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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. ERIC J. "EJ" DALIUS, an individual, PROFESSIONAL REALTY ENTERPRISES, INC., a Corporation, SAIVIAN LLC, a Limited Liability Company, SAVINGS NETWORK APP LLC, a Limited Liability Company, SAVING NETWORK APP LIMITED, a Limited Company, SAIVIAN INTERNATIONAL LIMITED, a Limited Company, SAIVIAN INT	Case No. 2:18-cv-08497-CJC-E **Hon. Cormac J. Carney** **DEFENDANTS' NOTICE OF MOTION AND MOTION TO DISMISS COMPLAINT** Date: July 29, 2019 Time: 1:30 p.m. Ctrm: 7C Complaint Filed: October 3, 2018

LIMITED, a Private Company, and REALTY SHARE NETWORK LLC, a Limited Liability Company,

Defendants.

PLEASE TAKE NOTICE THAT ON July 29, 2019 at 1:30 p.m. or as soon thereafter as the matter may be heard in the courtroom of the Honorable Cormac J. Carney, located at 350 W. 1st Street, Los Angeles, CA 90012, Defendants Eric J. "EJ" Dalius, Professional Realty Enterprises, Inc., Realty Share Network LLC, Saivian LLC, and Savings Network App LLC will and hereby do move pursuant to Rule 12(b)(6), Fed. R. Civ. P. to dismiss the complaint for failure to state a claim upon which relief may be granted.

This Motion is based on this Notice of Motion and Motion, the Memorandum of Points and Authorities filed and served herewith and upon the papers, records and pleadings on file herein.

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Pursuant to Local Rule 7-3, counsel for Defendants Eric J. "EJ" Dalius, Professional Realty Enterprises, Inc., Saivian LLC, Savings Network App LLC, and Realty Share Network LLC met and conferred with counsel for Plaintiff Securities and Exchange Commission on numerous occasions, including most recently by telephone on April 17, 2019, regarding Defendants' intent to file the instant Motion and the grounds for the Motion.

Dated: April 22, 2019

GARTENBERG GELFAND HAYTON LLP

By: /s/ Edward Gartenberg
Edward Gartenberg
Milena Dolukhanyan

SCHULTE ROTH & ZABEL LLP
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I. INTRODUCTION

The SEC's Complaint—which baselessly attacks a multi-level marketing ("MLM") enterprise offering shopping discount memberships—is woefully insufficient and ignores the Ninth Circuit's clear instruction that "[n]ot all MLM businesses are illegal pyramid schemes." *F.T.C. v. BurnLounge, Inc.*, 753 F.3d 878, 883 (9th Cir. 2014). The SEC hastily assumed—contrary to well-established Ninth Circuit law—that because Saivian LLC ("Saivian Domestic") and Saivian International Ltd. ("Saivian International") operated MLM businesses, they were necessarily unlawful. From there, the SEC became so fixated on Eric Dalius' income—regardless of whether that income had any connection to Saivian Domestic or Saivian International—that it failed to consider "how the MLM business operates in practice," *id.*, and lost sight entirely of whether there was a securities law violation in the first place.

The SEC's "shoot first, ask questions later" strategy resulted in a Complaint that never should have been filed. The SEC never carefully considered whether Saivian Domestic or Saivian International were selling "investment contracts" that implicate the securities laws. Nor did the SEC ever assess whether Saivian Domestic and Saivian International had been structured to comply with well-settled MLM laws. Despite its explicit mission to protect United States investors in United States markets, the SEC disregarded that it was investigating conduct that largely took place in China and literally had no effects in the United States. The SEC never bothered to assess whether there was a single "victim" of Saivian Domestic or Saivian International, and ignored that everyone who lost money in Saivian Domestic had been refunded and everyone who lost money in Saivian International had been offered rescission.[1] And, despite all of that, the SEC apparently failed to

[1] As the SEC knows, Saivian Domestic began offering refunds on or around July 31, 2017, long before the SEC commenced this action, and ultimately refunded over

consider whether filing a lawsuit in October 2018 made any sense in light of the fact that—as the Court has recognized—Saivian International "officially ended its global operations in September 2017" and Saivian Domestic "halt[ed] its United States business at the end of July 2017."[2]

Instead, the SEC jumped to conclusions, prejudged Dalius' liability at the start of its investigation, and then spent more than two years serving innumerable subpoenas on banks, brokerages, credit card companies, accountants, real estate companies, and cryptocurrency exchanges to determine how much money Dalius made investing in Bitcoin, where he bought real estate, and whether he took his daughter on a birthday vacation.

The SEC has clearly overreached in this case, and the Court should dismiss the Complaint in its entirety. As an initial matter, the SEC has not pleaded—because it cannot—that the Cashback Membership Program or the Affiliate Program were "investment contracts" under black-letter Supreme Court and Ninth Circuit law. Regarding the Cashback Membership Program, the SEC does not plead that Saivian Domestic or Saivian International ever referred to Cashback Membership fees as "investments," or articulate how the $125 fee for a Cashback Membership amounts to an "investment of money" rather than the purchase of a product. The SEC also admits that Cashback Members only would receive 20 percent discounts on their shopping if they submitted their receipts and, as the Complaint concedes, were fully in control of their own profitability. Thus, the Cashback Members were not the types of "passive investors" that the securities laws are meant to protect. And regarding the Affiliate Program, to the extent people profited from recruiting other Cashback

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$3.2 million. Similarly, Saivian International offered full rescission to any foreign members on or around September 1, 2017, long before the SEC commenced this action.

[2] (Order Denying Plaintiff's Ex Parte Application for a Temporary Restraining Order, Order to Show Cause, Preliminary Injunction, and Order Granting Other Relief, dated Oct. 11, 2018 [ECF No. 16] at 3.)

Members, they did not profit from any "investment of money" or through the "efforts of others"—as the law requires for the existence of an investment contract.

The SEC also has not come close to satisfying its pleading burden to allege its fraud-based claims with the particularity required by Federal Rule of Civil Procedure 9(b). That failure permeates the Complaint, which seeks to state the SEC's claims through allegations that impermissibly attribute the purported misconduct to all Defendants and legal conclusions that largely offer nothing more than rote recitations of the elements of the claims the SEC asserts. The most egregious example is the SEC's failure to distinguish between Saivian Domestic's operations in the United States and Saivian International's operations abroad. The SEC knows that the overwhelming majority of the conduct of Saivian International at issue took place overseas—primarily in China—and yet the Complaint treats Defendants interchangeably, suggesting that *all* Defendants took *all* of the alleged actions *both* domestically and internationally. This is not an innocent oversight. The SEC has intentionally blurred the critical distinction between the respective operations of Saivian Domestic and Saivian International because it wants to hide an 800-pound gorilla from the Court—namely, that the SEC lacks extraterritorial jurisdiction over Saivian International's activity, which constitutes the majority of conduct at issue in this case.

The Complaint also fails to allege the type of facts that the Ninth Circuit requires to adequately plead the existence of an unlawful pyramid or Ponzi scheme. With respect to the SEC's theory that the Affiliate Program was an illegal pyramid scheme, the Complaint does not plead that the Affiliate Program was "inherently fraudulent" under either element of the Ninth Circuit's pyramid scheme test—namely, that the Affiliate Program was "'characterized by the payment by participants of money to the company in return for which they receive (1) the right to sell a product *and* (2) the right to receive in return for recruiting other participants into the program rewards which are unrelated to the sale of product to ultimate

users.'" *BurnLounge*, 753 F.3d at 883 (citation omitted). Importantly, the structure of the Affiliate Program—*i.e.*, that a person had to sell three Cashback Memberships before he or she was eligible to receive commissions as an Affiliate—ensured that there would always be three times as many Cashback Members as Affiliates, and, therefore, that the Affiliate Program could not be a pyramid scheme.

Regarding its theory that the Cashback Membership Program was a Ponzi scheme, the SEC fails to plead that the program made cashback payments to existing members with fees contributed by new members, or that the collapse of Saivian Domestic and/or Saivian International was inevitable. The SEC also ignores that "a company is not a Ponzi scheme merely because it … has negative cash flow for several years." *In re EPD Inv. Co., LLC*, 587 B.R. 711, 720 (C.D. Cal. 2018). In fact, with respect to both the SEC's pyramid scheme and Ponzi scheme theories, the SEC's own Complaint makes allegations that are tantamount to concessions that the Cashback Membership Program and the Affiliate Program complied with existing Ninth Circuit law.

Nor does the Complaint adequately plead a claim Defendants made any material misstatements or omissions. As an initial matter, although the Complaint attributes the purported misstatements and omissions to both Saivian Domestic and Saivian International, virtually all of the statements at issue are alleged to have been made *before* Saivian International even came into existence. Plainly, that entity cannot be liable for any such alleged misstatements or omissions. The SEC also does not identify a single person who allegedly viewed or heard the purported misstatements, whether he or she actually purchased Cashback Memberships, and how statements made in English were communicated to Saivian International's Cashback Members—who primarily were based in China. Additionally, the Complaint's purported misstatements and omissions—relating either to (i) how Saivian Domestic and Saivian International purportedly generated the revenue to make cashback payments to members, or (ii) Dalius' role in Saivian Domestic and a

criminal conviction nearly 20 years ago—are not actionable. There are a host of reasons why this is so, including because the Complaint does not plead any of them with the particularly required by Rule 9(b), the statements plainly reflect Defendants' vision of the organization's future and, accordingly, constitute non-actionable puffery, and the Complaint does not (and cannot) allege that Defendants had any duty to disclose Dalius' prior conviction.

In sum, the SEC asks this Court to sustain a complaint that relies on impermissible labels and legal conclusions where well-pleaded allegations of fact are required under well-settled Supreme Court and Ninth Circuit precedent. Although the SEC may desperately want to believe that Saivian Domestic and Saivian International were fraudulent enterprises in order to justify its far-reaching, undoubtedly expensive investigation, even two years of discovery apparently was insufficient to adequately allege as much. The Court should grant Defendants' Motion in its entirety, and dismiss the Complaint without leave to amend.

II. SUMMARY OF FACTUAL ALLEGATIONS

A. The Defendants

The Complaint alleges that Professional Realty Enterprises, Inc. ("PRE"), Saivian Domestic, Savings Network App LLC ("SNAP"), Realty Share Network LLC ("Realty Share," and together with PRE, Savian Domestic and SNAP, the "Corporate Defendants"), along with three purportedly affiliated foreign entities—including Saivian International—are "seven connected entities based in the United States, Hong Kong and the United Kingdom that collectively operated under the business name Saivian."[3] (Complaint, dated Oct. 3, 2018 [ECF No. 3] ("Compl.") ¶ 5.) The Complaint further alleges that Dalius "controlled" all the Corporate

[3] The three foreign entities identified in the Complaint are Saving Network App Limited, Saivian International, and Saivian INT Limited. As the SEC has not served any of those entities, they do not yet have any obligation to appear in this action and, accordingly, are not among the moving Defendants here.

Defendants, and was the "founder, sole shareholder and sole director" of some, but not all, of the Corporate Defendants. (*Id.* ¶¶ 5, 13.) However, the Complaint is silent as to how each of the Corporate Defendants functioned within the corporate structure, and offers sparse details as to why each is named in the Complaint.[4] (*Id.* ¶¶ 14-20.)

B. The Cashback Membership Program

The Complaint alleges that from October 26, 2015 through September 2017, Defendants "operated under the business name Saivian" and sold "Cashback Memberships" in the U.S. and abroad. (Compl. ¶¶ 5-6, 28, 31.) According to the Complaint, "[t]he Memberships, which cost $125 every 28 calendar days, offered 20% cashback on Cashback Members' shopping purchases in exchange for submission of their POS receipts for those purchases to Saivian." (*Id.* ¶ 6.) The SEC alleges that "[t]he cashback payments to Cashback Members were on sixty day delay from when POS receipts were submitted," and "Cashback Members had to continue their Memberships … in order to remain eligible to receive payments." (*Id.* ¶ 31.) The fact that the Cashback Members had to submit shopping receipts in order to obtain payments necessarily means that the Cashback Membership Program was not an "investment contract." (*See* pp. 13-15, *infra*.)

While the SEC's articulation of the Cashback Membership payment inflows and outflows is generally correct, the documents incorporated by reference into the SEC's Complaint provide further information necessary to understand the program's

[4] For example, the Complaint does not allege that SNAP or Realty Share did anything other than open bank accounts that were purportedly used to "receive and transfer funds from Saivian investors located in the United States" and/or "around the world." (*Id.* ¶¶ 16, 20.) And apart from impermissibly pleading that PRE made misstatements collectively with Dalius, Saivian Domestic, and Saivian International (*see* pp. 44-45, *infra*), the only allegations about PRE are that it registered the "www.saivian.net" website, and—similar to SNAP and Realty Share—maintained certain bank accounts. (Compl. ¶ 14.)

structure.[5] To begin with, there was a 90-day delay between the date that a person initially purchased a Cashback Membership and the date that the Cashback Member would receive its first 20% cashback payment. (*See, e.g.*, Ex. 40 at 444, Ex. 60 at 588.) Moreover, Cashback Members could redeem a minimum of $125 and a maximum of $250 for any particular month. (*See, e.g.*, Ex. 23 at 298, Ex. 40 at 448.) Finally, for any particular Cashback Member's first cashback redemption, the Cashback Member was limited to a $125 redemption. (*See, e.g.*, Ex. 40 at 442, 448.)[6] Importantly, at the same time that Cashback Members were paying their monthly fees and redeeming their 20% cashback, the Cashback Members also had access to a program called the Instant Savings Benefit. The Instant Savings Benefit allowed Cashback Members to obtain shopping discounts at various nationally recognized brands from the outset of their enrollment as Cashback Members. (*See, e.g.*, Ex. 40 at 438, Ex. 56 at 574, Ex. 60 at 589.)

The mechanics of these payments are important to understanding why the

[5] "Ex. __" refers to the exhibits attached to the Authentication Declaration of Kenneth J. Guido in Support of Plaintiff's *Ex Parte* Motion for Emergency Injunctive Relief and Order to Show Cause, dated Oct. 3, 2018 [ECF No. 19] (the "Guido Declaration"). For the reasons set forth below (*see* Section III, *infra*), the Court can consider all of the documents referenced throughout this brief on a motion to dismiss because the documents—which are all exhibits to the Guido Declaration—directly relate and are central to the allegations in the Complaint.

[6] Moreover, although the Complaint refers generically to "Cashback Memberships," Saivian Domestic and Saivian International actually introduced several products to the market: (1) the Retail Shopping Membership, in which Cashback Members could pay $125 in exchange for 20% cashback on their everyday shopping (*see, e.g.*, Ex. 23 at 298, Ex. 51 at 545, Ex. 60 at 587); (2) the Instant Savings Benefit, which allowed Cashback Members to obtain instant savings at various nationally recognized brands (*see, e.g.*, Ex. 40 at 438, Ex. 56 at 574, Ex. 60 at 589); (3) the Global Travel Membership, which supplemented the Retail Shopping Membership and provided 20% cashback on hotel, resort, and airline purchases (*see, e.g.*, Ex. 60 at 587); and (4) the Global Savings Plan, which merged the Retail Shopping Membership's and the Global Travel Membership's features, and continued to provide members with the Instant Savings Benefit (*see, e.g.*, Ex. 40 at 438).

Cashback Membership Program was not a fraudulent Ponzi scheme. As discussed below, in order to be an illegal Ponzi scheme, a company must—at a minimum—use funds from new investors to repay old investors. *See, e.g.*, *In re Agric. Research & Tech. Grp., Inc.*, 916 F.2d 528, 531 (9th Cir. 1990). But here, the payment flows inherent in the Cashback Membership Program meant that, as a practical matter, existing members were *never* being paid cashback with membership fees from new members. (*See* pp. 31-34, *infra*.) Critically, therefore, the SEC has not alleged that money from new Cashback Members was, in fact, used to make payments to older Cashback Members—the hallmark of a Ponzi scheme.

Saivian also marketed products to businesses through the Merchant Advertising Platform ("MAP" or the "MAP Program"). (Compl. ¶ 34; *see also, e.g.*, Ex. 85 at 929.) As the Complaint alleges, "[u]nder this MAP Program, merchants who made a $125 membership payment every 28 days were listed on the Saivian website and mobile app and could offer the 20% cashback to certain Cashback Members for purchases at the merchant's business." (Compl. ¶ 35.) The MAP Program therefore functioned as a marketing tool for businesses looking for exposure to Saivian Domestic's and Saivian International's growing membership base, and provided advertising revenue to fund their expansion.

The SEC's allegations concerning the MAP Program are also critical to understanding why the Cashback Membership Program was not a Ponzi scheme. Indeed, despite alleging that "the returns [Saivian Domestic and Saivian International] paid to [the Cashback Members] were derived almost exclusively from other [Cashback Members'] funds in the form of Cashback Membership payments," the SEC concedes that the MAP Program generated advertising revenues that were independent of any Cashback Member payments. (*Id.* at ¶¶ 28, 37.) Thus, the growth of the MAP Program would ensure that the Cashback Membership Program's collapse was not inevitable—the hallmark of a Ponzi scheme.

C. The Affiliate Program

Separately from its Cashback Membership Program, Saivian Domestic and Saivian International enabled people to become "Affiliates" and sell Cashback Memberships and MAP Memberships to others. (Compl. ¶ 39.) The SEC alleges that once the Affiliates "qualified for commission income by personally recruiting three members (Cashback or MAP), they would receive a daily residual income stream based on their membership sales—both directly and indirectly through their 'downline' recruits." (*Id.*) Affiliates therefore earned more money as they sold—and as their downlines sold—more Cashback Memberships. (*Id.* ¶¶ 40-41.)

Similar to its allegations concerning the Cashback Membership Program, the SEC's own Complaint demonstrates why the Affiliate Program was not a pyramid scheme under Ninth Circuit law. Indeed, as set forth below, the fact that a person was ineligible to receive commissions as an Affiliate until it had sold three active Cashback Memberships necessarily ensured that Saivian Domestic and Saivian International were *not* paying "'rewards which are unrelated to product sales.'" *BurnLounge*, 753 F.3d at 884 (citation omitted). By contrast, the Complaint itself establishes that Affiliates were *only* paid commissions for the sale of products—*i.e.*, Cashback Memberships—which means the Affiliate Program was not an illegal pyramid scheme.

III. LEGAL STANDARD

To survive a motion to dismiss under Fed. R. Civ. P. 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)), and "a formulaic recitation of the elements of a cause of action" is insufficient, *Twombly*, 550 U.S. at 555. "While legal conclusions can provide the framework of a complaint, they must be supported by factual allegations." *Iqbal*, 556 U.S. at 679; *see also Moss v. U.S. Secret Serv.*, 572 F.3d 962, 969 (9th Cir. 2009) ("[T]he non-conclusory 'factual

content,' and reasonable inferences from that content, must be plausibly suggestive of a claim entitling the plaintiff to relief."); *S.E.C. v. Francisco*, 262 F. Supp. 3d 985, 989 (C.D. Cal. 2017) (Carney, J.) ("[T]he tenet that a court must accept as true all of the allegations contained in a complaint is inapplicable to legal conclusions.") (quotation marks and citations omitted).

Fraud claims, like those asserted by the SEC here, must satisfy the heightened pleading standard of Federal Rule of Civil Procedure 9(b). Fed. R. Civ. P. 9(b); *see also ESG Capital Partners, LP v. Stratos*, 828 F.3d 1023, 1031 (9th Cir. 2016). The plaintiff must allege "the time, place, and specific content of false representations as well as the identities of the parties." *Odom v. Microsoft Corp.*, 486 F.3d 541, 553 (9th Cir. 2007) (citations omitted). Thus, to satisfy Rule 9(b)'s heightened pleading standard, a plaintiff must "set forth an explanation as to why the statement or omission complained of was false or misleading." *Cooper v. Pickett*, 137 F.3d 616, 625 (9th Cir. 1997) (quoting *In re GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541, 1548 (9th Cir.1994)) (superseded by statute on other grounds); *see also Kearns v. Ford Motor Co.*, 567 F.3d 1120, 1124 (9th Cir. 2009) ("Averments of fraud must be accompanied by 'the who, what, when, where, and how' of the misconduct charged." (citations omitted)).

Accordingly, as this Court has explained in dismissing an SEC complaint, the SEC must "'allege the names of the persons who made the allegedly fraudulent representations, their authority to speak, to whom they spoke, what they said or wrote, and when it was said or written.'" *Francisco*, 262 F. Supp. 3d at 989 (quoting *UMG Recordings, Inc. v. Glob. Eagle Entm't, Inc.*, 117 F.Supp.3d 1092, 1107 (C.D. Cal. 2015)). Moreover, Rule 9(b) "does not allow a complaint to merely lump multiple defendants together but 'require[s] plaintiffs to differentiate their allegations when suing more than one defendant … and inform each defendant separately of the allegations surrounding his alleged participation in the fraud.'" *S.E.C. v. Jammin Java Corp.*, No. 2:15-cv-08921-SVW-MRW, 2016 WL 6595133,

at *21 (C.D. Cal. Jul. 18, 2016) (quoting *Swartz v. KPMG LLP*, 476 F.3d 756, 764-65 (9th Cir. 2007)). Thus, in the context a fraud suit involving multiple defendants—like this case—the SEC must, at a minimum, identify the role of each defendant in the alleged fraudulent conduct. *See id.*

That means the SEC cannot rely on the group pleading or group published doctrine—under which a plaintiff may rely on a presumption that statements made in group-published documents are the collective work of those involved in the day-to-day affairs of the company—to state its claims against each Defendant. *See, e.g.*, *S.E.C. v. Yuen*, 221 F.R.D. 631, 636 (C.D. Cal. 2004) ("The SEC makes general and conclusory allegations against the Defendants and asserts that the Defendants' acts are a part of some ill-defined 'scheme' …. [T]his Court will not allow the SEC to abuse the group pleading doctrine by asserting non-specific claims."). This is particularly true where—like here—the plaintiff engaged in "significant discovery" prior to filing its complaint. *Id.* at 637.

Finally, although in deciding a Rule 12(b)(6) motion, a court generally looks only to the face of the complaint, it is now well-settled in this Circuit that courts may consider materials that are not attached to the complaint or expressly referenced in the complaint when they "directly relate" to the claims asserted in the complaint. *In re Am. Apparel, Inc. S'holder Derivative Litig.*, No. CV 10-06576 MMM (RCx), 2012 WL 9506072, at *17 (C.D. Cal. Jul. 31, 2012); *see also Branch v. Tunnell*, 14 F.3d 449, 454 (9th Cir. 1994) (adopting rule permitting consideration on motions to dismiss of documents not attached to complaint where the complaint references the contents of such documents and their authenticity is not in dispute), *overruled on other grounds by Galbraith v. County of Santa Clara*, 307 F.3d 1119 (9th Cir. 2002); *Toneman v. U.S. Bank*, No. CV-12-09369 MMM (MRWx), 2013 WL 12131730, at *1 (C.D. Cal. Jun. 14, 2013) (court may consider documents not attached or expressly referenced in complaint where such documents are "central to" plaintiff's claims, as long as authenticity of documents is not in question); *Lee v. Gen. Nutrition*

Cos., No. CV 00-13550LGB(AJWX), 2001 WL 34032651, at *5 (C.D. Cal. Nov. 26, 2001) (explaining that "documents not mentioned in complaint, which are essential to a plaintiff's case and the authenticity of which is uncontested" may be considered on a motion to dismiss).

IV. ARGUMENT

A. The SEC Has Not Adequately Pleaded that the Cashback Membership Program and the Affiliate Program Are "Investment Contracts."

It is well-settled that "[a]n investment contract is (1) an investment of money (2) in a common enterprise, evidenced by either vertical or horizontal pooling, (3) with the expectation of profits produced by the efforts of others." *See S.E.C. v. Alliance Leasing Corp.*, 28 F. App'x 648, 651 (9th Cir. 2002); *see also S.E.C. v. W.J. Howey Co.*, 328 U.S. 293 (1946). Here, the SEC has not adequately alleged that the Cashback Membership Program or the Affiliate Program were "investment contracts" under *Howey*, which places the SEC's entire case beyond the scope of the federal securities laws and the SEC's enforcement purview. *See, e.g.*, *S.E.C. v. Pac. W. Capital Grp, Inc.*, No. CV 15–2563 FMO (FFMx), 2015 WL 9694808, at *5 (C.D. Cal. June 16, 2015). For this reason alone, the Court should grant Defendants' motion to dismiss.[7]

[7] As set forth above, the Court is not required to accept the SEC's "legal conclusion[s] couched as … factual allegation[s]." *Iqbal*, 556 U.S. at 678. But that is all the Complaint offers here. The SEC has merely pleaded that "Saivian's Cashback Membership and Affiliate program are securities under federal law, including as 'investment contracts,'" the "Cashback Members' investments were pooled together and their expectation of profit was dependent on Saivian being a profitable endeavor," and "[t]heir investments were pooled together and their expectation of profit was dependent on Saivian." (Compl. ¶¶ 31, 44, 70.) In other words, the SEC has done nothing more than parrot the applicable test for an investment contract.

1. The Complaint Fails to Adequately Allege that the Cashback Membership Program Was an "Investment Contract."

i. The Complaint Fails to Adequately Allege that the Cashback Membership Program Involved an "Investment of Money."

Although the SEC repeatedly refers to the Cashback Members' monthly fees as "investments" (*see, e.g.*, Compl. ¶¶ 9, 31, 44, 55, 56, 68), the SEC does not identify a single instance in which Saivian Domestic or Saivian International referred to Cashback Membership fees as "investments." The SEC also never pleads how a membership fee for a discount shopping program amounts to an "investment of money"—as opposed to the payment of money for a product. Indeed, the Cashback Members who paid their $125 monthly fees in exchange for shopping discounts and access to the Instant Savings Benefit were no differently situated than any other consumer who pays money for a good or service. The SEC's theory that the Cashback Membership Program was an "investment contract" should be rejected for that reason alone.

ii. The Complaint Fails to Adequately Allege that Cashback Members Had an Expectation of Profits Produced by Others.

The SEC also has not sufficiently alleged that the Cashback Membership Program was an "investment contract" because the Complaint makes no effort to plead that the Cashback Members had "an expectation of profits produced by the efforts of others." *Alliance Leasing Corp.*, 28 F. App'x at 651.

In this regard, the Ninth Circuit "has repeatedly required that a promoter's or third party's managerial efforts must be 'undeniably significant ones,' where the 'success of the investment program as a whole' is 'crucial to' and 'hinges on' the efforts by defendants." *Pac. W. Capital Grp., Inc.*, 2015 WL 9694808, at *6; *see also S.E.C. v. Rubera*, 350 F.3d 1084, 1092 (9th Cir. 2003).[8]

[8] "This element focuses on the investor's ability to control his investment. Three non-exhaustive factors guide this inquiry: (i) whether 'an agreement among the

Here, the Complaint fails to make substantive allegations that the "undeniably significant" efforts required were those of Saivian Domestic and Saivian International's promoters (or any other third party), or that the success of the Cashback Members "hinge[d] on" Defendants' efforts, as would be necessary to plead that the Cashback Membership Program was an investment contract. To the contrary, the "undeniably significant" efforts identified in the Complaint were those of the Cashback Members themselves, who—as the SEC concedes—were entirely in control of their own profitability. (*See* Compl. ¶ 31.) Thus, the Complaint's allegations regarding Cashback Members render them entirely distinguishable from the types of "'passive investors'" that courts typically find satisfy *Howey*'s third prong, *see, e.g.*, *Galea v. Lincoln National Corp.*, No. 11-cv-1218-CAB (KSC), 2013 WL 12069054, at *5 (S.D. Cal. Oct. 31, 2013) (citation omitted), because they had to actively manage their memberships in order to profit from the program. (Compl. ¶ 31.) In other words, the individual Cashback Members had the complete "ability to control" the profitability of their memberships, regardless of what any Defendant did. *Schaffer Family Inv'rs*, 2014 WL 12603128, at *4. The Cashback Members only received money if they submitted POS receipts—if they did nothing, they received nothing.

The Ninth Circuit's decision in *Bitter v. Hoby's International, Inc.*, 498 F.2d 183 (9th Cir. 1974), is instructive on this point. There, the Ninth Circuit held that a

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parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership'; (ii) whether 'the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers'; or (iii) whether 'the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.'" *Schaffer Family Inv'rs, LLC v. Sonnier*, No. 2:13-CV-5814-SVW (JEMx), 2014 WL 12603128, at *4 (C.D. Cal. Nov. 26, 2014) (quoting *Koch v. Hankins*, 928 F.2d 1471, 1476-77 (9th Cir. 1991)). The Complaint makes no allegations of fact addressing any of these factors.

restaurant franchise was not an "investment contract" under *Howey* because "each franchisee's active management was essential to the success of his retail restaurant," "its success was not dependent upon the success of the franchise system," and "the failure of the franchisor would not necessarily doom the franchisee's investment." *Id.* at 185. The same is true here. As set forth above, the Complaint alleges that "[i]n order to obtain the 20% cashback, Cashback Members were required to maintain an active Membership and submit their POS receipts to Saivian." (Compl. ¶ 31.) Put differently, the SEC agrees that—as was the case in *Bitter*—each Cashback Member's own conduct (*i.e.*, active submission of receipts) was essential to her ability to generate cashback payments, the Cashback Member's success was not dependent upon the overall success of Saivian Domestic and Saivian International, and the organizational failure of Saivian Domestic or Saivian International would not necessarily doom the particular Cashback Member's overall success.

iii. The Complaint Fails to Adequately Allege that the Cashback Membership Program Was a Common Enterprise.

The Ninth Circuit recognizes two types of common enterprises— horizontal commonality and vertical commonality. *See, e.g.*, *S.E.C. v. TLC Invs. & Trade Co.*, 179 F. Supp. 2d 1149, 1156 (C.D. Cal. 2001). Horizontal commonality exists when "[t]he participants pool their assets; they give up any claim to profits or losses attributable to their particular investments in return for a pro rata share of the profits of the enterprise; and they make their collective fortunes dependent on the success of a single common enterprise." *Hocking v. Dubois*, 885 F.2d 1449, 1459 (9th Cir. 1989). Vertical commonality exists when "'the fortunes of the investors are linked with those of the promoters.'" *S.E.C. v. R.G. Reynolds Enters., Inc.*, 952 F.2d 1125, 1130 (9th Cir. 1991) (quoting *S.E.C. v. Goldfield Deep Mines Co. of Nevada*, 758 F.2d 459, 463 (9th Cir. 1985)).

As the Complaint makes clear, the Cashback Membership Program did not

have horizontal or vertical commonality, and, therefore, it was not a security. The Complaint concedes that Cashback Members "were entitled to obtain 20% cashback on their retail purchases" and "[i]n order to obtain the 20% cashback, Cashback Members were required to maintain an active Membership and submit their POS receipts to Saivian." (Compl. ¶ 31.) Thus, the SEC has acknowledged that the Cashback Membership Program lacked horizontal commonality because the members did not "give up any claim to profits or losses *attributable to their own particular investments*." *Hocking*, 885 F.2d at 1459 (emphasis added). Instead, the Cashback Members received an amount that was directly proportionate to the value of the shopping receipts they submitted.

Similarly, the SEC has not adequately alleged that the Cashback Membership Program had vertical commonality because the Complaint does not contain a single well-pleaded allegation that "the fortunes" of the Cashback Members were "linked with those of the promoters" (*i.e.*, Affiliates, Saivian Domestic's management, or Saivian International's management). *R.G. Reynolds*, 952 F.2d at 1130. To the contrary, the Complaint concedes that Cashback Members were entitled to the same amount of cashback—20 percent of the value of the shopping receipts they submitted—regardless of whether the Affiliates were successful in signing up new members. (Compl. ¶ 31.)

2. The Complaint Fails to Adequately Allege that the Affiliate Program Was an "Investment Contract."

The SEC's attempt to adequately plead that the Affiliate Program was an "investment contract" under *Howey* fares no better, as the relevant allegations in the Complaint allege that affiliates had an expectation of profit from their involvement in the program, and not from any "investments," as governing law requires.[9]

[9] Defendants acknowledge that in the Ninth Circuit "investments in a pyramid scheme [are] 'investment contracts' and thus securities." *Webster v. Omnitrition Int'l, Inc.*, 79 F.3d 776, 784 (9th Cir. 1996). For all the reasons set forth below, however, the Complaint does not adequately plead that the Affiliate Program was,

Specifically, the Complaint makes the following allegations regarding the way in which the Affiliates could profit:

- "The promised residual income to Affiliates ranged from $5 per day for recruiting and maintaining three active, paying Members up to $3,000 per day (or $1,095,000 annually) for recruiting 8,000 active Members." (Compl. ¶ 40.)
- "As long as three Members remained active, the Affiliate was entitled to $5 per day or $1,825 annually." (*Id.* ¶ 41.)
- "Beyond this level, the Affiliate Program ranks generally progressed based on the number of active Members 'below' the Affiliate in his/her 'downline.'" (*Id.*)
- "[Affiliates] would receive a daily residual income stream based on their membership sales—both directly and indirectly through their 'downline' recruits." (*Id.* ¶ 39.)

None of these allegations are sufficient to plead that the Affiliate Program was an "investment contract" under *Howey* and its progeny.

Indeed, courts have rejected efforts to characterize multi-level marketing programs similar to the Affiliate Program—as it was alleged to operate in the Complaint—as "investment contracts." For example, in *Whole Living, Inc. v. Tolman*, 344 F. Supp. 2d 739, 748 (D. Utah 2004), the District Court reached precisely that conclusion because the affiliates there "expect[ed] to receive profits on their own sales and commissions on the downline sales, which are profits of the 'scheme' itself, not profits on the 'investment.'" Thus, as the court explained, there was no expectation of profits from any "investment of money" in the analogous multi-level marketing program at issue in *Whole Living*; there was only an

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in fact, a pyramid scheme under Ninth Circuit precedent. (*See* pp. 22-30, *infra*.) Accordingly, the SEC must plead that the Affiliate Program was an "investment contract" under the three-factor *Howey* test, which it has not done and cannot do.

expectation of profits from the recruiting program on the whole. *Id.* at 747-48. In so holding, the *Whole Living* court relied on *S.E.C. v. Edwards*, 540 U.S. 389 (2004), where the Supreme Court made clear that *Howey*'s "investment contract" test focuses on whether a person has an expectation of profits from his "investment," as opposed to from the "scheme" at issue. *Whole Living*, 344 F. Supp. 2d at 747-48.

Nothing in the Complaint here supports a different conclusion. The SEC's own allegations demonstrate that Affiliates of Saivian Domestic and Saivian International had no expectation that they would derive profits from any "investment of money," but instead expected that any profits they would receive would be based on the structure of the Affiliate Program itself. Accordingly, the Complaint fails to plead that the Affiliate Program qualifies as an "investment contract" under *Howey*.

3. The Complaint Fails to Adequately Allege a Section 5 Violation Because the Cashback Membership Program and the Affiliate Program Were Not Securities.

It is axiomatic that the registration requirements for securities under Section 5 of the Securities Act are inapplicable when the product at issue is not, in fact, a security. *See, e.g.*, *Lopez v. Dean Witter Reynolds, Inc.*, 805 F.2d 880, 884-85 (9th Cir. 1986). Because, as set forth above, the Cashback Membership Program and the Affiliate Program were not securities, Defendants could not have violated Section 5 by failing to register them as securities.

B. The Complaint Blurs the Distinction Between Saivian Domestic and Saivian International to Prevent the Court from Ruling on a Threshold Issue of Extraterritorial Jurisdiction.

As discussed above, to survive this motion, the SEC must satisfy the heightened pleading standard of Rule 9(b), which prohibits reliance on allegations that merely lump Defendants together or presume that multiple Defendants are responsible for any "group-published" information. Yet here, the SEC has done precisely that in its Complaint, which repeatedly fails to distinguish between Defendants, even though certain Defendants operated domestically and others

operated only internationally. The SEC's failure to comply with Rule 9(b) is particularly egregious in that regard, as the Complaint repeatedly lumps together Saivian Domestic and Saivian International to obscure the existence of a threshold jurisdictional issue.

Having conducted an investigation for two years, the SEC knows full well that Saivian International's Cashback Members and Affiliates were offshore—primarily in China—and none were in the United States. Given the well-established presumption that U.S. law applies only within the country's borders, it is beyond cavil that the SEC only may enforce the federal securities laws extraterritorially in limited circumstances. The SEC has intentionally made no effort in its Complaint to distinguish Saivian Domestic's operations in the United States from Saivian International's operations abroad because the SEC wants to prevent the Court from being able to determine whether the Complaint is challenging conduct over which the SEC cannot establish jurisdiction. For this reason alone, the Complaint should be dismissed.

Under controlling Supreme Court precedent, the federal securities laws apply only "in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States." *Morrison v. Nat'l Austl. Bank Ltd.*, 561 U.S. 247, 273 (2010); *see also Stoyas v. Toshiba Corp.*, 896 F.3d 933, 948-49 (9th Cir. 2018) (to establish a "domestic" transaction under *Morrison*, a plaintiff must show that "the purchaser incurred irrevocable liability in the United States to take and pay for a security, or that the seller incurred irrevocable liability within the United States to deliver a security"). Nevertheless, the SEC will likely rely on a recent Tenth Circuit decision to argue that the Dodd-Frank Act restored the more expansive pre-*Morrison* "conduct and effects" test for determining the SEC's reach over extraterritorial conduct.[10] *See*

[10] As its name suggests, this test focuses on a defendant's domestic conduct and the domestic effects of a defendants' international conduct. More specifically, the

S.E.C. v. Scoville, 913 F.3d 1204, 1215 (10th Cir. 2019). To date, the Ninth Circuit has not considered whether the *Morrison* test continues to apply following Dodd-Frank, and ultimately the issue may well be decided by the Supreme Court.[11]

Instead of making substantive allegations that distinguish between Saivian Domestic's conduct in the United States and Saivian International's extraterritorially, the SEC glosses over this critical jurisdictional issue through vague allegations that conflate Defendants' purported foreign and domestic conduct. Specifically, the Complaint alleges that Defendants "targeted investors in the United States and around the world" (Compl. ¶ 4), those Defendants include "seven connected entities based in the United States, Hong Kong and the United Kingdom" (*id.* ¶ 5), and that "Defendants raised millions of dollars from Cashback Members in

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conduct test "requires the Court to evaluate whether the defendant's domestic activities were 'significant with respect to the alleged violation … and … furthered the fraudulent scheme.'" *Crosbie v. Endeavors Techs., Inc.*, No. SA CV 08–1345 AHS (SSx), 2009 WL 3464135, at *4 (C.D. Cal. Oct. 22, 2009) (quoting *Grunenthal GmbH v. Hotz*, 712 F.2d 421, 424 (9th Cir. 1983)). Moreover, the defendant's "conduct in the United States cannot be merely preparatory … and must be material, that is, directly cause the loss." *Id.* (citation omitted). To determine "materiality," courts must assess "what and how much was done in the United States and … what and how much was done abroad." *Id.* (citation omitted).

The effects test "focuses on the impact of overseas conduct on securities purchasers, sellers, and markets in the United States," analyzing "whether the defendants' fraudulent, extraterritorial conduct substantially 'affected [American] securities markets or American investors.'" *Id.* (quoting *Butte Mining PLC v. Smith*, 76 F.3d 287, 291 (9th Cir. 1996).

[11] Nevertheless, a number of courts—including at least one district court in this Circuit—have questioned whether the statutory interpretation ultimately adopted by the Tenth Circuit is correct. *See, e.g.*, *S.E.C. v. Brown*, No. 14 C 6130, 2015 WL 1010510, at *4 (N.D. Ill. Mar. 4, 2015) (finding that "construing the Dodd-Frank Act to supersede *Morrison* may be problematic"); *S.E.C. v. Funinaga*, No. 2:13–CV–1658 JCM (CWH), 2014 WL 4977334, at *7 (D. Nev. Oct. 3, 2014) ("Other jurisdictions have noted a lack of clarity regarding the effect of Dodd-Frank on the *Morrison* test."); *Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE*, 763 F.3d 198, 211 n.11 (2d Cir. 2014) (noting that the Dodd-Frank Act's "import" is "unclear").

the United States and abroad" (*id.* ¶ 10). The Complaint offers *nothing* more on this critical issue. And, in fact, the opposite is true—Saivian Domestic had Cashback Members in the United States and its territories, and Saivian International had Cashback Members abroad. They were different entities doing business in different parts of the world.

As a result, the SEC has deprived the Court of the ability to determine whether the SEC has jurisdiction over the majority of the conduct at issue in the Complaint, even though the SEC cannot dispute that the overwhelming majority of the Cashback Membership sales took place outside the U.S. In short, the SEC, through its impermissibly vague group pleading, is attempting to hold all Defendants responsible for extraterritorial conduct over which the SEC has not even attempted to allege it has jurisdiction. The Court should not allow it, and should instead dismiss the Complaint in its entirety.

C. The Complaint Fails to Adequately Allege a Fraudulent Pyramid Scheme or Ponzi Scheme.

The Complaint's allegations are similarly insufficient to plead scheme liability against any Defendant. The SEC alleges in conclusory fashion that Defendants violated Sections 17(a)(1) and 17(a)(3) of the Securities Act, and Section 10(b) of the Securities Exchange Act and Rules 10b-5(a) and (c) thereunder, by operating the Affiliate Program as a pyramid scheme and the Cashback Membership Program as a Ponzi scheme. (*See* Compl. ¶¶ 28-45, 80-82, 86-88, 89-91.) But, under well-settled Ninth Circuit law, the Complaint's substantive factual allegations do not adequately allege the existence of a pyramid scheme or a Ponzi scheme, let alone with the particularity required by Rule 9(b).[12]

[12] To state a claim under Rules 10b-5(a) and (c), the SEC must adequately allege (i) a device, scheme or artifice to defraud, or an act, practice or course of business that operates as fraud; (ii) in connection with the purchase or sale of securities; (iii) scienter; and (iv) the use of the means or instrument of interstate commerce. *See, e.g., S.E.C. v. Zouvas*, No. 3:16-cv-0998-CAB-(DHB), 2016 WL 6834028, at *5

1. The Complaint Fails to Adequately Allege the Existence of a Pyramid Scheme.

As set forth above, the SEC cannot dispute that "[n]ot all MLM businesses are illegal pyramid schemes." *BurnLounge*, 753 F.3d at 883; *see also, e.g.*, *U.S. v. Gold Unlimited, Inc.*, 177 F.3d 472, 480 (6th Cir. 1999) ("Courts and legislatures recognize a distinction between legitimate programs (known as multi-level marketing systems) and illegal schemes."); *In re Amway Corp., Inc.*, 93 F.T.C. 618, 1979 WL 198944, at *106-08 (1979). Indeed, the SEC itself has acknowledged that there is a difference between legitimate MLMs in which the participants—like the Affiliates here—"typically get paid for products or services that [they] and the distributors in [their] 'downline' … sell to others," and illegal pyramid schemes which are "a type of fraud in which participants profit almost exclusively through recruiting other people to participate in the program."[13]

The Ninth Circuit has explained that "a pyramid scheme is 'characterized by the payment by participants of money to the company in return for which they receive (1) the right to sell a product *and* (2) the right to receive in return for recruiting other participants into the program rewards which are unrelated to product sales.'" *BurnLounge*, 753 F.3d at 883 (quoting *Omnitrition*, 79 F.3d at 781). Given that scheme liability claims must be pleaded with the particularity required by Rule

(S.D. Cal. Nov. 21, 2016) (citing *S.E.C. v. Phan*, 500 F.3d 895, 907-08 (9th Cir. 2007). Additionally, to state a scheme claim, the SEC must allege that Defendants each committed a manipulative or deceptive act in furtherance of the scheme. *S.E.C. v. Nationwide Automated Sys., Inc.*, No. CV 14-07249 SJO (FFMx), 2014 WL 12811969, at *6 (C.D. Cal. Sept. 30, 2014). "The same elements required to establish a Section 10(b) and Rule 10b-5 violation suffice to establish a violation under Sections 17(a)(1) -(3)." *Zouvas*, 2016 WL 6834028, at *11; *see also, e.g.*, *S.E.C. v. Fitzgerald*, 135 F. Supp. 2d 992, 1028-29 (N.D. Cal. 2001).

[13] *Beware of Pyramid Schemes Posing as Multi-Level Marketing Programs*, SEC Office of Investor Education and Advocacy (Oct. 17, 2013), https://www.sec.gov/oiea/investor-alerts-bulletins/investor-alerts-ia_pyramidhtm.html (last visited Apr. 19, 2019).

9(b),[14] the Ninth Circuit has held that it is not sufficient under *Omnitrition* to merely allege that a multi-level marketing program is a fraudulent pyramid scheme. Instead, a complaint must contain substantive factual allegations pleading why the program is "inherently fraudulent" and, therefore, fails the *Omnitrition* test. *See Miron v. Herbalife Int'l, Inc*, 11 F. App'x 927, 930 (9th Cir. 2001).

In *Herbalife*, the Ninth Circuit affirmed the dismissal of fraud claims because the plaintiffs' "conclusory statements regarding Herbalife's multi-level marketing business [were] insufficient to satisfy the requirement for particularity in pleading fraud claims under federal and state law." *Id.* The appellate court reached that conclusion despite allegations in the complaint, among others, that Herbalife had "intentionally and negligently misrepresented the potential for [plaintiffs] to profit from their own goals, desires and personal effort," and that "[t]he true facts were that the Herbalife marketing plan was nothing more than a sophisticated pyramid scheme' which caused 'an inherent end to Plaintiffs' stream of income.'" *Id.* (internal quotation marks omitted).

Here, like in *Herbalife*, the Complaint simply does not contain sufficiently particular allegations of fact that possibly could satisfy either prong of the Ninth

[14] The SEC cannot dispute that it must plead its "scheme liability" claims with particularity under Rule 9(b). *See, e.g., S.E.C. v. Yuen*, 221 F.R.D. 631, 634-37 (C.D. Cal. 2004); *see also In re Galena Biopharma Inc. Sec. Litig.*, 117 F. Supp. 3d 1145, 1193 (D. Ore. 2015) (explaining that "the conduct underlying claims for scheme liability must be alleged with particularity under Rule 9(b)"). Indeed, it is well-established that "[t]he specificity requirement of Rule 9(b) in the context of securities fraud means that mere conclusory allegations or general statements alleging fraud fail to satisfy the rule[.]" *S.E.C. v. Cal-Am Corp.*, 445 F. Supp. 1329, 1335 (C.D. Cal. 1978); *see also, e.g., Oaktree Principal Fund V, LP v. Warburg Pincus, LLC*, No. CV 15–8574 PSG (MRWx), 2016 WL 6782768, at *15 (C.D. Cal. Aug. 9, 2016) (dismissing scheme liability claims when the plaintiff, among other things, had "failed to plead their existence with sufficient particularity under Rule 9(b)"). Instead, to satisfy Rule 9(b), a plaintiff alleging scheme liability must plead "the nature, purpose, and effect of the fraudulent conduct and the roles of the defendants" in the purportedly fraudulent scheme. *In re Galena*, 117 F. Supp. 3d at 1193 (internal citation and quotation marks omitted).

Circuit's pyramid scheme test, a failure made all the more egregious by the fact that—as demonstrated by the extensive factual record submitted by the SEC in support of its *ex parte* application for an asset freeze (which the Court denied)—the SEC conducted wide-ranging discovery in this action prior to filing the Complaint. Moreover, the Ninth Circuit found that, like here, the plaintiffs in *Herbalife* "made admissions in their pleadings which substantially support the truth of the representations by" the defendant and failed to allege "any *facts*" adequately pleading that the defendant "did not intend to perform the promises at the time they were made." *Id.* (emphasis added).

i. The Complaint Fails to Adequately Allege that Affiliates Were Required to Purchase Non-Returnable Inventory to Become Affiliates.

The Complaint does not plead a single fact alleging that Affiliates were required to purchase non-returnable inventory—such as Cashback Memberships—to become Affiliates and receive commissions for selling those memberships. Indeed, as set forth above, the documents filed by the SEC with its Complaint (which the Court may consider here) reveal that Affiliates were *not* required to purchase Cashback Memberships in order to be Affiliates. (Ex. 42 at 482.) That pleading failure is fatal to the SEC's effort to state scheme liability claims based on an alleged pyramid scheme. *See F.T.C. v. Vemma Nutrition Co.*, No. CV-15-01578-PHX-JJT, 2015 WL 11118111, at *3 (D. Ariz. Sept. 18, 2015) (explaining that "the first part of the [applicable] test can be satisfied by a required purchase to become a distributor … or a required purchase of non-returnable inventory to receive the full benefits of the program").

The only allegation in the Complaint remotely aimed at satisfying this element of the well-settled pyramid scheme test is the conclusory claim is that "Cashback Members had to continue their Memberships during most of this period in order to remain eligible to receive payments for recruiting Affiliates to Saivian." (Compl. ¶ 44.) On its face, this allegation relates to the interplay between those participants

who were both Cashback Members and Affiliates, and says nothing about the ability of Cashback Members to become Affiliates *without* purchasing Cashback Memberships. The SEC also ignores that one of the documents central to the Complaint—which the Court may consider on a motion to dismiss—is a February 2017 press release issued by Saivian International, which explicitly states "[t]here are three sign up options available: Customer Only, Affiliate Only, or both a Customer and Affiliate." (Ex. 42 at 482.)[15] Accordingly, the SEC's allegation—offered without a single well-pleaded fact to support it—is plainly insufficient under *Omnitrition*.

There, the Ninth Circuit explained the type of "inventory loading" that satisfies the first prong of this Circuit's pyramid scheme test:

> To become a supervisor, a participant must pay a substantial amount of money to Omnitrition in the form of large monthly product orders. The "payment of money" element of a pyramid scheme can be met where the participant is required to purchase "non returnable" inventory in order to receive the full benefits of the program. In exchange for these purchases, the supervisor receives the right to sell the products and earn compensation based on product orders made by the supervisor's recruits.

Omnitrition, 79 F.3d at 782 (citations omitted). Here, even if the Court were to credit

[15] It is black-letter law in the Ninth Circuit that to be deemed a pyramid scheme, a company must require the payment of money in exchange for the right to sell a product. *See BurnLounge*, 753 F.3d at 883. For the reasons set forth below, neither Saivian Domestic nor Saivian International operated as a pyramid scheme. But the SEC cannot dispute—in light of this document—that Saivian International did *not* require that Affiliates also be Cashback Members. In other words, the SEC cannot dispute that Saivian International was not operating a pyramid scheme under Ninth Circuit law because Saivian International was not obligating its Affiliates to purchase Cashback Memberships in order to become Affiliates. And that is precisely why the SEC pleads that people had to purchase Cashback Memberships "*during most of this period*" in order to receive commissions as an Affiliate. (Compl. ¶ 44 (emphasis added).) The SEC knows that Saivian International permitted people to become Affiliates without buying Cashback Memberships.

the Complaint's conclusory allegation on this issue (and it should not in light of the lack of well-pleaded allegations supporting it), it falls far short of pleading the type of required purchases and inventory loading identified by the Ninth Circuit in *Omnitrition* as sufficient to allege the existence of a pyramid scheme.

ii. The Complaint Fails to Adequately Allege that Saivian Domestic or Saivian International Paid Rewards for Recruitment Unrelated to the Sale of Cashback Memberships to Ultimate Users.

Nor does the Complaint contain sufficient allegations of the "sine qua non of a pyramid scheme," *Vemma Nutrition*, 2015 WL 11118111, at *3—that Saivian Domestic and Saivian International paid recruiting commissions to Affiliates that were unrelated to the Affiliates' sales of Cashback Memberships to ultimate users. In fact, the SEC has pleaded the opposite. The SEC has explicitly alleged that Affiliates received commissions that were linked to their sales of Cashback Memberships to ultimate users, which means the Affiliate Program cannot be an unlawful pyramid scheme under well-established Ninth Circuit law.

The Complaint alleges that "[t]he promised residual income to Affiliates ranged from $5 per day for recruiting and maintaining three active, paying Members up to $3,000 per day (or $1,095,000 annually) for recruiting 8,000 active Members," and "[a]s long as three Members remained active, the Affiliate was entitled to $5 per day or $1,825 annually." (Compl. ¶¶ 40-41.) That allegation is a clear concession that the Affiliate Program—unlike an unlawful pyramid scheme—paid commissions that were directly tied to the Affiliates' sales of active Cashback Memberships. The Affiliate Program ensured that a person could not become an Affiliate, and thus could not be eligible for commissions, until that person made three Cashback Membership sales to people who were using the memberships. Thus, the Affiliate Program was entirely different, in this dispositive regard, from the recruiting program in *Omnitrition*, where the Ninth Circuit found that "compensation [was] facially 'unrelated to the sale of the product to ultimate users' because it [was] paid based on the suggested retail price of the amount *ordered* from *Omnitrition*, rather

than based on *actual sales* to consumers." *Omnitrition*, 79 F.3d at 782.

This is a critically important distinction, and one that obliterates the SEC's pyramid scheme theory. In *Omnitrition*, the company paid distributors commissions based on the inventory—*i.e.*, nutritional supplements, vitamins, and skincare products—*purchased* by the distributors themselves, regardless of whether they *sold* that inventory to downstream customers. The Complaint alleges that Saivian Domestic and Saivian International, by contrast, paid its Affiliates based on their ultimate sales of inventory—*i.e.*, Cashback Memberships—which means the Affiliate Program "tie[d] recruitment bonuses to actual retail sales in some way." *Omnitrition*, 79 F.3d at 783. Put differently, the Affiliate Program—unlike the program in *Omnitrition*—was not designed such that Affiliates would first purchase Cashback Memberships and receive commissions based on those purchases, and *then* sell (or not sell) the Cashback Memberships. As alleged in the Complaint, Affiliates were paid *only* once they had sold three Cashback Memberships to people who actually signed up and paid to use the Cashback Memberships.

Relatedly, in analyzing the second prong of the *Omnitrition* test, courts typically look for evidence of "inventory loading—the purchase of product for the purpose of remaining eligible for bonuses," as "evidence that distributors purchase and consume product for the purpose of qualifying for recruiting incentives is evidence of a pyramid scheme.'" *Vemma Nutrition*, 2015 WL 11118111, at *3. In other words, the analysis turns on whether the distributors in a particular multi-level marketing program bought the product because they actually intended to sell it to people who would use the product, or whether they "loaded up" on the product because that was how they earned sales commissions.[16]

[16] It could also be that the distributors plan on consuming some portion of the products because, after the Ninth Circuit's ruling in *BurnLounge*, "distributors may themselves consume some inventory as ultimate users, and thus a program that permits internal consumption is not *per se* a pyramid scheme." *Vemma Nutrition*, 2015 WL 11118111, at *3.

Here, despite conducting several years of extensive discovery, the SEC has failed to allege that even one Saivian Domestic or Saivian International participant bought a Cashback Membership to become eligible for commissions as an Affiliate, as opposed to buying a Cashback Membership to obtain discounts on their shopping. In fact, the economic incentives for "inventory loading" that existed in *Omnitrition* were entirely absent from the Affiliate Program. For example, if an individual had purchased 100 Cashback Membership "passes,"[17] that individual—unlike in *Omnitrition*—would not necessarily have received any commissions. The individual who bought the passes would have been eligible to become an Affiliate—and obtain commissions—only if she actually sold the "passes" to three or more active Cashback Members.

Finally, courts in the Ninth Circuit typically examine the purchasing patterns in a particular multi-level marketing program to determine whether people are buying products for their ultimate use, or whether they are buying products to remain eligible for recruiting bonuses. For example, in *BurnLounge*, the Ninth Circuit found evidence of a pyramid scheme based on the disparity in sales between music packages that offered a recruiting opportunity and those that did not. 753 F.3d at 884 (explaining that "Moguls" were people who got paid for recruiting other members, and highlighting that 96.8 percent of the participants who bought packages became "Moguls"). Similarly, in *Vemma*, the court found evidence of a pyramid scheme where the majority of product sales were to people who also were paid to recruit. 2015 WL 11118111, at *2 (finding that "approximately 86% of [the company's] U.S. product sales were to participants classified as Affiliates, and 14% of U.S. sales were to participants classified as customers").

In this case, the Complaint's allegation that a person could not become an

[17] As the Complaint alleges, "a 'pass' was an electronic code that could be entered on the Saivian website to activate or renew a membership" and "Cashback Members who received these 'passes' could use them to renew their own memberships or sell them to a prospective Saivian investor for cash." (Compl. ¶ 38.)

Affiliate until it had "recruit[ed] and maintain[ed] three active, paying Members" (Compl. ¶ 40) means that—unlike *BurnLounge* or *Vemma*—it was mathematically impossible for the majority of Cashback Members to receive commissions as Affiliates. Because of the three-member rule, at each level of the "downline," there necessarily would be Cashback Members who were ineligible to become Affiliates because they had not made three Cashback Membership sales.[18] Thus, the structure of the Affiliate Program ensured that there would always be at least three times as many Cashback Members as there were Affiliates, and it would never be the case that the Affiliate Program was sustaining itself without actual demand for the Cashback Memberships.

Apparently unable to plead its pyramid scheme claims with the required particularity, the SEC instead alleges that certain "promotional content" emphasized the Affiliate Program to the exclusion of the Cashback Memberships themselves. (*See* Compl. ¶ 39 (alleging that "much of its promotional content was devoted to inspiring its Cashback Members to become Affiliates," rather than "focus[ing] on the sale of products (in this case, Cashback Memberships) to non-Affiliates").)[19] But that is not true. The promotional content relied on by the SEC—which, as explained

[18] Based on its two-plus-year investigation, the SEC knows that this is the case because it is aware of documentary evidence—which it did not incorporate by reference into its Complaint—showing the large disparity between Cashback Members and Affiliates.

[19] Defendants acknowledge that, in *BurnLounge*, the Ninth Circuit noted that pyramid schemes exist when the "focus [is] on recruitment and where rewards [are] paid in exchange for recruiting others, rather than simply selling the products," *BurnLounge*, 753 F.3d at 885, and in *Omnitrition*, the Ninth Circuit emphasized that "[t]he mere structure of the scheme suggests that [Defendant's] focus was in promoting *the program* rather than selling *the products*," *Omnitrition*, 79 F.3d at 782. But the Ninth Circuit's recognition that pyramid schemes tend to promote their recruiting opportunity does not mean that the SEC can satisfy Rule 9(b) simply by alleging that Saivian Domestic or Saivian International promoted its Affiliate Program. The SEC still must plead the two elements of a pyramid scheme under *Omnitrition*, and it simply has not met that pleading burden here.

above, can be considered on this motion—focus extensively on promoting the Cashback Membership Program, and repeatedly tout the various products being rolled out to existing and prospective members. (*See, e.g.*, Ex. 51 at 536-47, Ex. 60 at 586-89, Ex. 62 at 702-25, Ex. 65 at 778-98, Ex. 85 at 928-32.)[20] Thus, even if the SEC could plead the existence of a pyramid scheme by alleging solely that certain "promotional content" emphasized recruiting instead of pleading facts satisfying the two prongs of the *Omnitrition* test (and it cannot), the actual "promotional content" directly contradicts the Complaint's allegations.

2. The Complaint Fails to Adequately Allege the Existence of a Ponzi Scheme.

Under well-settled law, a Ponzi scheme is "an arrangement whereby an enterprise makes payments to investors from the proceeds of a later investment rather than from the proceeds of the underlying business venture, as the investors expected." *In re Agric. Research & Tech. Grp., Inc.*, 916 F.2d at 531; *see also S.E.C. v. World Capital Mkt., Inc.*, 864 F.3d 996, 1000 n.1 (9th Cir. 2017) ("The SEC defines a Ponzi scheme as 'an investment fraud that involves the payment of purported returns to existing investors from funds contributed by new investors.'"). Critically, for an enterprise to be deemed a Ponzi scheme, its operators must know that its collapse is inevitable and that its last investors necessarily will lose their money. *See, e.g.*, *In re Slatkin*, 310 B.R. 740, 748 (C.D. Cal. 2004) (explaining that "[a] Ponzi scheme cannot work forever," "[t]he perpetrator must know that the scheme will eventually collapse as a result of the inability to attract new investors," and "[h]e must know all along, by the very nature of his activities, that investors at the end of the line will lose their money.") (internal citation and quotation marks

[20] Of course, a portion of the promotional content focused on the Affiliate Program, but that would be true for any multi-level-marketing company. The reality is that the documents incorporated by reference in the Complaint, which the SEC alleges do not "focus[] on the sale of products," are replete with extensive explanations and promotions of the Cashback Membership Program.

omitted).

Here, the Complaint does not contain a single substantive factual allegation pleading these factors. In fact, many of the SEC's allegations actually demonstrate the fallacy of its Ponzi scheme theory. Accordingly, all of the Complaint's claims relying on that theory should be dismissed.

i. The Complaint Fails to Adequately Allege that Returns Paid to Cashback Members Were Derived Solely from New Members' Funds.

The Complaint alleges in conclusory fashion that the Cashback Membership Program was a Ponzi scheme because "the returns it paid to investors were derived almost exclusively from other investors' funds," and Saivian Domestic's and Saivian International's other sources of income—including the MAP Program and the sale of point of sale data—were insufficient to fund cashback payments. (Compl. ¶¶ 28, 33-37.)

But the Complaint does not make any particularized allegations as to why that is so. By way of example, the SEC makes no attempt to allege (i) how much cashback Saivian Domestic or Saivian International paid to their members; (ii) when, why, or to what extent funds contributed by new members were used to fund such payments to existing members; or (iii) when, why, or to what extent other sources of revenue, including from the MAP program, were insufficient to cover the cashback payments. Accordingly, the Complaint's Ponzi scheme allegations do not satisfy Rule 9(b)'s heightened pleading standard and are plainly insufficient to stave off dismissal. In fact, far from making allegations necessary to state a claim that the Cashback Membership Program was a Ponzi scheme, the Complaint—on its face—actually supports the opposite conclusion.

For example, the SEC's allegations demonstrate that it is entirely possible that funds contributed by new members were not needed to make cashback payments to existing members. Specifically, the Complaint expressly alleges that Cashback Members paid $125 every 28 days, and that the 20 percent cashback payments were

made after a 60-day delay. (Compl. ¶ 31.) And the promotional materials for Cashback Memberships, which the Court may consider on this motion because the SEC necessarily relied on them in explaining the Cashback Membership Program,[21] demonstrate that Cashback Members were entitled to a maximum of $125 for their first cashback payment on Day 90, and a maximum of $250 for subsequent payments every 30 days thereafter. (*See* pp. 7-8, *supra*.) Thus, as a matter of simple math, the sequencing of payment inflows from and outflows to Cashback Members *prove* that, at least until a member's seventh month of membership, Saivian Domestic and Saivian International never had to pay a member from anything other than that member's prior payments. In other words, the very structure of the Cashback Membership Program ensured that, based on the timing of the payment inflows and outflows to Cashback Members, it could not constitute a Ponzi scheme as a matter of law.[22]

The Complaint is devoid of any suggestion that the SEC made any attempt to run this simple calculation. But its significance is nevertheless underscored by a

[21] *See Parrino v. FHP, Inc.*, 146 F.3d 699, 706 (9th Cir. 1998) (holding that district courts may on a motion to dismiss consider documents not explicitly incorporated in a complaint where such documents are "crucial" to the plaintiff's claims, as such a rule serves the important purpose of "[p]reventing plaintiffs from surviving a Rule 12(b)(6) motion by deliberately omitting references to documents upon which their claims are based"), *superseded by statute on other grounds as recognized in Abrego Abrego v. The Dow Chem. Co.*, 443 F.3d 676 (9th Cir. 2006) (per curium); *see also Lee v. Gen. Nutrition Cos.*, No. CV 00-13550LGB(AJWX), 2001 WL 34032651, at *5 (C.D. Cal. Nov. 26, 2001). Here, the SEC has cherry picked a handful of anomalous statements from these presentations, while ignoring scores of other statements that contradict its claims. As the Ninth Circuit explained in *Parrino*, the Court should consider these materials so that the SEC is not rewarded for omitting them.

[22] Importantly, as explained above, the Cashback Members had access to the Instant Savings Benefit from the outset of their enrollment as Cashback Members, which provided them with the ability to obtain immediate shopping discounts from nationally recognized retail brands. (*See, e.g.*, Ex. 40 at 438, Ex. 56 at 574, Ex. 62 at 574.)

number of the Complaint's allegations. For example, the Complaint alleges that "Cashback Members had to continue their Memberships during this entire period in order to remain eligible to receive payments" (Compl. ¶ 31), an allegation that provides support for Defendants' argument that by the time Saivian Domestic or Saivian International possibly could have needed other revenue sources to make cashback payments, it would have had funds available from other members who had not continued their memberships long enough to be eligible for payments. And the Complaint further alleges that the MAP Program did, in fact, generate revenue—an implicit acknowledgement that other sources of revenue were available to fund the payments. (*See id.* ¶¶ 34, 37.)

Accordingly, based largely on the Complaint itself, it is beyond dispute that (i) for the first six months of any particular Cashback Member's involvement with the program, Saivian Domestic or Saivian International would not have needed any revenues other than that member's prior payments to fund any cashback payments owed to that member; and (ii) following those six months, there would be multiple revenue sources—including, at least, payments from members who did not follow through with the program and revenue from the MAP Program—to fund subsequent cashback payments.[23] In short, the Complaint simply does not adequately allege that Saivian Domestic or Saivian International had to make "'payment[s] … to existing investors from funds contributed by new investors,'" and, accordingly, the SEC has not pleaded the existence of a Ponzi scheme under well-settled Ninth Circuit law.

[23] The SEC pleads that the MAP Program was launched on or around July 2016 and was ultimately successful in generating advertising revenue. (Compl. ¶¶ 34, 37.) The SEC also alleges that Saivian International was not registered to do business until October 2016—four months after the MAP Program's launch. (*Id.* ¶ 18.) Therefore, by the time that Saivian International—as opposed to Saivian Domestic—came into existence, the MAP Program was generating revenue that was available to fund payments to Cashback Members. Accordingly, the SEC's allegations that the Cashback Membership was a Ponzi scheme because it depended on inflows from new members (*id.* ¶ 28) are inapplicable to Saivian International on their face.

World Capital Mkt., Inc., 864 F.3d at 1000 n.1.

ii. The Complaint Fails to Adequately Allege that Defendants Knew that the Cashback Membership Program Eventually Would Collapse.

Even if the Complaint did adequately allege that Saivian Domestic or Saivian International made payments to existing members from funds contributed by new members (and it does not), the SEC's Ponzi claims still should be dismissed because the Complaint does not remotely plead, as it must, that the operators of Saivian Domestic or Saivian International knew that either venture eventually would collapse and, therefore, the final investors would lose their money.

As set forth above, to plead that the Cashback Membership Program was a Ponzi scheme, the SEC must allege specific facts indicating that the proprietors of Saivian Domestic and Saivian International, from their inception, "kn[e]w that the scheme [would] eventually collapse as a result of the inability to attract new investors, and that, by the very nature of [their] activities, that investors at the end of the line [would] lose their money." *In re Slatkin*, 310 B.R. at 748. But, once again, the Complaint supports the contrary conclusion.

For example, the Complaint acknowledges that Saivian Domestic and Saivian International already were generating advertising revenues—and were taking steps to generate additional revenues—through the MAP Program. (Compl. ¶ 37.) Had the business been given the necessary time to mature, the continued growth of the MAP Program could have ensured that Saivian Domestic and Saivian International had more than sufficient revenues to make cashback payments—regardless of whether new members stopped enrolling. In other words, the Cashback Membership Program—unlike a Ponzi scheme—would not have "inevitably collapse[d]" if Saivian failed to sign up new members. *S.E.C. v. Traffic Monsoon, LLC*, 245 F. Supp. 3d 1275, 1299 (D. Utah 2017), *aff'd*, 913 F.3d 1204 (10th Cir. 2019).[24]

[24] Although the SEC alleges that "Saivian never generated any revenue from the sale of POS receipt data to marketing partners (or advertising partners)," and "Saivian

The Court's recent decision in *In re EPD Investment Co., LLC*, 587 B.R. 711 (C.D. Cal. 2018), is instructive on that point. There, the bankruptcy court held that a company had operated as a Ponzi scheme, rejecting the defendant's argument that—even though the company admittedly used money from new investors to pay old investors—it was not a Ponzi scheme "because an *opportunity* for investors to profit existed." *In re EPD Inv. Co., LLC*, No. 2:10-bk-62208-ER, 2018 WL 1004162, at *9 (Bankr. C.D. Cal. Feb. 17, 2018). In rejecting that argument, the bankruptcy court held that "[t]he remote possibility that a miracle turnaround could suddenly make the operations profitable does not defeat the Ponzi presumption." *Id.*

The District Court reversed, explaining that "[t]he perpetrator of a Ponzi scheme 'must know that the scheme will eventually collapse as a result of the inability to attract new investors,'" and finding the company's principal "could testify that he did not operate [the company] as a Ponzi scheme … because a Ponzi scheme requires the participant to know that the scheme is unsustainable." *In re EPD Investment Co., LLC*, 587 B.R. at 718. The Court further noted that "a company is not a Ponzi scheme merely because it has negative cash flow for several years," and found that the defendants had "introduced sufficient evidence that [the company] tried to legitimately invest its money." *Id.* at 720. This is critical—even though the company in *EPD Investments* admittedly paid back investors with money from new investors, the Court *still* held that there was an issue of fact as to whether the company was operating as a fraudulent Ponzi scheme.

EPD Investments makes clear that the SEC cannot plead that the Cashback Membership Program was a Ponzi scheme with the particularity required by Rule

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did not have these partners, nor the means to convert the POS receipts submitted by its Cashback Members from their raw form into marketable date" (Compl. ¶ 36), the SEC ignores the fact that the business model was predicated on a multi-phase strategy that contemplated the accumulation of a sufficient point of sale data to make the data valuable enough to be monetized. What matters here is that, as the Complaint acknowledges, Saivian Domestic and Saivian International were actively taking steps to do just that.

9(b) by alleging merely that "the returns it paid to [Cashback Members] were derived almost exclusively from other [Cashback Members'] funds[.]" (Compl. ¶ 28.) The SEC is required to make factual allegations showing how the payments made by Saivian Domestic and Saivian International rendered the Cashback Membership Program a fraudulent scheme, despite the fact that, as the Complaint acknowledges, the proprietors were taking steps to create income streams necessary to fund the cashback payments. The Complaint falls woefully short of meeting that pleading burden; indeed, the SEC's own allegations show that the business models of Saivian Domestic and Saivian International was set up to prevent the "structural certainty of collapse" typically found in Ponzi schemes.

D. The Complaint Fails to Adequately Allege Any Material Misstatements or Omissions.

The SEC alleges that Defendants (i) "falsely represented that Saivian generated the revenue for cashback payments from the sale of Cashback Members' [point of sale] receipts to marketing partners (and advertising partners), or monetized the [point of sale] receipt data to sell targeted advertising" (Compl. ¶¶ 46-56), and (ii) failed to disclose Dalius' role and that he previously had been convicted of a crime (*id.* ¶¶ 58-66).[25] As a matter of law, the Complaint does not adequately allege a securities law violation with respect to either of these categories of purported misstatements or omissions.

[25] The Complaint asserts that these purported misstatements and omissions constitute violations of § 17(a)(2) of the Securities Act, 15 U.S.C § 77q(a), § 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and SEC Rule 10b–5(b), 17 C.F.R. § 240.10b–5. It is well-settled that each of those claims require the SEC to adequately plead at least three elements: (i) a material misstatement or omission, (ii) in connection with the offer or sale of a security, and (iii) by means of interstate commerce. *See, e.g.*, *S.E.C. v. Phan*, 500 F.3d 895, 907–08 (9th Cir. 2007) (citation omitted). These claims also require the SEC to sufficient plead an intent element, which is scienter under § 10(b) and Rule 10b–5, and negligence under §§ 17(a)(2). *See id.*

1. The Complaint Fails to Adequately Allege that Defendants Made Any Material Misstatements Regarding Revenue Generation.

The Complaint alleges that Defendants made seven misstatements relating to the way in which Saivian Domestic and Saivian International purportedly generated the revenue necessary to fund payments to members of the Cashback Program. (Compl. ¶¶ 46-54.) Not one of them is actionable because (i) the Complaint does not plead any of the purported misstatements with the particularly required by Rule 9(b), and (ii) the statements identified by the SEC plainly reflect Defendants' vision of Saivian's future and, accordingly, constitute non-actionable puffery.

i. The Complaint's Allegations Regarding Defendants' Purported Misstatements Fail to Satisfy Rule 9(b).

As this Court has held, to comply with Rule 9(b), the SEC must plead alleged misstatements with particularity, including "the names of the persons who made the allegedly fraudulent representations, their authority to speak, to whom they spoke, what they said or wrote, and when it was said or written." *Francisco*, 262 F. Supp. 3d at 989 (citation omitted). Here, because the Complaint does not specifically identify a single person to whom any Defendant made *any* of the alleged misstatements, the SEC has failed to satisfy its pleading burden with respect to even one of the alleged misstatements.[26] *See, e.g.*, *McMillan v. Connected Corp.*, No. CV

[26] Moreover, with respect to the final three alleged misstatements, the Complaint does not even allege who made the statements at issue, identifying the speakers only as "Saivian's then-Mark[et]ing Director" (Compl. ¶ 53), "Saivian's Operations Director" (*id.* ¶ 54), and, finally, "a top Affiliate," as opposed to even an employee (*id.* ¶ 51). In addition, the Complaint alleges that "Saivian's Operations Director misrepresented that MAP Memberships—which he claimed numbered 400 worldwide at the time—were fully funding cashback payments at the time." (*Id.* ¶ 54.) But by failing to explain how MAP revenue was insufficient to fund cashback payments—including by ignoring that, as set forth above (*see* pp. 31-33, *supra*), little, if any, cash was needed for that purpose until at least seven months after any individual member had joined Saivian Domestic or Saivian International—the SEC has not satisfied Rule 9(b) because the Complaint does not "set forth an explanation

10-03297 MMM (JCGx), 2010 WL 11549680, at *4 (C.D. Cal. Dec. 6, 2010) (dismissing fraud claim based on, among reasons, complaint's failure to identify to whom the alleged misstatements were made). This pleading failure alone mandates dismissal of the SEC's misstatement claims.

ii. The Complaint's Alleged Misstatements Are Forward Looking Statements That Are Not Actionable Under the Securities Laws.

It is bedrock Ninth Circuit law that "vague, generalized assertions of corporate optimism or statements of 'mere puffing' are not actionable material misrepresentations under federal securities laws." *In re Impac Mortg. Holdings, Inc. Sec. Litig.*, 554 F. Supp. 2d 1083, 1096 (C.D. Cal. 2008) (Carney, J.); *see also Glen Holly Entm't, Inc. v. Tektronix, Inc.*, 352 F.3d 367, 379 (9th Cir. 2003). Such statements of "mere puffing" are generally "forward-looking statements of optimism that 'are not capable of objective verification' and 'lack a standard against which a reasonable investor could expect them to be pegged.'" *Impac Mortg. Holdings*, 554 F. Supp. 2d at 1096 (internal citations omitted).

Thus, courts have dismissed securities laws claims where the alleged misstatements related to the defendant companies' "vision," "strategic direction," and "goals." *Wozniak v. Align Tech., Inc.*, No. C-09-3671 MMC, 2011 WL 2269418, at *3-4 (N.D. Cal. Jun. 8, 2011) (dismissing claims after finding that the alleged misrepresentations regarding the company's vision and goals were "generalized statements of optimism that constitute non-actionable puffing"); *see also In re UBS AG Sec. Litig.*, No. 07 Civ. 11225(RJS), 2012 WL 4471265, at *36 (S.D.N.Y. Sept. 28, 2012) (dismissing securities law claims because company's statements regarding its "vision" were non-actionable puffery).

Here, like in those cases, the purported misstatements focused on Defendants' "goals" and constitute non-actionable puffery. Specifically, each of the alleged

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as to why the statement or omission complained of was false or misleading." *Cooper v. Pickett*, 137 F.3d 616, 625 (9th Cir. 1997).

misstatements addresses the ways in which Saivian Domestic and/or Saivian International *intended* to generate the revenue necessary to fund payments to members of its Cashback Membership Program, including by selling point of sale data collected from members to marketing partners and from the MAP program (which, as described above, was a marketing tool sold to businesses who wanted access to Saivian Domestic and Saivian International's growing membership base). (Compl. ¶¶ 46-54.) Nevertheless, the Complaint alleges that these statements were misrepresentations because Defendants purportedly told customers of Saivian Domestic and Saivian International that cashback payments were being funded with revenues generated from those sources at the time of the statements (*id.* ¶ 46), when, in reality, "Saivian never had any marketing partners (or advertising partners)" (*id.* ¶ 52) and "had sold very few MAP memberships to retailers" (*id.* ¶ 55). The SEC is wrong. With the exception of the fifth alleged misstatement—which the Complaint acknowledges was made by a "top Affiliate," as opposed to Dalius or any of the other Defendants (*id.* ¶ 51)—the purported misstatements, on their face, focus on Saivian Domestic's vision of the future.[27]

Indeed, the very first purported misstatement alleged in the Complaint squarely puts the lie to the SEC's theory. There, the Complaint alleges that Dalius made that statement on October 26, 2015—*prior to* Saivian Domestic's launch—

[27] As set forth above, the Court may take judicial notice of those documents and consider them on this motion because they are central to the SEC's claims and their authenticity is not in dispute. (*See* Section III, *supra*.) Thus, even without going beyond the documents filed with this Court by the SEC at the time it filed the Complaint, there are numerous examples that confirm the forward-looking nature of these statements of corporate optimism. (*See, e.g.*, Ex. 54 (in a November 15, 2015 script sent by Dalius, he wrote that "I want everyone to know that we have a long term strategy to help build out this cashback strategy. [T]he best way to explain this is to understand the [F]acebook ad model"); Ex. 65 at 792 (a presentation explains that the company's "*vision* is to build a network into the millions across the US and ultimately around the world…. This *will create* a HIGH VALUE for 3rd party advertising partners…") (emphasis added).

which establishes beyond any reasonable dispute that comments he made regarding the sale of members' point of sale data were wholly prospective statements of corporate optimism. (Compl. ¶¶ 15, 47.)[28] But even if the timing of this alleged statement is not dispositive, the content should be. Dalius allegedly stated that "[t]he goal of the advertising revenue is to help subsidize the cashback model to our members," and then compared Saivian Domestic's vision to Facebook's model, which he noted "make[s] billions of dollars a year." (*Id.* ¶ 47.) Dalius' alleged description of Saivian Domestic's "goal" for advertising revenue (made before it was registered to do business) and his reference to Facebook's success are precisely the type of forward-looking statements of corporate optimism that courts regularly find constitute non-actionable puffery.[29] *See, e.g.*, *Impac Mortg. Holdings*, 554 F. Supp. 2d at 1096.

The other two purported misstatements the Complaint alleges Dalius made about point of sale data similarly focused on optimistic comparisons to Facebook and allegedly were made on a call with an unnamed prospective customer at a time—approximately two months after Saivian Domestic's launch—when it was inconceivable that the company was making any serious revenue from the sale of such data. (Compl. ¶¶ 48-49.)[30] In any event, Dalius also purportedly stated that

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[28] Moreover, although the SEC attributes the misstatements to both Saivian Domestic and Saivian International, the majority of the alleged misstatements were purportedly made before Saivian International even was in business. (Compl. ¶¶ 18, 47-53.) This is yet another example of why the SEC's impermissible lumping of Defendants should be rejected.

[29] Another of the Complaint's handful of alleged misstatements—content purportedly drafted by Dalius and posted to Saivian Domestic's website by February 3, 2016—includes the same statement about Saivian Domestic's "goal" of generating advertising revenue "to help subsidize" cashback payments. (Compl. ¶ 50.) Nothing in the website statements the Complaint quotes suggests that Saivian Domestic already was subsidizing the payments with advertising revenue. (*See id.*)

[30] Moreover, as the Complaint alleges, Dalius effectively acknowledged as much

Saivian Domestic's point of sale data was "about 10 to 100 times more valuable than [Facebook's] likes and interests, and everyone agrees with that" (*id.* ¶ 49), which is precisely the type of expression of corporate optimism—particularly given that Facebook is one of the largest publicly traded companies in the U.S.—that is "not capable of objective verification" and, therefore, constitutes puffery. *Impac Mortg. Holdings*, 554 F. Supp. 2d at 1096.[31] As such, none of these statements can form the basis of a misstatement claim under the securities laws.

2. The Complaint Fails to Adequately Allege that Defendants Made Any Material Omissions Regarding Dalius.

The Complaint alleges that Dalius, Saivian Domestic, Saivian International, and PRE made material omissions by failing to disclose (i) "the full scale of Dalius's involvement in the Saivian enterprise" during the first year of the company's existence (Compl. ¶ 63), and (ii) after Dalius was introduced as president, that he had been convicted of a crime fifteen years earlier (*id.* ¶¶ 64-65). And in a transparent effort to plead that these purported omissions somehow violated the securities laws, the Complaint further alleges that "[t]he truth about Dalius's prior criminal conviction and the extent of his control over the Saivian enterprise was material information to Saivian investors." (*Id.* ¶ 66.) But that conclusory allegation falls far short of satisfying the SEC's pleading burden.

As the Supreme Court has held, to survive a motion to dismiss, a plaintiff must

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when he juxtaposed Saivian with Facebook by pointing out that the latter—as opposed to the former—"already" was generating revenue from the sale of data. (*Id.* at ¶ 49.)

[31] Finally, the Complaint's allegation that Dalius made a misstatement when he "indirectly" told a Cashback Member that the revenue funding cashback payments was "all about third party advertising which is being officially rolled out through the MAP program" (Compl. ¶ 53) is similarly a forward-looking statement of corporate optimism that constitutes nothing more than puffery. As alleged by the SEC, Dalius told the member that Saivian Domestic was only then launching the MAP program; there is no reasonable reading of that statement that suggests that Dalius "falsely" conveyed that MAP revenues already were funding cashback payments.

plead "more than labels and conclusions, and a formulaic recitation of the elements of a cause of action." *Twombly*, 550 U.S. at 555; *see also Francisco*, 262 F. Supp. 3d at 989 (observing that legal conclusions are not accepted as true on a motion to dismiss). The Complaint's assertion that the information Defendants purportedly withheld was material—offered without a single supporting allegation of fact as to *why* it was material—is precisely the type of rote recitation of the elements that the Supreme Court has held was insufficient under even notice pleading standards. And here, the SEC must meet the even higher standard of Rule 9(b), which, *a fortiori*, the Complaint simply does not do. For this reason alone, the Complaint's omission claims should be dismissed. But even if the Court were to find that the Complaint's naked allegation of materiality was sufficient, the allegations regarding these purported omissions are insufficient for additional reasons that warrant their dismissal.

i. The Complaint Fails to Adequately Allege that Defendants Concealed Dalius' Role at Saivian Domestic.

While the SEC alleges that Defendants "[i]nitially [c]oncealed Dalius's [r]ole in Saivian" by installing a "figurehead" president to effectively act as the face of the business (Compl. p. 17 (heading), ¶ 63), the Complaint tells an entirely different story that should dispose of this claim. Indeed, the SEC itself alleges that Dalius was introduced to Cashback Members and Affiliates as the company's "lead consultant" (*id.* ¶ 63), which amounts to a complete concession that his involvement in Saivian was not concealed.

Moreover, even a cursory review of the purported misrepresentations alleged in the Complaint demonstrates the very public nature of Dalius' senior role at Saivian Domestic. As discussed above, the Complaint describes seven alleged misrepresentations by Defendants—and five of those are expressly attributed to Dalius. (Compl. ¶¶ 47-51, 53-54.) The Complaint even alleges that Dalius made misstatements as early as October of 2015 during a conference call announcing the

"pre-launch" of the business. (*Id.* ¶ 47.) The SEC cannot argue, on the one hand, that Dalius made most of the misstatements alleged in the Complaint (including during calls announcing Saivian Domestic's launch), while simultaneously alleging, on the other hand, that Defendants concealed his role at the company until October of 2016—a full year later.

ii. The Complaint Fails to Adequately Allege the Existence of Any Duty to Disclose Dalius' Conviction.

Nor do the SEC's allegations regarding Defendants' failure to disclose Dalius' 2001 criminal conviction state an omission claim. Although the Complaint spends five paragraphs setting forth the details of that conviction (Compl. ¶¶ 58-62), the SEC's goal in doing so appears aimed more at poisoning the proverbial well than at alleging a viable claim. It is well-settled that, in the case of an omission, "silence, absent a duty to disclose, is not misleading under Rule 10b-5" unless it renders another statement misleading. *S.E.C. v. Fehn*, 97 F.3d 1276, 1289 (9th Cir. 1996) (citing *Basic Inc. v. Levinson*, 485 U.S. 224, 240 (1988)).

Here, the Complaint does not allege that Defendants had *any* duty to disclose Dalius' 15-year-old conviction or that they made any statements that possibly could be considered misleading because they did not disclose it. Thus, the Complaint does not allege an actionable omission regarding that information.

Indeed, a judge in the Southern District of New York has dismissed a Rule 10b-5 claim based on virtually identical allegations. *See In re Optionable Secs. Litig.*, 577 F. Supp. 2d 681, 692 (S.D.N.Y. 2008). There, the company, like alleged here (Compl. ¶ 64), made basic biographical statements about a senior executive, but did not disclose that the executive had been convicted of crimes nine and thirteen years earlier. *Optionable Secs. Litig.*, 577 F. Supp. 2d at 692. Unlike the SEC here, Plaintiffs in that case actually attempted to plead that the defendant had a duty to disclose the convictions, arguing that disclosure was required both to make the biographical statements not misleading and to satisfy the company's disclosure

duties under Regulation S-B (which is not applicable here). *Id.* Nevertheless, the court still dismissed the omission claim, finding that the "information was not necessary to make other statements not false or misleading," and that the regulation was inapplicable because it only required disclosure of convictions during the prior five years. *Id.* Particularly because the Complaint does not even allege a duty to disclose, the result should be no different here.

E. The SEC's Control Liability Claims Fail for All the Reasons Set Forth Above.

The SEC also alleges that Dalius is additionally liable because he "directly or indirectly controlled the Saivian entities[.]" (Compl. ¶ 97.) However, to sufficiently allege control person liability under Section 20(a) of the Securities Exchange Act, the SEC must adequately allege: (i) "'a primary violation of federal securities laws,'" and (ii) "'that the defendant exercised actual power or control over the primary violator.'" *Webb v. Solarcity Corp.*, 884 F.3d 844, 858 (9th Cir. 2018) (dismissing control person allegation because plaintiff did not adequately allege a primary violation of the securities laws). Because, as set forth in detail above, the SEC has not sufficiently alleged any primary violations of the federal securities laws, this Court must dismiss the control person liability claim.

F. The SEC's Claims Against PRE, SNAP, And Realty Share Must Be Dismissed On Rule 9(B) Grounds.

Finally, the SEC's claims against PRE, SNAP and Realty Share cannot possibly survive this motion. The Complaint contains not a single well-pleaded allegation that any of these entities took *any* action that could have violated the securities laws. Indeed, other than providing basic background information about these entities in the "Defendants" section of the Complaint, the only other "allegation" against any of them is contained in the sections relating to alleged misrepresentations, where the SEC alleges—in entirely conclusory fashion—that PRE (but not SNAP or Realty Share), along with Dalius, Saivian Domestic, and

Saivian International, made certain purported misstatements and omissions. (*See* Compl. ¶¶ 46, 57.) But despite those "allegations," the Complaint does not attribute a single actual statement to PRE. Plainly, these bare, conclusory allegations are insufficient to "inform [PRE, SNAP and Realty Share] separately of the allegations surrounding [their] alleged participation in the fraud." *See Swartz*, 476 F.3d at 764-765. Accordingly, the causes of action asserted against PRE, SNAP, and Realty Share must be dismissed.

V. CONCLUSION

For all of the foregoing reasons, the Complaint is woefully deficient and should be dismissed. In sum, the SEC has not alleged that the Cashback Membership Program or the Affiliate Program were "investment contracts" because, among other things, the SEC has not pleaded that they required an "investment of money" or that profits were generated through the efforts of others. Indeed, the Cashback Members were not the type of passive investors that are protected by the federal securities laws. The Complaint—which is plagued by its rampant group pleading—also does not comply with Rule 9(b), which is perhaps most apparent in its failure to differentiate between the conduct of Saivian Domestic and Saivian International. The SEC also has not pleaded that the Affiliate Program was not an "inherently fraudulent" pyramid scheme under the controlling Ninth Circuit test. Similarly, the SEC has not adequately alleged that the Cashback Membership Program was a Ponzi scheme because, among other things, it has not alleged that its collapse was "inevitable." Nor has the SEC pleaded any actionable misrepresentations or omissions, or specifically attributed any misconduct to three of the Defendants—PRE, SNAP, and Realty Share. Finally, the SEC's "control person" claim against Dalius should be dismissed absent an underlying violation of the federal securities laws.

Given that the SEC conducted comprehensive discovery prior to filing the Complaint, the Complaint should be dismissed with prejudice because any

amendment here would be futile. The SEC should be presumed to have used the volumes of discovery that it obtained during several years of extensive fact-finding to sufficiently plead its claims. Alternatively, the Complaint should be dismissed without prejudice and the Court should require the SEC's strict compliance with Rule 8 and Rule 9(b) in any amended pleading.

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