuation in Oil and Gas Prices” that “could result in the Partnership earning less revenue, resulting in lower or no distributions to the Partners.” Fund II PPM at 13. Moreover, both PPMs stress that investment in the Funds is highly speculative.<sup>10</sup>

In addition, the SEC claims that the Fund 1 PPM falsely represented that REOT or Fund I owned working interests or wells: “The PPM falsely states that [REOT] owned working interests in two producing gas wells, and that Fund I intended to purchase those interests and outfit the wells with PDS technology.” Complaint, ¶ 21; “claims that the well is “company owned”; Complaint, ¶ 22; or “that Fund I ‘currently owns’ an ‘inventory of 20 wells,’ with which the fund ‘will be able to increase its monthly distributions’ as it adds new wells from its inventory to the program.” Complaint, ¶ 23. The SEC claims that neither the Fund nor REOT owned such interests or wells but rather a “former partner of Shindler.” The SEC fails to mention that at the time PPM was distributed, that “former partner” owned Rockwell Energy of Texas and the interests in the alleged wells. *See* Fund 1 PPM at page 25.

Similarly, the statements about fees and commissions about which the SEC complains in paragraphs 32 through 35 and paragraphs 41 through 45 are taken out of context of the full

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<sup>9</sup> *See id.*

<sup>10</sup> *See, e.g.,* page 2 of Fund 1 PPM and page i of Fund 2 PPM.

cautionary language. Indeed the PPMs clearly grant the General Partner broad discretion to use the “proceeds of this offering” to “include, but [] not limited to, syndication, marketing, administration, geologic, land, engineering, drilling, purchase of oil producing properties, completion, and commissions, if any. . . . It may be that commissions may be paid. However, the General Partner may pay certain fees to third parties or affiliates for consultation, marketing services expenses, management fees, finders’ fees in connection with this offering.”<sup>11</sup>

Regarding the loan transactions about which the SEC’s complains in paragraphs 29 through 31 and paragraphs 41 through 45, the PPMs, again, provide context belying the SEC’s assertions of fraud: the section entitled “Loans and Borrowing” on page 15 of the PPM for Fund I discloses that the General Partner has the authority to “loan Limited Partnership funds.” Page 10 of the PPM for Fund II contains an identical provision in the “Loans and Borrowing” section.

2. *The SEC does not establish scienter.*

Even more glaring than the SEC’s failure to plead Defendants’ specific misrepresentations is its inability to plead any facts to support a claim that the Rockwell Defendants had an intent to deceive the investors. “[S]cienter is an element of a violation of § 10(b) and Rule 10b-5, regardless of the identity of the plaintiff or the nature of the relief sought.” *Aaron v. SEC*, 446 U.S. 680, 697, 100 S. Ct. 1945, 1953, 64 L. Ed. 2d 611 (1980). The Supreme Court has held that a Section 17(a)(1) claim also requires a showing of scienter, while claims under Section 17(a)(2) or (3) do not. *Id.* Notwithstanding their failure to allege scienter against *any* Defendant, the SEC first attempts to meet the scienter requirement by impermissibly lumping the Defendants together. A securities fraud complaint must demonstrate that *each*

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<sup>11</sup> See Fund 1 PPM at pages 17-18; Fund 2 PPM at page 21.

defendant possessed the required scienter: “the complaint shall with respect to *each* act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.” § 78u-4(b)(2) (emphasis added). Furthermore, to establish scienter on the part of a corporation, “it is not enough . . . that one corporate officer makes a false statement that another officer knows to be false. A defendant corporation is deemed to have the requisite scienter for fraud only if the individual corporate officer making the statement has the requisite level of scienter . . . .” *In re Apple Computer, Inc., Sec. Litig.*, 243 F. Supp. 2d 1012, 1023 (N.D. Cal. 2002); *see also Nordstrom, Inc. v. Chubb & Son, Inc.*, 54 F.3d 1424, 1435-36 (9th Cir. 1995) (rejecting “collective scienter” theory). To the extent that the SEC’s allegations purport to describe “the collective actions” of the Defendants as a group, they are fatally flawed.

Next, the SEC implies that the Rockwell Defendants were motivated by fees received related to Fund I and Fund II. The Fifth Circuit has routinely held that compensation alone is not a motive to commit fraud, and allegations such as these do not allow even a reasonable inference of scienter because the same motives are present in nearly every case. For example, in *Tuchman*, the plaintiffs alleged that the defendants acted “for the purpose of . . . increasing compensation for themselves.” 14 F.3d at 1068. The Fifth Circuit upheld the trial court’s conclusion that incentive compensation was no evidence of motive to commit fraud. *Id.* at 1068-69. In the context of this case, the compensation incentive allegation is legally deficient. The SEC’s failure to plead facts sufficient to allege scienter is an independent basis for the Court to dismiss its securities fraud claims.

3. *The SEC does not establish in connection with the purchase, sale or offering of a security*

To constitute securities fraud, the alleged misrepresentations must be made “in connection with” the purchase, sale, or offering of a security. *SEC v. Zandford*, 535 U.S. 813, 822 (2002). There is no claim for securities fraud if, after a lawful transaction has been consummated, a decision to engage in fraudulent conduct is made. *Id.* at 820, 825 n.4 (“If a broker embezzles cash from a client’s account or . . . induce[s] his client into a fraudulent real estate transaction, then the fraud would not include the requisite connection to the purchase or sale of securities.”). Thus, unless the alleged fraud and the sale of securities coincide, there is no securities law violation, but rather in this case, a vaguely pled garden variety fraud allegation.<sup>12</sup>

In its Complaint, the SEC makes many vague allegations of post-subscription representations but does not tie any alleged misrepresentations to any Defendants at the time of the sale of the limited partnership interests. These insufficient garden variety fraud allegations are not connected to any knowingly false representation made in connection with the purchase, sale or offering of any security. For example, the SEC alleges that Shindler made improper investments and improper payments with the investor funds from Fund I, but fails to connect any of the conduct to the offer or sale of securities. See Complaint ¶¶ 29-35. In addition, the Complaint at paragraphs 41 through 45, alleges an improper alternative investment by Fund II and but again fails to make any connection to the purchase, sale or offering of securities. The Complaint even alleges that the transaction was terminated when the Commission questioned it. See Complaint at ¶ 45. The SEC is not permitted to plead a formulaic recitation of the elements to support its claim that misrepresentations were made in the offer and sale of securities,

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<sup>12</sup> Again, the Rockwell defendants have specifically denied that they made any material misrepresentations or committed any form of fraud.

especially when, as in this case, there is a heightened pleading requirement for fraud. *See Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555, 127 S. Ct. 1955, 1964-65, 167 L. Ed. 2d 929 (2007).

**B. The Court Should Dismiss the Claim for Injunctive Relief**

Although the SEC may obtain injunctive relief upon “a proper showing” that there is a “reasonable likelihood that the defendant[s][are] engaged or about to engage in practices that violate the federal securities laws,” *SEC v. First Fin. Group of Tex.*, 645 F.2d 429, 434 (5th Cir. Unit A May 1981) (citations omitted), in this case the SEC cannot show—and has not even attempted to plead—a reasonable likelihood of future substantive violations. *First Fin. Group of Tex.*, 645 F.2d at 434 (citations omitted); *SEC v. Tyler*, 2002 WL 32538418, at \*2 (N.D. Tex. Feb. 21, 2002).<sup>13</sup>

In this case, the Complaint shows that the Rockwell Defendants have been very cooperative with the SEC’s investigation and even states that the Rockwell Defendants agreed to put investor funds in escrow at the request of the Commission. Complaint at ¶¶ 36, 47. Not only does the SEC fail to allege, much less prove, past substantive violations or scienter, there is clearly no “reasonable likelihood that the defendant[s][are] engaged in or about to engage in practices that violate the federal securities laws.” Accordingly, the claim for injunctive relief is not supported by the pleadings and should be dismissed pursuant to 12(b)(6).

**VIII.  
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

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<sup>13</sup> Additionally, “[w]hen scienter is an element of the substantive violation sought to be enjoined, it must be proven before an injunction may issue.” *Tyler*, 2002 WL 32538418, at \*2 (citing *Aaron v. SEC*, 446 U.S. 680, 699-700, 100 S.Ct. 1945, 64 L.Ed.2d 611 (1980)).

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 attached order 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 Brooks

Linda Brooks