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Hon. Lyle W. Cayce, Clerk
U.S. Court of Appeals
for the Fifth Circuit
600 S. Maestri Place
New Orleans, LA 70130

Re: No. 14-20128, *Torres v. SGE Management et al.*

Dear Clerk Cayce,

We write at the Court's invitation to clarify four issues raised at oral argument. We believe these confirm that the district court did not abuse its discretion in certifying this class action, and that any remaining concerns can be addressed on further proceedings below.

(1) The standard is *predominance*, not perfect uniformity.

Defendants consistently address their argument to a straw-man version of the standard. They assert that a class cannot be certified if they could raise an idiosyncratic defense with respect to even a tiny number of plaintiffs, so that we must prove that there is "literally" no class member who would have joined Stream knowing it was an illegal pyramid scheme. *See, e.g.*, Arg. 11:50-13:17. Defs. 28(j) Resp. at 1. This is not the law.

Rule 23(b)(3) requires that "questions of law or fact common to class members *predominate* over any questions affecting only individual members." (Emphasis added). As the Supreme Court recently clarified, "[t]hat the defendant might attempt to pick off the occasional class member here or there through individualized rebuttal does not cause individual questions to predominate." *Halliburton v. Erica P. John Fund*, 134 S. Ct. 2398, 2412 (2014). This Court has repeatedly stressed the same point. *In re Monumental Life Ins. Co.*, 365 F.3d 408, 421 (5th Cir. 2004) (valid defenses as to some plaintiffs do "not establish that individual issues predominate, particularly in the face of defendants' common scheme of fraudulent concealment"); *Mullen v. Treasure Chest Casino, LLC*, 186 F.3d 620, 626 (5th Cir. 1999) (class certified even where causation might be individual issue based on other, predominating questions). As the Court noted at argument, Arg. 47:30-45, the core, predominating question here is clearly whether Stream actually is or is not an illegal pyramid scheme. *See also* ROA.2256. Hundreds of thousands of people must use the same evidence to seek the same answer to that same, central question.

But even if reliance were the only question, defendants' approach to reliance involves the same infirmity. No court actually conditions certification on a literal showing that *no one* would suffer the fraud knowingly, and the core appellate precedents provide much fairer statements of the rule. Under these cases, reliance is provable in common if a jury could "**reasonably infer**" that plaintiffs who joined up relied on the misrepresentation that Stream was a lawful venture and not an illegal pyramid scheme. *E.g.*, *Klay v. Humana*, 382 F.3d 1241, 1259 (11th Cir. 2004) (reliance provable in common if "[i]t does not strain credulity to conclude that each plaintiff … relied upon the defendants' representations" and "[a] jury could quite reasonably infer" reliance from common misrepresentation); *In re U.S. Foodservice Inc. Pricing Litig.*, 729 F.3d 108, 120 (2d Cir. 2013) (plaintiffs' participation can provide common "circumstantial proof of reliance

based on the reasonable inference that [plaintiffs would not participate] absent reliance"). That standard is easily met here: Based on substantial experience, the law treats pyramid schemes as "inherent[ly] deceptive" *per se* frauds, making an inference of reliance quite reasonable indeed. *Webster v. Omnitrition Inc.*, 79 F.3d 776, 788 (9th Cir. 1996) (so holding).

It is easy to see that defendants misstate the standard by applying it to the actual facts of the cases. Defendants must claim that, in *Foodservice*, the reliance inference was justified because "no one" would knowingly pay inflated bills. 729 F.3d at 120. But that is obviously false: Some people pay bills they know are wrong because they are too busy or care more about their relationship with the biller. Defendants must also claim that, in *CGC Holding Co. v. Broad & Cassel*, 773 F.3d 1076, 1082-83 (10th Cir. 2014), "no one" would knowingly pay fees seeking loans from underfunded banks, Arg. 2:45-50. But the bank in *CGC* actually *did* write some loans, and so, even knowing the bank was undercapitalized, some plaintiffs might still have hoped they would be the ones to get a deal. As the Court correctly observed, human motivation is complex, making defendants' straw-man standard unreachable. Arg. 12:24-32; 14:49-16:00.

Accordingly, no previous case actually indulges the kind of theoretical unicorn hunt defendants propose. The question is if common questions *predominate*; the answer must be yes where reliance is, *undisputedly*, the only "reasonable inference" with respect to hundreds of thousands of plaintiffs. Defendants believe there might be *someone* who (1) was told that Stream was a legitimate business; (2) was savvy enough to figure out that it was a pyramid scheme where success was very unlikely and required victimizing others; (3) chose to join anyway; but (4) somehow still managed to lose money. If defendants have actual evidence of the unicorns they hypothesize, they can exclude them, *see Halliburton*, 134 S. Ct. at 2412, or—if this question arises often enough to *predominate*—attack certification with evidence rather than conjecture. That defendants did not even try this below, after years of discovery, shows that the district court did not abuse its discretion in finding that this question would not predominate.

Defendants proposed at argument that the classwide reliance inference fails, even though pyramid schemes are inherently deceptive and illegal, because people do knowingly join illegal schemes—as they might knowingly agree to sell knockoff handbags, Arg. 42:50-43:32. We doubt a substantial number of people would knowingly dupe their *friends and family* into buying fakes, then knowingly dupe them into selling illegal goods themselves and becoming unwitting fraudsters, and still manage to lose money, as would be necessary for this analogy to hold. Nor is it fair to attack an inference of reliance on a *mis*representation based on a hypothetical where class members are *told the truth*. *Id*. But even still, this example creates no individualized question; defendants simply argue that the reliance inference fails for the whole class based on a common argument. As the Second Circuit noted in *Foodservice*, that argument should go to the jury on a classwide basis because it involves no individualized proof. *See* 729 F.3d at 120-22.

(2) In most pyramid-scheme cases, the merits will matter.

Stream consistently represents that our view is that the merits of our pyramid scheme allegation are irrelevant, and that our "rule" would provide a class action to any plaintiff who simply alleged such a scheme, Arg. 6:58-7:07; 38:40. As we explained at argument, *id.* at 29:45-31:10, that is not our view, the Court need not adopt that proposition or anything like it for class certification to be appropriate, and any confusion stems from Stream's forfeitures below.

The merits matter because there are two key doctrinal barriers to obtaining a class action based on a mere pyramid-scheme allegation. First, under *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 556 (2007), that allegation must be plausible. And second, under *Walmart v. Dukes*, 131 S. Ct. 2541, 2551-52 (2011), the common evidence given to substantiate the allegation must survive "rigorous" scrutiny at the Rule 23 stage. Accordingly, trumped-up pyramid scheme allegations against legitimate companies (like Avon or Tupperware) will not yield class actions.

The reason these doctrines do not feature here is that defendants *never invoked them*. And for good reason: The complaint is exceptionally detailed in laying out the basis for its pyramid claim, ROA.1022-1141, and the class certification motion (Doc. 121) and simultaneous motion for summary judgment (Doc. 122), powerfully develop that evidence. By then, discovery had yielded an email where defendants' CEO admitted that the business model was, quite literally, "robbing Peter to pay Paul." SRE26. Defendants no doubt feared the consequences of a decision holding that our pyramid-scheme allegation survived rigorous scrutiny and laying out the damning evidence. *See* Stay Motion at App. 45 (Defendants representing to this Court that no one would sign up if class members where informed of plausible pyramid allegation). So when the district court asked how much of the merits it should decide at the Rule 23 stage, defendants begged for no such decision at all. *See* Pltfs' Br. 48-50; Doc. 154 at 48.

After defendants failed to defeat certification, they coined the new argument that the court was required to find "proof" that Stream was a pyramid scheme at the Rule 23 stage. That argument is forfeited, and also inconsistent with *In re Deepwater Horizon*, 739 F.3d 790, 810-811 (5th Cir. 2014), which requires rigorous analysis at the Rule 23 stage, not a full "dress rehearsal for the merits." But had defendants made a proper demand for rigorous scrutiny of the merits evidence below, they would have been entitled to it. And we would have prevailed.

(3) Our evidence shows that Stream is an illegal pyramid scheme; Defendants' responded at argument with irrelevant and deceptive figures.

As we explained at argument, 16:44-18:12; 32:15-35:31, Stream was—from inception—an illegal pyramid scheme in which everyone who joined was either a victim or bound to victimize others. That is because, under the system in place since 2005, IAs overwhelmingly must recoup their investment by recruiting others into the scheme. The *relevant* facts are brutal: 86% of IAs lost money; less than 1% could make money selling energy, only 3 of 54 dollars per customer in IA compensation went to the person who actually sold the energy account (rather than upstream recruiters), and Stream's own materials confirm that their system is "not about becoming an energy salesperson." SRE 2, 10, 14; Arg. 31:30-34:55, Pltfs. Br. 5-16. This is the only relevant inquiry: If Stream is "not about becoming an energy salesperson," and instead about recruiting ever more IAs, it is a *per se* fraud. *Omnitrition*, 79 F.3d at 782.

Pressed on this at argument, Stream claimed that *its* revenue (not profits) comes mostly from selling energy at a markup. Arg. 39:01-40:37. This sleight of hand is designed to trick the Court the same way Stream tricks IAs. The question isn't how *Stream* makes money, but how *IAs* do. Without an adequate incentive to sell, they will be forced to recruit, and harm, an ever-expanding set of people to avoid a loss. That Stream makes money on each new recruit's energy account (and the one or two they sell on average) shows only that the recruitment pyramid enriches both the defendants who put themselves at the top and the company itself.

Stream also continues to prevaricate about the numbers. It misleadingly claimed at argument that "many" individuals who joined after 2008 made "six-figures" or "half a million dollars," and reacted to probing by moving the goalposts. Arg. 3:00-5:30; 13:00-14:45; 40:50. We urge the Court to review the exhibit Stream cited (Doc. 123, App. III, Ex.1). It is a 3576 page list of every IA from greatest loss to greatest gain through 2012. The list of IAs who made over $500,000 is less than half a page; many of those 34 IAs (.01% of the total) are defendants who set up the pyramid before Stream was even allowed to sell energy; there are two IAs who joined in 2007, one in 2008, and *none* for the several years after. Those that made over $100,000 in *years* of working for Stream begin on page 3572, represent 0.1% of all IAs, and fully 16 of them (.005%) joined in the four years after 2008. And none of these are even class members.

We briefed these points extensively, Pltfs. Br. 5-16, 53-54, including the relevant law, and Stream chose not to respond. It is clear why. We particularly urge the Court to compare this case to *FTC v. BurnLounge*, 753 F.3d 878 (9th Cir. 2014), which rejects Stream's argument that requiring *one* real sale is enough. Nor can the Court conclude that Stream is lawful because the FTC has not (yet) prosecuted. Arg. 44:49-45:39. Indeed, if there is any question as to whether our evidence raises a serious pyramid claim, we would gladly have the Court ask the FTC.

(4) The district court should consider our merits evidence on remand.

Stream has consistently said that is does not seek a *per se* rule against certification, Arg. 16:04-16:34, but has offered no case-specific factor that would distinguish this case from any other pyramid scheme case—including one with an ironclad showing of an illegal recruitment structure (like this one). And Stream affirmatively waived the *Walmart* inquiry that would allow the Court to approve only those cases that involve real evidence of common *mis*representations. That waiver permits the Court to affirm while directing the proper analysis in future cases.

Nonetheless, we are completely willing to have the district court perform that inquiry again, this time with a specific order providing the holding defendants swore off the last time around. As this Court made clear in affirming a RICO fraud class action in *Brand v. National Bank of Commerce,* 2000 WL 554193 (5th Cir. 2000), class certification decisions are always contingent, and defendants can always obtain decertification if "in the course of the post-certification proceedings, it is demonstrated that a common practice cannot be proven and the class members must prove individual representations and reliance to prevail." Again, the correct standard involves "rigorous analysis" of the sufficiency of our allegedly common evidence, not a merits mini-trial. But we are quite confident that we can prevail under any standard.

Briefly put, it will be necessary in this case, as in any class action, for the district court to monitor class definition and, as needed, "adjust the class, informed by the proceedings as they unfold." *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 620 (1997) (citing Rule 23(c), (d)). If defendants choose to make such arguments, that might involve adjusting the class definition in terms of time period, as the Court proposed, Arg. 7:35-8:39; 10:22-11:11, or even decertifying it if there is no substance to the pyramid allegation. Given the arguments defendants have actually made, it would be most appropriate to affirm and remand while instructing the district court to be attentive to this obligation as it arises. But, at a minimum, if the Court decertifies, it must allow the plaintiffs to obtain a new certification upon establishing the substantiality of the purely common evidence for their purely common pyramid-scheme claim.

CERTIFICATE

I hereby certify that the attached letter brief complies with the order of the Court dated February 3, 2015 seeking supplemental letter briefing not to exceed four pages. I further certify that, on February 9, 2015, I served a copy of the attached letter brief on counsel for all parties through the Court's CM/ECF system. Counsel for all parties are registered users of the system.

/s/Eric F. Citron
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