No. 14-20128

In the United States Court of Appeals for the Fifth Circuit

JUAN RAMON TORRES; EUGENE ROBISON,

Plaintiffs-Appellees,

v.

SGE MANAGEMENT, LLC; STREAM GAS & ELECTRIC, LTD.; STREAM SPE GP, LLC; STREAM SPE, LTD; IGNITE HOLDINGS, LTD; ET AL.,

Defendants-Appellants.

On Petition for Review from the United States District Court for the Southern District of Texas, Houston Division, Case No. 4:09-CV-02056

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INTRODUCTION

In the district court, Plaintiffs did not seek class certification on the ground that they can prove reliance through common rather than individualized evidence—but rather because they thought they were not required to prove reliance *at all*, under *Bridge v. Phoenix Bond & Indem. Co.*, 553 U.S. 639 (2008).

The district court correctly rejected Plaintiffs' interpretation of *Bridge*—and Plaintiffs now abandon that argument in their merits brief on appeal. The district court also correctly observed that the individualized issues of reliance, knowledge, and causation in this case would ordinarily preclude certification.

But the court certified the class anyway, based on a theory that no court has ever endorsed, until now—namely, that Plaintiffs are entitled to class certification simply because they have alleged that Defendants operate a pyramid scheme.

There are two ways to interpret the district court's certification order. Both interpretations, however, lead to the same result: Any fraud plaintiff who alleges that the defendant operates a pyramid scheme is now automatically entitled to class certification. But both approaches are incorrect—indeed, even Plaintiffs do not seem comfortable embracing either of them.

First, the district court theorized that no rational person would knowingly join a pyramid scheme—so as a result, there is no individualized issue of reliance:

Just prove the existence of a pyramid scheme at trial, and that fact alone will automatically prove reliance as well.

But rational people can, and do, engage in a variety of economic activities—including pyramid schemes as well as legitimate businesses. They do so for one simple reason: the opportunity to make money. Thus, merely proving that a defendant operates a pyramid scheme does not prove reliance, knowledge, or causation for every class member. Individualized issues still predominate, thereby precluding certification.

Even Plaintiffs appear to concede this, when they suggest that Defendants could present evidence that rational people would knowingly participate in the alleged pyramid scheme. Pltfs' Br. 36-37. Plaintiffs' real argument, then, appears to be an attempt to shift the burden at the class certification stage from plaintiffs to defendants, contrary to established precedent.

Second, the district court suggested a new rule, akin to the fraud-on-the-market theory, in which plaintiffs in pyramid scheme cases can simply *presume* reliance, just because they have alleged a pyramid scheme. But no court has ever endorsed such a doctrine, and this Court should not be the first. Even Plaintiffs do not appear to defend this heretofore unheard of rule.

Moreover, granting certification just because a plaintiff alleges a pyramid scheme is dangerous and untenable. The proposed rule would inevitably open the

floodgates to unjust recovery for undeserving plaintiffs—and against innocent defendants—contrary to established principles of fraud and class action law.

Under core principles of fraud law, a plaintiff cannot prevail unless the plaintiff was actually harmed by the fraud. Accordingly, if a member of the putative class in this case knew the truth of—or did not rely on—any alleged fraudulent statement, they cannot prevail. Under either scenario, there is no causation—and therefore no RICO fraud claim.

This rudimentary principle is fatal to class certification in this case—just as it has been in every RICO civil fraud precedent ever issued by this Court. After all, even under Plaintiffs' own theory of the case, the class will inevitably contain countless plaintiffs who do not possess a valid RICO fraud claim—either because they knew the truth of, or did not rely on, any allegedly fraudulent statement.

Certification of this class would also harm innocent defendants. After all, if this class is certified, then *every* multi-level marketing business will be automatically subject to certification, based on the mere allegation of a pyramid scheme—and the threat of *in terrorem* settlements that come with it. That is why both this Court and the U.S. Supreme Court rigorously enforce limits on class action certification. The Court should reverse.

ARGUMENT

I. Plaintiffs' False Pyramid Scheme Allegation Does Not Change The Fact That This Case Presents Individualized Issues Of Knowledge and Reliance—Just As In This Court's RICO Fraud Precedents.

The district court certified the class based on the premise that rational people do not participate in pyramid schemes. The court concluded that, if Plaintiffs can prove a pyramid scheme at trial, they will then automatically prove reliance for each and every class member as well—because (as Plaintiffs now argue) no rational person would knowingly participate in a pyramid scheme.

But that premise is wrong. Rational people can and do engage in a variety of economic activities, including pyramid schemes as well as legitimate businesses. As a result, merely proving that a defendant operates a pyramid scheme does not prove reliance, knowledge, or causation for every class member. Individualized issues still predominate—so class certification must still be denied.

Even Plaintiffs seem to acknowledge this, when they later admit that Defendants could *decertify* the class on remand by showing that rational people could decide to participate in a pyramid scheme. They simply want to shift the burden at class certification from plaintiffs to defendants. But that conflicts with established and well-founded precedent. And not surprisingly, *none* of the cases cited by Plaintiffs comes close to supporting certification just because a plaintiff has alleged a pyramid scheme.

A. Stream Energy Is Not A Pyramid Scheme—But That Has Nothing To Do With This Appeal.

Stream Energy looks forward to proving on remand (in an individualized rather than class setting) that it is not a pyramid scheme, but a legitimate multi-level marketing company—a business strategy employed by some of the biggest names in American business. Stream Energy is not just a legitimate seller of energy—it is the fourth largest provider of energy in Texas. Thousands of its sales associates have earned profits by selling hundreds of millions of dollars of energy. Over a million Stream Energy customers are not, and have never been, sales associates. In sum, Stream Energy sells a real product to real customers—it is emphatically not a pyramid scheme. *See generally* Defts' Br. 3-5, 16, 24-25. Indeed, the class representative in this case became an IA *to sell energy*, not to recruit IAs. Doc. No. 129, Ex 6 at 41:2-17 (Sealed Robison Dep.) ("the real reason that [he] got into it, was to sell electricity to commercial accounts . . . and family members"). Stream Energy also looks forward to rebutting the countless false statements about its IA program that appear in Plaintiffs' brief.

None of this is relevant, however, to this appeal. Rather, the question presented by the certification order is this: *Assuming* proof of a pyramid scheme, would that automatically prove reliance, knowledge, or causation for every class member as well? As detailed below, the answer is, emphatically, no.

Plaintiffs' false pyramid allegation is likewise not an issue on appeal under the second interpretation of the district court's class certification order. As detailed in Section II below, this Court should not invent a new presumption of reliance in this case, akin to the fraud-on-the-market theory—and what's more, Plaintiffs could not certify this class, even under that theory, until they first proved the existence of a pyramid scheme *in the district court*, not for the first time on appeal in this Court.

B. Rational People Engage In Economic Activities Of All Kinds—Including Pyramid Schemes.

Plaintiffs base their entire argument for certification on a strikingly absolute premise: that no rational person would ever join a pyramid scheme. But that is simply not true, for the following reasons:

1. Rational people engage in all manner of economic activities to try to make money. Accordingly, a rational person could knowingly participate in a particular venture, so long as that person could rationally think they might earn a profit by doing so. That includes pyramid schemes, as well as legitimate multi-level marketing enterprises, like Stream Energy, and other legitimate businesses.

For example, a rational person could knowingly choose to become an IA of Stream Energy—regardless of what some future court might call it. That is for the simple reason that a rational person could believe they would make money by doing so. It is irrefutable as a matter of common sense (and arithmetic) that the

opportunity to become an IA could be worth more than the cost. The mere structure of the program evidences this truth.

A rational person could easily decide that the benefits of becoming an IA outweigh the costs, and join the program accordingly—regardless of whether the program is or is not a pyramid scheme. All it takes is locating a sufficient number of relatives, friends, and colleagues who are willing to buy or sell energy from Stream Energy—an easy task to imagine for an at-home parent, office assistant, or anyone else seeking a little extra income for themselves or their family, by doing just a little part-time work, through one or more multi-level marketing programs.

Indeed, *tens of thousands* of IAs who joined the program during the same period of time as members of this class made a profit. *See, e.g.*, Doc. No. 121, App'x III, Ex. 1 at 4 (Sealed Expert Report).

In sum, this Court can accept Plaintiffs' false allegation that Stream Energy is a pyramid scheme as true—and still deny class certification.

2. For their part, Plaintiffs argue that rational people do not join pyramid schemes "because they will inevitably harm *later* investors." Pltfs' Br. 34 (quotations omitted, emphasis added).

But that statement only proves our point. A true pyramid scheme might inevitably harm "later" investors—but it can also benefit investors who appear

early enough on the scene. Thus, if someone reasonably believes that they are not a "later" investor, it could be rational for them to join a pyramid scheme.

In this case, tens of thousands of IAs joined during precisely the *same* time period as the class members—*and they made money doing so*. Indeed, countless people can and do make money through the IA program to this very day. *See, e.g.*, Doc. No. 121, App'x III, Ex. 1 (Sealed Expert Report).

3. Nor does it make any sense to suggest that rational people do not join pyramid schemes "because they must eventually collapse." Pltfs' Br. 9.

To use an analogy, consider asset bubbles. An asset bubble can exist when the price of the asset rises at a rate that so exceeds its true value that a sudden collapse in price is likely. Investors know that bubbles eventually burst—and that some people will be left holding the bag when it does. But they nevertheless believe they can make money before the bubble bursts. It may or may not turn out to be a prudent investment strategy—but it is certainly something "rational" people do every day. They do so not because they have been defrauded, but because they are willing to take the risk in exchange for the potential benefit. Indeed, even if some people are intentionally defrauded about the actual value of the asset, others may still be willing to take a chance in hopes of being one of the winners.

A blanket rule declaring that no rational person would knowingly invest in an asset bubble would be patently absurd. And so too with pyramid schemes.

Depending on the nature and details of the alleged pyramid scheme, it might be utterly rational for an individual to take a chance and join. They could rationally believe that they can make some money before the alleged pyramid collapses.

In this case, *tens of thousands* of people have made money by becoming IAs. Thus, it would be entirely rational for someone who wants to make money to become an IA, regardless of the ultimate truth or falsity of Plaintiffs' allegation. As even the district court admitted elsewhere in its opinion, "it could be the case that some especially entrepreneurial class members . . . became IAs nonetheless because they believed they (though not necessarily everyone else) would make a significant amount of money." ROA.2265. Translation: Rational people can and did become IAs. The court should have denied certification under its own logic.

Put simply, rational people differ in their economic decisions—including risk-taking decisions concerning rumored pyramid schemes and asset bubbles alike. This is an individualized inquiry that is fatal to class certification.

4. Plaintiffs also argue that Defendants' affidavits in support of a stay pending appeal effectively admitted that no rational person would join a pyramid scheme because the affidavits stated that being (falsely) accused of running a pyramid scheme would hurt their attempts to enlist new IAs. Pltfs' Br. 35.

This argument makes no sense. The district court based class certification on the belief that *no* rational person would join a pyramid scheme. The stay

affidavits suggest only that *some* rational people would not knowingly join a business that has been publicly (and falsely) accused of being a pyramid scheme.

C. Plaintiffs' Real Argument Is That The Burden Of Proof At Class Certification Should Be Shifted From Plaintiffs To Defendants—Contrary To Established Precedent.

Plaintiffs eventually admit that it is "a question of fact" and "evidence"—not an unalterable truth—whether rational people could knowingly decide to join a pyramid scheme. *Id.* at 36. They further admit that Defendants are "free to try to show that the logical inference that individuals rely on the legality of organizations they join was unjustified or incorrect." *Id.* at 36-37. "Indeed, they can still make that showing, and if it turns out that this is a substantial issue on which individualized testimony is needed, they can move for decertification." *Id.* at 37.

Plaintiffs' real argument, then, is *not* that a rational person would never join a pyramid scheme. Rather, they only claim that Defendants never produced evidence on that point. In short, Plaintiffs believe it is Defendants' duty to prove that a rational person would knowingly become an IA.

But it is the *plaintiff's* duty to present all evidence necessary at the class certification stage to prove that common issues predominate—not the *defendant's* duty to present evidence to prove that individual issues exist. *See, e.g., Sandwich Chef of Texas, Inc. v. Reliance Nat'l Indem. Ins. Co.*, 319 F.3d 205, 218 (5th Cir. 2003) (plaintiff must "show that the common issues predominate" and "[t]he party

seeking certification bears the burden of proof") (internal quotation omitted); *Comcast Corp. v. Behrend*, 133 S. Ct. 1426, 1432 (2013) (same); *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2550-52 (2011) (same). That is fatal to class certification, because Plaintiffs have not carried their burden—indeed, they have not even tried.

In the court below, Plaintiffs did not try to prove that rational people would not join the IA program. To the contrary, they argued that, after *Bridge*, they are no longer required to prove reliance at all.

At the class certification stage, Plaintiffs argued that *Bridge* "did away with first-party reliance in RICO cases." Doc. No. 154 at 18:7 (Sealed Transcript of Certification Hearing). Thus, according to Plaintiffs, it was unnecessary to decide "whether every plaintiff relied on a misrepresentation or not." *Id.* at 18:17. "We need proof of a RICO enterprise, proof of predicate acts, proof of conspiracy for 1962(b). We don't need proof of first-party reliance." *Id.* at 20:21-25. *See also id.* at 18:5-9 (describing *Bridge* as the "key case" that "opens the door fairly wide for certifying the RICO class action, because you no longer have to go look at every plaintiff, whether every plaintiff relied on a misrepresentation or not").

At no point below did Plaintiffs argue that reliance could be proved on a class-wide basis, or that no rational person would ever knowingly join a pyramid scheme. Only now, at the merits stage of this appeal, do they abandon their

argument that they do not need to prove reliance under *Bridge*. Instead, they now argue that reliance can be proven in this case on a class-wide basis. But they never even argued that point below—let alone produced evidence to support that conclusion. That lack of proof is fatal to class certification in this case.

In fact, the evidence is precisely the opposite. As explained above, the evidence establishes many reasons why a rational person would become an IA, regardless of the truth or falsity of Plaintiffs' pyramid scheme allegation.

Indeed, Plaintiffs previously *admitted* that Defendants produced evidence demonstrating that there are individual issues of reliance in this case. Their sole response was that they are not required to prove reliance under *Bridge*:

> Thus, the claim that . . . "each potential class member will have to submit individualized evidence as to what he or she received and read and heard, what he or she thought it meant, what he or she already knew about Ignite . . ." (Response at 32-33) is simply legally wrong. *All of the so-called evidence listed by the Defendants is first-party reliance*, specifically done away with by *Bridge*.

Doc. No. 134 at 11 (Sealed Reply in Support of Certification) (emphasis added).

Plaintiffs thus conceded that Defendants presented "evidence" that reliance is "individualized." *Id.* They responded only that Defendants' evidence was "done away with by *Bridge*." *Id.* Now that Plaintiffs have abandoned their argument under *Bridge*, their entire basis for class certification has collapsed.

D. There Is No Authority For Automatically Certifying A Class Action Just Because A Plaintiff Has Alleged A Pyramid Scheme.

There is no authority for the proposition that a class should automatically be certified—and individualized issues of reliance and knowledge set aside—just because the plaintiff has alleged a pyramid scheme. And Plaintiffs cite none. In fact, every case cited by Plaintiffs falls into one of four categories—none of which justify their rule.

First, Plaintiffs cite two Ninth Circuit cases involving class actions that defendants *consented* to for purposes of settlement—not cases certified over opposition for trial. *See Marshall v. Holiday Magic, Inc.*, 550 F.2d 1173 (9th Cir. 1977); *Arata v. Nu Skin Int'l, Inc.*, 1993 WL 321710 (9th Cir. Aug. 24, 1993). Moreover, neither case involved a challenge to certification due to individualized issues of reliance. *Marshall* involved an alleged conflict of interest between the plaintiffs, while *Arata* involved an alleged absence of common misrepresentations and the alleged atypicality of the class representative.

Second, Plaintiffs cite two cases that were not actually certified as class actions. *See Bell v. Health-Mor, Inc.*, 549 F.2d 342 (5th Cir. 1977); *Stull v. YTB Int'l, Inc.*, 2011 WL 4476419 (S.D. Ill. Sept. 26, 2011). *Bell* was on appeal over a motion to dismiss. There is no indication that the class was ever certified. *Stull* has also never been certified as a class. The case is currently pending certification—but only as an *agreed* settlement class.

Third, Plaintiffs cite five cases that did involve certified class actions—but *none* of them confronted the issue of individualized questions of reliance. *See Piambino v. Bailey*, 610 F.2d 1306 (5th Cir. 1980); *Webster v. Omnitrition Int'l, Inc.*, 79 F.3d 776 (9th Cir. 1996); *In re Glenn W. Turner Enterps. Litig.*, 521 F.2d 775 (3d Cir. 1975); *In re Am. Principals Holdings, Inc. Sec. Litig.*, 1987 WL 39746 (S.D. Cal. July 9, 1987); *Nguyen v. FundAmerica, Inc.*, 1990 WL 165251 (N.D. Cal. Aug. 16, 1990). Crucially, *none* of those cases even *mentioned* (let alone examined) the argument that evidence of reliance is typically individualized—presumably because the defendants in those cases never raised the issue. Indeed, four of those decisions—*Piambino*, *Webster*, *Glenn*, and *Am. Principals*—are not class certification rulings at all.

Finally, Plaintiffs cite just one case where the issue of individual reliance was discussed. *See Davis v. Avco Corp.*, 371 F. Supp. 782 (N.D. Ohio 1974). There, the court acknowledged the argument that there would be "varying degrees of reliance"—yet still certified the case. *Id*. at 792. But *Davis* was a Rule 10b-5 securities fraud case—a fact Plaintiffs fail to mention. As the court explained, "the Supreme Court has done away with any requirement that the plaintiff must offer

positive proof of individual reliance in cases under Rule 10b-5." *Id*. (citing *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972)).[1]

The most that Plaintiffs can claim is that a class action *can* be certified in a case involving a pyramid scheme (especially when a defendant does not even argue the existence of individualized questions of reliance and knowledge). *See, e.g.*, Defts' Br. 17-18 (explaining that this case does not meet the "high bar" of cases like *Negrete* and *Peterson* in which fraud is "[t]he only logical explanation" for plaintiffs' conduct, because it was "inconceivable" that any "rational class member" would have knowingly proceeded absent reliance on a misrepresentation) (citing *Negrete v. Allianz Life Ins. Co.*, 287 F.R.D. 590 (C.D. Cal. 2012); *Peterson v. H&R Block Tax Services, Inc.*, 174 F.R.D. 78 (N.D. Ill. 1997)).

In this case, however—as in this Court's RICO fraud precedents—individualized issues of knowledge, reliance, and causation preclude certification. *See* Defts' Br. 10-18. A class cannot be certified based on a bare pyramid scheme allegation and a sweeping and highly disputable assertion about what rational people do.

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[1] Moreover, none of the cases cited by Plaintiffs are within the Fifth Circuit after this Court's decisions in *Bolin v. Sears, Roebuck & Co.*, 231 F.3d 970 (5th Cir. 2000), *Patterson v. Mobil Oil Corp.*, 241 F.3d 417 (5th Cir. 2001), and *Sandwich Chef*. In each of those precedents, this Court made clear that "cases that involve individual reliance fail the predominance test" and thus may not be certified for class action. *Sandwich Chef*, 319 F.3d at 219.

II. This Court Should Not Create A Special Rule, Akin To The Fraud-On-The-Market Doctrine, That Allows Plaintiffs To Presume, Rather Than Prove, Reliance In Pyramid Scheme Cases.

The district court might have also created a special rule for pyramid schemes, akin to the fraud-on-the-market theory. Under this rule, it would not matter whether a rational person would knowingly join a pyramid scheme. Courts would certify pyramid scheme cases based on a *presumption* of reliance. ROA.2266. But no court has ever announced such a rule—for good reason—and this Court should not be the first. Not surprisingly, even Plaintiffs do not defend this approach.

A. There Is No Justification For Creating A Special Presumption Of Reliance In Pyramid Scheme Cases.

As this Court explained in *Sandwich Chef*, there is "a working presumption against class certification" in RICO fraud cases, due to "[t]he pervasive issues of individual reliance that generally exist in RICO fraud actions." 319 F.3d at 219.

Instead of following this principle, however, the district court turned it on its head. Rather than apply a presumption against class certification, it applied a presumption in favor of it. As the court explained, this presumption is "based on a fraud-on-the-market theory and the common sense inference that IAs were duped into joining a pyramid scheme." ROA.2266. Under this theory, "all the class members are *presumed* to be relying on the same misrepresentation." *Id.* (emphasis added).

But there is no valid justification for reversing the *Sandwich Chef* presumption in this case, and Plaintiffs have not offered one. No court (until now) has ever announced a presumption of reliance simply because a plaintiff alleges a pyramid scheme. This Court should not be the first. *See, e.g.*, *Summit Props. Inc. v. Hoechst Celanese Corp.*, 214 F.3d 556, 561 (5th Cir. 2000) ("No court has accepted the use of [the fraud-on-the-market] theory outside of the context of securities fraud, and one circuit has expressly rejected its use in the context of a similar civil RICO case.") (citing *Appletree Square I, Ltd. P'ship v. W.R. Grace & Co.*, 29 F.3d 1283, 1287 (8th Cir. 1994)); *Se. Laborers Health & Welfare Fund v. Bayer Corp.*, 444 F. App'x 401, 410 n.4 (11th Cir. 2011) ("Southeast may not rely on a fraud-on-the-market or fraud-on-the-FDA theory of causation for its RICO claim."); *Sikes v. Teleline, Inc.*, 281 F.3d 1350, 1363 (11th Cir. 2002) ("neither this circuit nor the Supreme Court has extended a presumption of reliance outside the context of securities cases"); *Int'l Union of Operating Eng'rs Local No. 68 Welfare Fund v. Merck & Co.*, 929 A.2d 1076, 1088 (N.J. 2007) ("We have rejected the fraud-on-the-market theory as being inappropriate in any context other than federal securities fraud litigation."); *Mirkin v. Wasserman*, 858 P.2d 568, 584 (Cal. 1993) ("[T]o permit common law claims based on the fraud-on-the-market doctrine would open the door to class action lawsuits based on exceedingly speculative theories.").

B. There Is An Additional Problem With Adopting A Special Presumption In Pyramid Scheme Cases: Plaintiffs Must Prove The Existence Of A Pyramid Scheme Before Certification.

There is an additional flaw with the district court's presumption of reliance. As explained below, Plaintiffs must first *prove*—not merely allege—the predicate fact that triggers the presumption of reliance before a court will certify a class action based on that presumption. Plaintiffs here did not do so. *See* ROA.2266 (granting certification on the basis of an "alleged[]" pyramid scheme).

1. Plaintiffs contend that Defendants waived the argument that plaintiffs must prove the predicate fact that enables the presumption of reliance invented by the district court. Pltfs' Br. 48-50.

This makes no sense. Plaintiffs below did not argue for a presumption of reliance—rather, they argued for no reliance requirement *at all*. As discussed above, Plaintiffs argued that *Bridge* "did away with first-party reliance in RICO cases." *See supra* at 10-12. Defendants could hardly waive an argument concerning a theory that Plaintiffs did not advocate below, that no court had ever announced before, and that did not appear in this case until the district court issued its class certification order.[2]

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[2] Plaintiffs quote a portion of the certification hearing, where Defendants said the district court did not "need to decide whether this is a pyramid scheme" in order to deny class certification. But that statement is entirely correct—and waives nothing. Defendants' lead argument in

[Footnote continued on next page]

Moreover, "a well-settled discretionary exception to the waiver rule exists where a disputed issue concerns 'a pure question of law.'" *New Orleans Depot Servs., Inc. v. Dir., Office of Worker's Comp. Programs*, 718 F.3d 384, 388 (5th Cir. 2013) (en banc) (citation omitted). That is precisely the case here. This issue is a pure question of law, and one that both parties have now fully briefed on appeal: Should plaintiffs be required to prove the existence of a pyramid scheme at the certification phase, in order to invoke the district court's new presumption of reliance in pyramid scheme cases? The Court need not address this question, because no such presumption should be invented in the first place. But if the Court wishes to address the question, the answer is plainly yes.

2. The fraud-on-the-market doctrine contains two distinct components. First, the plaintiff must prove "that the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations." *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2408 (2014) (quotation marks and citation omitted). Second, the doctrine includes a judicially-created assumption that an "investor who buys or

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this case has *always* been that the district court should have denied class certification—without regard to Plaintiffs' false pyramid scheme allegation—because this case presents individualized issues of knowledge, reliance, and causation. *See also supra* at 5-6. By contrast, Plaintiffs did not argue below for a presumption of reliance in pyramid scheme cases, akin to the fraud on the market theory—to the contrary, they argued for no reliance requirement *at all*. Put simply, Defendants could not waive an issue that no one presented.

sells stock at the price set by the market does so in reliance on the integrity of that price." *Id*. Consequently, "whenever the investor buys or sells stock at the market price, his reliance on any public material misrepresentations may be presumed." *Id.* (quotation marks and citation omitted).

Essentially, the fraud-on-the-market doctrine allows a plaintiff to combine proof that the price of a stock reflects all publicly available information, with the assumption that all investors rely on the integrity of the price of a stock, to create a rebuttable presumption that all investors relied on any alleged misrepresentations by the simple act of purchasing the stock.

Notably, however, a plaintiff must actually *prove* the first component—that the price of the stock reflects all publicly available information. *See id.* at 2412 ("The *Basic* presumption does not relieve plaintiffs of the burden of proving—before class certification—that [the predominance] requirement is met.").

3. The presumption of reliance employed by the district court likewise involves two essential components. The first is Plaintiffs' allegation that Stream operates a pyramid scheme. The second is the district court's newly announced assumption that all persons rely on the fact that any business venture they decide to join is not a pyramid scheme. (This assumption is, of course, entirely without support—which is why the Court should reject it at the outset.)

These two components combine to create (in the district court's view) a presumption that anyone who joins a venture does so in reliance on the fact that the venture is not a pyramid scheme.

But if the district court is going to certify the class on this basis, it should have first required plaintiffs to prove the factual predicate that enables the presumption of reliance—namely, that the IA program was in fact a pyramid scheme. After all, the existence of a pyramid scheme is a "fundamental premise" of the district court's novel reliance theory, and "thus has everything to do with the issue of predominance at the class certification stage." *Id.* Without proof of that factual predicate, the "theory underlying the presumption completely collapses, rendering class certification inappropriate." *Id.* After all, "to maintain the consistency of the presumption with the class certification requirements of Federal Rule of Civil Procedure 23, defendants must be afforded an opportunity before class certification to defeat the presumption through evidence" that the opportunity at issue here was not a pyramid scheme. *Id.* at 2417.

Instead, the district court certified this class based on nothing more than Plaintiffs' *allegation* of a pyramid scheme. In doing so, the court violated the Supreme Court's repeated admonitions that plaintiffs "must actually *prove*—not simply plead—that their proposed class satisfies each requirement of Rule 23,

including (if applicable) the predominance requirement of Rule 23(b)(3)." *Id.* at 2412 (citing *Comcast*, 133 S. Ct. at 1431-32; *Wal-Mart*, 131 S. Ct. at 2551-52).

4. Plaintiffs respond by arguing that the Supreme Court's decision in *Amgen* relieves them of having to prove the existence of a pyramid scheme at class certification. Pltfs' Br. 50-51 (citing *Amgen Inc. v. Connecticut Ret. Plans and Trust Funds*, 133 S. Ct. 1184 (2013)). But *Amgen* does no such thing—as the Court's later decision in *Halliburton* (completely ignored by Plaintiffs in this discussion) makes clear.

In *Amgen*, the Supreme Court held that a securities fraud plaintiff need not prove materiality at class certification—even though materiality is a prerequisite of the fraud-on-the-market presumption—because materiality is itself an element of a securities fraud claim. 133 S. Ct. at 1191 ("As to materiality, . . . the class is entirely cohesive: It will prevail or fail in unison. In no event will the individual circumstances of particular class members bear on the inquiry.").

Unlike materiality, the existence of a pyramid scheme is not an element of Plaintiffs' RICO fraud claims. A failure of proof as to the existence of a pyramid scheme would not, therefore, necessarily "end the case." *Amgen*, 133 S. Ct. at

1191.[3] Accordingly, unlike materiality, a plaintiff must prove the existence of an unlawful pyramid scheme in order to certify the class.

This result is confirmed by *Halliburton*—issued after *Amgen*. In *Halliburton*, the Court reiterated that proof of price impact was necessary at the certification stage. As the Court explained, this proof "is needed to ensure that the questions of law or fact common to the class will 'predominate' . . . . even though such proof is also highly relevant at the merits stage." *Halliburton*, 134 S. Ct. at 2416-17 (citations omitted). The same is true here for proof of a pyramid scheme.

Finally, *Amgen* held only that plaintiffs need not prove materiality prior to obtaining class certification. It said nothing about reliance. And reliance is fundamentally different from materiality. As the *Amgen* Court itself noted, "materiality is judged according to an objective standard." *Amgen*, 133 S. Ct. at 1191 (emphasis added). Therefore, proof of materiality is necessarily common to all class members. By contrast, reliance is inherently subjective—and can accordingly vary from class member to class member.

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[3] As the complaint makes clear, Plaintiffs' RICO claim does not depend exclusively on the existence of an unlawful pyramid scheme. In addition to alleging that the pyramid scheme was a "*per se* scheme and artifice to defraud to obtain money," Plaintiffs *also* alleged that Stream Energy "defrauded purchasers" by making "numerous false statements" and "omitting material facts for the purpose of and with the intention of defrauding by obtaining money from the victims." ROA.1006-08. Thus, although the *class* will fall apart if Plaintiffs are unable to prove the existence of a pyramid scheme on the merits, the *case* will not end, because each class member would still be allowed to prove that he individually relied on the alleged false statements and omissions.

III. The Ruling Below Will Inevitably Reward Undeserving Plaintiffs And Harm Innocent Defendants.

The consequences of the district court's certification ruling are troubling. Whether it is because the district court thinks the issues of knowledge and reliance are common (because no rational person would join a pyramid scheme), or because it thinks plaintiffs may simply presume rather than actually prove reliance (akin to the fraud-on-the-market doctrine), the effect of the ruling is the same: A plaintiff who alleges a pyramid scheme is automatically entitled to try the case as a class.

That cannot be right. Allowing certification—in this case, and in the countless other cases that will inevitably follow—would violate bedrock principles of both fraud law and class action law. It would lead to recovery by undeserving plaintiffs against innocent defendants.

First, countless undeserving plaintiffs would now be able to prevail in a RICO fraud suit. That includes, for example, class members who knew full well what they were getting involved in. In fact, it includes class members who *wanted* to get involved in a pyramid scheme.

That means that there will be individuals who should be civil *defendants*, owing to their knowing participation in an alleged pyramid scheme—but who will now instead get to serve as *plaintiffs*. It is not difficult to imagine one plaintiff blaming another plaintiff for knowingly recruiting the first plaintiff into an alleged pyramid scheme. Indeed, consider this very case: Plaintiffs here are suing not

only corporate entities, but also various individual IAs. Under the district court's methodology, there will be a number of members of the certified plaintiff class who should join them on the other side of the "v."

Moreover, certification here would lead to the perverse effect of actually *encouraging* people to knowingly invest in pyramid schemes. After all, if knowledge of the truth no longer prevents recovery in RICO fraud suits, then individuals will have a *greater* incentive to participate in pyramid schemes. Indeed, it may become a win-win scenario: either you profit from the scheme itself, or you lose your investment but file a RICO fraud suit (indeed, due to trebled damages, you could double your investment).

These absurd scenarios are precisely why knowledge has always been fatal to fraud claims—and why this class cannot be certified. The district court's theory of certification violates bedrock fraud law: "The maker of a fraudulent misrepresentation is not liable to one who does not rely upon its truth but upon the expectation that the maker will be held liable in damages for its falsity." RESTATEMENT (SECOND) OF TORTS § 548 (1977).

Second, the district court's certification ruling also violates a basic principle of class action law—the need to guard against abusive certifications.

The order below paints a bull's eye on the back of every company that utilizes a multi-level marketing system. If the mere allegation of a pyramid

scheme is enough to satisfy the predominance requirement, then plaintiffs will be able to automatically obtain certification in every case by alleging a pyramid scheme—and then use the threat of treble damages to extract lucrative settlements from scores of innocent companies that engage in multi-level marketing.

That is precisely what this Court and the Supreme Court have repeatedly sought to prevent: innocent businesses with legitimate defenses nevertheless coerced into settling, simply because of the certification of a class. As the Supreme Court has explained, litigation on a class basis "greatly increases risks to defendants" such that they will be forced into "*in terrorem*" settlements where, "[f]aced with even a small chance of a devastating loss, defendants will be pressured into settling questionable claims." *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1752 (2011). *See also Coopers & Lybrand v. Livesay*, 437 U.S. 463, 476 (1978) ("Certification of a large class may so increase the defendant's potential damages liability and litigation costs that he may find it economically prudent to settle and to abandon a meritorious defense.").

As this Court has likewise observed, "certification dramatically affects the stakes for defendants." *Castano v. Am. Tobacco Co.*, 84 F.3d 734, 746 (5th Cir. 1996). It often imposes "insurmountable pressure on defendants to settle, whereas individual trials would not. The risk of facing an all-or-nothing verdict presents too high a risk, even when the probability of an adverse judgment is low." *Id.*

(internal citation omitted). "These settlements have been referred to as judicial blackmail." *Id*.

Tellingly, Plaintiffs do not even bother to deny that a class can now be certified in any case involving a multi-level marketing program. After all, there is no way to distinguish the certification here from any other case involving a multi-level marking program, including Avon, Mary Kay, Tupperware, and thousands of other legitimate multi-level marketing companies operating worldwide, benefiting millions of people.

Instead, Plaintiffs offer only the cold comfort that innocent defendants might be able to defeat these class actions on the merits, without the risk of going to trial—such as on a motion to dismiss or motion for summary judgment. But that is no response. A carefully lawyered complaint could survive a motion to dismiss, considering that a motion to dismiss must assume that all facts alleged in the complaint are true. And many defendants will not be willing to endure class certification followed by extensive, prolonged discovery, in the hope of someday winning at summary judgment. Indeed, consider this case: Defendants have moved for summary judgment, and briefing on it is complete. Yet the district court certified a class, and threatened to issue notices to the class—all without even granting a hearing on the summary judgment motion, let alone a ruling.

Not surprisingly, then, a broad coalition of amici—including the U.S. Chamber of Commerce—have joined Stream Energy in asking this Court to reverse the district court's certification of this class.[4]

* * *

The opportunity presented by the IA program in this case is simple and easy to understand: If an IA sells a certain number of customer accounts under certain conditions, they will earn a certain level of commissions.

These simple economics should be devastating to class certification. After all, any person who understood the economic realities of the opportunity and chose to proceed accordingly has no valid claim for fraud, regardless of any alleged misrepresentation. And the only way to determine who falls in that category is to ask each class member.

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[4] Moreover, the evident eagerness of Plaintiffs' counsel to jettison all claims that are not ready-made for class treatment should alert this Court to the attorney-driven nature of this case. Recall that, at the class certification hearing, Plaintiffs' counsel pressed two distinct and independent theories of RICO fraud liability—various specific misrepresentations, as well as the generic claim that Stream Energy operates a pyramid scheme. But now that the district court has certified the second theory but not the first, Plaintiffs' counsel seem all too eager to abandon the first theory of liability and proceed to a class trial solely on the second theory. Imagine, then, that Plaintiffs are defeated on their pyramid scheme claim at trial. Class members would now be barred from bringing individual claims based on any specific misrepresentations. Yet Plaintiffs' counsel is apparently quite willing to sacrifice those claims, in the hope of certifying this class and thereby extorting a class-wide settlement (one that will presumably include substantial attorneys' fees as well). This class-action-or-nothing approach reveals the true driving force behind this litigation. The filing of Plaintiffs' brief on appeal thus raises additional questions about the adequacy of the named Plaintiffs and their ability to faithfully represent the interests of the class—and thus further militates in favor of decertification.

CONCLUSION

The Court should reverse the judgment of the district court, deny class certification, and remand for proceedings on an individualized basis.

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Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

The undersigned counsel certifies that this brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in Times New Roman, 14-point. The brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because it contains 6,864 words, excluding the parts exempted from brief requirements under Fed. R. App. P. 32(a)(7)(B)(iii).

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CERTIFICATE OF SERVICE

I hereby certify that, on October 30, 2014, a true and correct copy of the foregoing Reply Brief of Appellants was served via the Court's CM/ECF system on all counsel of record for all parties.

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