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IN THE UNITED STATES DISTRICT COURT
DISTRICT OF UTAH, CENTRAL DIVISION

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF, v. TRAFFIC MONSOON, LLC, a Utah Limited Liability Company and CHARLES D. SCOVILLE, an individual, DEFENDANTS.	**PLAINTIFF'S REPLY IN SUPPORT OF MOTION FOR PRELIMINARY INJUNCTION** Case No.: 2:16-cv-00832-JNP Judge Jill N. Parrish

Plaintiff, Securities and Exchange Commission (the "Commission"), by and through its counsel of record, respectfully submits this Reply in Support of Motion for Preliminary Injunction ("Reply"). On Tuesday, July 26, 2016, the Court granted the Commission's *Ex Parte* Motion for Temporary Restraining Order, Order Appointment Receiver, Freezing Assets and Other Ancillary Relief ("TRO Motion"), including its request for a temporary restraining order

against the two defendants in this matter, Traffic Monsoon, LLC "Traffic Monsoon") and Charles D. Scoville ("Scoville"), as well as an order freezing the assets of both defendants. *See* Doc. No. 8. The following day, the Court also granted the Commission's application for the appointment of a receiver over the assets of both defendants. *See* Doc. No.11. In granting the Commission's emergency applications, the Court evaluated the evidence and determined that the Commission had met its initial burden of demonstrating a *prima facie* case that the defendants had violated the antifraud provisions of the federal securities laws and that, if not restrained, they would continue to violate the securities laws in the future. By issuing these orders, the Commission was permitted to restrain the massive Ponzi scheme that was being operated by Scoville, and the Receiver was able to marshal and preserve tens of millions of dollars that will be returned to defrauded investors.

INTRODUCTION

In his Opposition to Plaintiff's Motion for Preliminary Injunction ("Opposition"), Scoville argues that the federal securities laws do not extend to the 90% of Traffic Monsoon investors who reside outside of the United States. Scoville's basis for this argument is *Morrison v. National Australia Bank Ltd.*, 561 U.S. 273 (2010), in which the Supreme Court revised the circumstances in which the anti-fraud provisions of the securities laws would apply in extraterritorial matters. He further argues that Traffic Monsoon's profit-sharing product, the Banner AdPack ("AdPack"), does not constitute a security and therefore its sale is not subject to the federal securities laws. Scoville is incorrect as to both arguments.

As to the *Morrison* extraterritorial argument, Scoville inexplicably fails to mention, let alone discuss or distinguish, Section 22(c) of the Securities Act of 1933 (15 U.S.C. §77v(c)) ("Securities Act") and Section 27(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78aa(b)) ("Exchange Act") which codify Section 929P(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Section 929P(b) of Dodd-Frank,

colloquially known as the *Morrison* fix, was drafted and implemented in response to the issues raised in the *Morrison* case and, for matters brought by the Commission and/or the Department of Justice (as opposed to private causes of action), reinstated the conduct-and-effects test that had been the governing law for 40 years prior to *Morrison*. Whether his failure to raise, reference, or discuss the governing law on this issue was intentional or unintentional, the effect is the same. Scoville's argument that the anti-fraud provisions of the federal securities laws do not apply to his fraudulent conduct relating to Traffic Monsoon investors who reside outside of the United States is without merit.

Moreover, even if *Morrison* did apply in this case, the Traffic Monsoon Ponzi scheme would still be subject to the federal securities laws. Traffic Monsoon was a Utah registered business being run out of Murray, Utah. Its Utah address was included on its website. Scoville was a U.S. citizen who resided (by his own admission) in Utah, irrespective of time he may have spent in the United Kingdom. Traffic Monsoon was operated exclusively through computer servers housed entirely in North Carolina, which facilitated all of the transactions conducted by Traffic Monsoon investors, wherever situated. Because the transactions were effected with a U.S. Company, through U.S.-based servers, they were "domestic securities transactions" under *Morrison*, regardless of where the investors resided at the time of the transaction.

Lastly, the $50 AdPack, with its profit-sharing component that paid investors a 10% return after 55 days, was a security under *SEC v. W.J. Howey*, 328 U.S. 293, 298-99 (1946). It involved (1) an investment of money, (2) in a common enterprise, (3) with a profit derived from the efforts of others. Neither Scoville's attempt to embed $11 worth of imaginary "advertising services" within the $50 investment, nor his requirement that investors click on other banner ads for 4 minutes per day irrespective of the number of AdPacks purchased, changed the nature of what he was selling – the opportunity to receive a return, based on the initial investment of money, that was to be drawn from the sales of Traffic Monsoon's products. Scoville's

comparison of AdPacks to breakfast cereal or Happy Meals, while perhaps clever, is nevertheless legally meaningless. Because investors were investing money into Traffic Monsoon with the expectation of earning a return, Scoville was selling securities. And because the returns were financed exclusively through the sale of additional securities (*i.e.* AdPacks), his operation constituted an unlawful Ponzi scheme, which also establishes his scienter.

For these reasons, Scoville's arguments against the requested preliminary injunction and the previously-ordered asset freeze are without merit. Accordingly, the Commission respectfully requests that the Court grant its application to continue the relief provided for in the temporary restraining order by issuing a preliminary injunction in this matter and by continuing the asset freeze in order to protect and preserve the assets for the benefit of the Traffic Monsoon investors.

ARGUMENT[1]

I. CONTRARY TO THE DEFENDANT'S CONTENTION, THE "CONDUCT-OR-EFFECTS" TEST DETERMINES THE TERRITORIAL SCOPE OF SECTIONS 10(b) AND 17(a) AND CONFIRMS THAT BOTH SECTIONS APPLY HERE.

The conduct-or-effects test is the proper standard to use in evaluating the application of the federal securities laws in matters involving extraterritorial considerations. And, when applied to the facts and allegations of this case, the test confirms that Sections 10(b) and 17(a) apply here. In his Opposition, Defendant incorrectly asserts that *Morrison v. Nat'l Australia Bank Ltd.*, 561 U.S. 247 (2010), is the controlling authority in Commission enforcement matters. Rather, by enacting Section 929P(b) of Dodd-Frank, which amended Section 22(c) of the Securities Act and Section 27(b) of the Exchange Act, Congress expanded the Commission's authority to reach transnational securities fraud by codifying the conduct-or-effects test that the Supreme Court had just rejected in *Morrison*. The statutory language of Sections 27(b) and

[1] In his Opposition, Scoville does not contest the Commission's factual allegations, choosing instead to contest the legal conclusions asserted by the Commission. As such, the factual allegations should be deemed true for purposes of the Preliminary Injunction analysis.

22(c), as well as the full legislative history of the amendments under Dodd-Frank, demonstrates Congress's intent to reinstate this historic test. As such, Defendant's reliance on *Morrison* in this matter is misplaced, and his omission of any reference to these governing provisions improper.

A. For Nearly Four Decades, Every Court of Appeals that Considered the Extraterritorial Reach of Section 10(b) Applied a Conduct-or-Effects Test and Considered it to be a Requirement of Subject-Matter Jurisdiction.

Beginning with the Second Circuit in 1972, the lower federal courts prior to *Morrison* came to apply a so-called "conduct-or-effects test" to determine the extraterritorial reach of Section 10(b) and the other anti-fraud provisions of the securities laws. *See Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1334 (2d Cir. 1972); *see also Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 664-665 (7th Cir. 1998); *SEC v. Kasser*, 548 F.2d 109, 112-113 (3d Cir.). Under this test, the anti-fraud provisions applied to securities fraud if sufficient "wrongful conduct occurred in the United States" or "the wrongful conduct had a substantial effect in the United States or upon United States citizens." *SEC v. Berger*, 322 F.3d 187, 192-93 (2d Cir. 2003).

Moreover, federal courts prior to *Morrison* consistently treated the conduct-or-effects test as a requirement of subject-matter jurisdiction. *See, e.g., Schoenbaum*, 405 F.2d at 208; *In re CP Ships Ltd. Sec. Litig.*, 578 F.3d 1306, 1313 (11th Cir. 2009); *Continental Grain (Australia) PTY Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 421 (8th Cir. 1979). Thus, whether sufficient conduct or effects occurred in the United States for the anti-fraud provisions to apply was a question for the judge to dispositively resolve at the outset of the case, even if the issue turned on contested facts. *See generally Arbaugh v. Y&H Corp*, 546 U.S. 500, 514 (2006) (quoting 5B C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1350 (3d Ed. 2004)).

B. In 2006, the Supreme Court Announced a New "Bright Line" Rule to Determine Whether a Statutory Requirement is Jurisdictional or, Instead, Relates to the Merits of the Action.

In *Arbaugh v. Y&H Corp.*, the Supreme Court considered how to distinguish statutory requirements that are jurisdictional in nature from those that relate to the merits. 546 U.S. 500 (2006). *Arbaugh* involved the "proper classification of Title VII's statutory limitation of covered employers to those with 15 or more employees," requiring the Court to decide between "the lower court's subject-matter jurisdiction characterization" and the petitioner's claim that the 15-or-more-employees requirement "concerns the merits of his case." *Id*. at 510. The Court held that, because Congress did not place the requirement within the federal-court subject-matter jurisdiction provisions, it relates to the merits of a Title VII claim. *Id*. at 515.

In explaining its reasoning, the Court candidly acknowledged that "[o]n the subject-matter jurisdiction / ingredient-of-claim-for-relief dichotomy, this Court and others have been less than meticulous." *Id*. at 511. To end this confusion, the Court adopted a new "readily administrable bright line" rule – "when Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character." *Id*. at 516.

In establishing that bright line, the Court expressly stated that the power to make a statutory requirement jurisdictional lies with Congress:

> [W]e … leave the ball in Congress' court. If the Legislature clearly states that a threshold limitation on a statute's scope shall count as jurisdictional, then courts and litigants will be duly instructed and will not be left to wrestle with the issue.

Id. at 515-16. Thus, the Court explained, Congress can readily shift a merits-related statutory requirement into a jurisdictional requirement by amending the statute to move the requirement into the statute's subject-matter jurisdiction provision: "Of course, Congress could make the employee numerosity requirement 'jurisdictional,' just as it has made an amount-in-controversy threshold an ingredient of subject-matter jurisdiction in delineating diversity-of-citizenship

jurisdiction under 28 U.S.C. §1332." *Id.* at 514-15. *See also Union Pacific RR v. Brotherhood of Locomotive Engineers*, 558 U.S. 67 (2009).

C. In *Morrison*, the Supreme Court Rejected the Lower Courts' Long-Standing View of Section 10(b)'s Extraterritorial Reach.

As discussed below, in *Morrison* the Court rejected the lower courts' approach to the extraterritorial reach of Section 10(b) of the Exchange Act both in treating it as an issue of subject-matter jurisdiction and also with regard to the test to be applied.

1. The Court applied the *Arbaugh* rule to hold Section 10(b)'s extraterritorial reach is not a subject-matter jurisdiction issue.

In their briefing, the parties and the United States as *amicus curiae*, citing *Arbaugh* and *Union Pacific*, alerted the Supreme Court that the issue of Section 10(b)'s extraterritorial reach should not be treated as a question of subject-matter jurisdiction because the extraterritorial reach of the Exchange Act was not addressed in the statute's jurisdictional provision. As the United States explained, "[u]nder the *Arbaugh* test, limits on the transnational application of Section 10(b) are not jurisdictional." Brief of the United States as *Amicus Curiae* Supporting Respondents, No. 08-1191, Feb. 26, 2010, at 10.

Given the parties' agreement on this issue, the Court engaged in a truncated discussion. The Court cited *Arbaugh* and *Union Pacific*, quoted the subject-matter jurisdiction provision (which did not contain language indicating that Congress considered the territorial reach a jurisdictional issue), and summarily stated "[t]he District Court here had jurisdiction … to adjudicate the question whether §10(b) applies to [respondents'] conduct," and that therefore, as written, the statute left the question as one on the merits of the case. *Morrison*, 561 U.S. at 254.

2. The Court rejected the conduct and effects test and limited Section 10(b)'s reach to domestic transactions.

After concluding that the question of Section 10(b)'s extraterritorial reach is a merits issue, the Court examined the language of Section 10(b) and the Exchange Act. The Court did

so mindful of the "longstanding principle of American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States." *Id*. at 2877. The Court explained that, in order to find a congressional intent to apply a statutory provision extraterritorially, "context can be consulted" and "a clear statement" is not required. *Id*.at 2883. Nonetheless, the Court found "no affirmative indication in the Exchange Act that §10(b) applies extraterritorially." *Id*.

Accordingly, the Court rejected the lower court's application of the conduct-or-effects test and, instead, held that Section 10(b) is limited to securities frauds involving domestic transactions.

D. While *Morrison* was Pending Before the Supreme Court, Congress Took Up the Issues of (i) Whether to Make the Question of the Extraterritorial Reach of the Securities Laws' Anti-fraud Provisions, Including Section 10(b), a Jurisdictional Question and (ii) Whether the Conduct-or-Effects Test Embodies the Appropriate Extraterritorial Standard.

In October 2009, while the *Morrison* petition for *certiorari* was pending, Representative Kanjorski, Chairman of the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, introduced the provision that would eventually be enacted as Section 929P(b) of Dodd-Frank, which amended Section 22(c) of the Securities Act and Section 27(b) of the Exchange Act. *See* Investor Protection Act of 2009, H.R. 3817 (111th Cong.), at § 216. In fact, the legislative proposal responded to part of the Second Circuit's decision in *Morrison*. The Court of Appeals had recognized the somewhat precarious footing on which its conduct-or-effects test stood absent express statutory language. In its *Morrison* decision, the Court of Appeals wrote that it is for Congress to "determine a lower federal court's subject-matter jurisdiction" and that Congress had "omitted" any such discussion as to "transactions taking place outside the United States"; the Court therefore "urge[d] that this omission receive the appropriate attention in Congress." *Morrison v. Nat'l Australia Bank Ltd*.,

547 F.3d 167, 170 & n.4 (2d Cir. 2008) (quoting *Itoba Ltd. v. LEP Group PLC*, 54 F.3d 118, 121 (2d Cir. 1995)).

Kanjorski's proposal sought to make Congress's intent clear by expressly incorporating the conduct-or-effects test and incorporating it as a requirement of subject-matter jurisdiction. *See* Committee Report on the Investor Protection Act of 1009, H.R. Rep. 111-687, pt. 1, at 80 (Dec. 16, 2010) ("This section addresses the authority of the SEC and the United States to bring civil and criminal law enforcement proceedings involving transnational securities frauds" by "codify[ing] … both the conduct and effects tests"). The provision did so by proposing to amend the sections of the securities laws that addressed the Commission's jurisdiction to provide:

> SEC. 216. EXTRATERRITORIAL JURISDICTION OF THE ANTIFRAUD PROVISIONS OF THE FEDERAL SECURITIES LAWS
>
> * * *
>
> (b) EXTRATERRITORIAL JURISDICTION.—The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation of [antifraud provisions], involving—
>
> (1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or
>
> (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.

Pub. L. No. 111-203, Section 929P(b), 124 Stat. 1376 (2010), 15 U.S.C. 78aa(b) (Section 27(b) of the Exchange Act); 15 U.S.C. 77v(c) (Section 22(c) of the Securities Act); 15 U.S.C. 80b-14(b) (Investment Advisers Act).[2] Thus, it addressed the *Arbaugh* issue by expressly placing the

[2] The proposed language amending the Investment Advisers Act differed slightly insofar as subsection (1) referred to "conduct within the United States that constitutes significant steps in furtherance of the violation, *even if the violation is committed by a foreign adviser* and involves only foreign investors." 15 U.S.C. 77v(c)(1) (emphasis added).

language into the jurisdictional provisions, and it addressed the open issue of the proper standard by expressly incorporating the conduct-or-effects test.

As it happened, the Supreme Court acted before Congress took any final action on Representative Kanjorski's proposal. In fact, the proposal was incorporated into the House-Senate Conference Committee on what became the Dodd-Frank Act the same day that the Supreme Court issued its decision in *Morrison*. Thus, what had begun as a codification of the law as it had existed in the lower courts with regard to the treatment of the extraterritorial reach of the antifraud provisions of the securities laws, an issue of jurisdiction, and one to which the conduct-or-effects test applied, became effectively a response to the Supreme Court's decision—overriding the decision as to Commission and DOJ enforcement actions involving transnational securities frauds that occur after the Act became law.

The proposal's sponsors subsequently recognized the changed context of the statutory language during the legislative debates on Dodd-Frank. Representative Kanjorski explained on the House floor that *Morrison* "appl[ied] a presumption against extraterritoriality" and his amendment "rebut[s] that presumption by clearly indicating that Congress intends extraterritorial application in cases brought by the SEC or Justice Department." 156 Cong. Rec. H5237 (daily ed. Jun. 30, 2010). He emphasized:

> Thus, the purpose of the language of section 929P(b) of the bill is to make clear that in actions and proceedings brought by the SEC or the Justice Department, the specified provisions of the Securities Act, the Exchange Act and the Investment Advisers Act may have extraterritorial application, and that extraterritorial application is appropriate, irrespective of whether the securities are traded on a domestic exchange or the transactions occur in the United States . . . .

Id. Senator Jack Reed likewise explained on the Senate floor that the amendment would replace *Morrison*'s transaction-based test with the traditional conduct-or-effects test:

> [Section 929P(b) added] extraterritoriality language that clarifies that in actions brought by the SEC or the Department of Justice, *specified provisions in the securities laws apply* if the *conduct* within the United States is significant, or the external U.S. conduct has a

> foreseeable substantial *effect* within our country, *whether or not the securities are traded on a domestic exchange or the transactions occur in the United States*.

156 Cong. Rec. 105, S5915-16 (July 15, 2010) (emphasis added).

Both the language of Section 929P(b) and its history support the conclusion that it dealt with the *Arbaugh* issue by expressly addressing extraterritorial application of the antifraud provisions of the securities laws in the jurisdictional provisions of the statutes and that it mandated that the conduct-or-effects test apply.[3]

Additionally, there are several textual indicia of Congress's intent that Section 929P(b) extended the Commission's extraterritorial authority to pursue Section 10(b) and Section 17(a) claims. *First*, Section 929P(b) is included under a heading entitled "STRENGTHENING ENFORCEMENT BY THE COMMISSION." *See generally INS v. Nat'l Ctr. For Immigrants' Rights, Inc*., 502 U.S. 183, 189 (1991) ("[T]he title of a . . . section can aid in resolving an ambiguity in the legislation's text."). *Second*, Section 929Y(a) of Dodd-Frank required the Commission to "conduct a study to determine the extent to which private rights of action under the antifraud provisions . . . should be extended" extraterritorially using the same conduct-or-effects test set forth in Section 929P(b). This provision's exclusive focus on private actions would be difficult to understand unless Congress believed that it had already "extended" the

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[3] *See, e.g.*, *Liu v. Siemens A.G.*, 2013 WL 5692504, *3 (S.D.N.Y. Oct. 21, 2013) ("Section 929P(b) permits the SEC to bring enforcement actions for certain conduct or transactions outside the United States."); *SEC v. Tourre*, 2013 WL 2407172, *1 n.4 (S.D.N.Y. June 4, 2013) (929P(b) "effectively reversed Morrison in the context of SEC enforcement actions"); *In re Optimal U.S. Litig.*, 865 F. Supp. 2d 451, 456 n.28 (S.D.N.Y. 2012) ("Congress has . . . restor[ed] the conducts and effects test for SEC enforcement actions."); *SEC v. Gruss*, 2012 WL 3306166, *3 (S.D.N.Y. Aug. 13, 2012) ("Section 929P(b) . . . allows the SEC to commence civil actions extraterritorially in certain cases."); *SEC v. Compania Internacional Financiera S.A.*, 2011 WL 3251813, *6 n.2 (S.D.N.Y. July 29, 2011) ("It may be that [929P(b)] was specifically designed to reinstate the Second Circuit's 'conduct and effects' test."); *Cornwell v. Credit Suisse Grp.*, 729 F. Supp. 2d 620, 627 n.3 (S.D.N.Y. 2010) ("[I]n legislation recently enacted, Congress explicitly granted federal courts extraterritorial jurisdiction under the conduct or effect test for proceedings brought by the SEC.").

"antifraud provisions" in actions brought by the Commission. *Third*, the related amendments to the anti-fraud provisions of the Securities Act and the Investment Advisers Act, which similarly expressly adopted the conduct-or-effects test as a requirement of subject-matter jurisdiction, reference the specific antifraud provisions of those statutes. Taken together, these amended provisions indicate that Congress acted deliberately to ensure that the Commission's various antifraud enforcement authorities would reach transnational frauds that satisfy the conduct-or-effects test.

Moreover, the *Morrison* decision does not operate as a barrier to this Court's ability to effectuate Congress's intent. When the Supreme Court construed Section 10(b) in *Morrison* to determine its territorial scope, it acknowledged that the language of Section 10(b) neither required nor precluded extraterritorial application. *Morrison*, 561 U.S. at 262. It was merely silent. The Court also looked to other provisions of the Exchange Act for evidence of extraterritorial intent, but found none. The Court thus applied a "presumption" to find that Section 10(b) lacked extraterritorial effect, while making clear that this presumption was not "a limit upon Congress's power to legislate" and only applied "unless a contrary intent appears." *Id*. at 255.

Section 929P(b) now provides that contrary intent. In order to "make sense rather than nonsense of the *corpus juris*," courts must construe statutory language in a manner that "fits most logically and comfortably into the body of both previously *and subsequently* enacted law." *W. Virginia Univ. Hosps. v. Casey*, 499 U.S. 83, 100-101 (1991) (emphasis added). The antifraud provisions must therefore be read in light of Section 929P(b)'s subsequent enactment. Section 929P(b) thus supplies the "indication of an extraterritorial application" that was missing in *Morrison*, and this indication should be used when construing the ambiguous scope of the antifraud provisions. *Morrison*, 561 U.S. at 255. Rather than applying a default presumption against extraterritoriality, as the Court did in *Morrison*, courts in Commission actions should

now look to Section 929P(b) and construe the antifraud provisions to reach the conduct over which Section 929P(b) specifically granted jurisdiction.

II. BECAUSE THE DEFENDANTS' CONDUCT WITHIN THE UNITED STATES CONSTITUTED SIGNIFICANT STEPS IN FURTHERANCE OF THE ALLEGED VIOLATIONS, AND BECAUSE THE ADPACK SALES CONSTITUTED DOMESTIC TRANSACTIONS, THIS COURT SHOULD ENTER A PRELIMINARY INJUNCTION AGAINST FURTHER VIOLATIONS.

The defendants' actions in operating the Traffic Monsoon Ponzi scheme constituted significant steps within the United States in furtherance of the alleged violations. As such, the federal securities laws apply to enjoin this unlawful scheme. Moreover, even under *Morrison*, the AdPack sales constitute "domestic transactions," thereby confirming the scope and application of the federal securities laws in this case.

As set forth in the Commission's TRO Motion, Section 20(b) of the Securities Act and Section 21(d) of the Exchange Act empower the Court to grant injunctive relief where it appears that a person is engaged in or about to engage in violations of the federal securities laws. 15 U.S.C. §§ 78(b) and 78u(d). Under these sections, the Commission is required to make a "proper showing" of violative activity in order to obtain injunctive relief. The Court may appoint a receiver on a "*prima facie* showing of fraud and mismanagement," and should not permit "those who were enjoined from fraudulent misconduct to continue in control of [the defendant's] affairs." *SEC v. Keller Corp.*, 323 F.2d 397, 403 (7th Cir. 1963); *see also SEC v. Current Fin. Servs.*, 783 F. Supp. 1441, 1443 (D.D.C. 1992); *SEC v. Manor Nursing Ctrs. Inc.*, 458 F.2d 1082, 1105 (2d Cir. 1972). The Commission has satisfied its burden of demonstrating Scoville's improper conduct, and the federal securities laws clearly apply in this case. As such, the Court is empowered to, and should, preliminarily enjoin his continuing illegal scheme.

Pursuant to Section 22(c) of the Securities Act and Section 27(b) of the Exchange Act, this Court is empowered to hear and adjudicate the Commission's case against Scoville's and

Traffic Monsoon's transnational fraudulent scheme, in violation of the federal securities laws, because it involved:

> (1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or
>
> (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.

§ 27(b) of the Exchange Act. In this case, Scoville's and Traffic Monsoon's conduct in creating, marketing, selling, and managing the Traffic Monsoon investment scheme all occurred within the United States. Accordingly, Scoville's argument that this Court lacks jurisdiction over Traffic Monsoon's transnational scheme, or that the federal securities laws do not extend to encompass this scheme, is without merit.

In considering the "conduct test," courts have held that "jurisdiction exists only when substantial acts in furtherance of the fraud were committed within the United States, and that the test is met whenever (1) the defendant's activities in the United States were more than merely preparatory to a securities fraud conducted elsewhere and (2) the activities or culpable failures to act within the United States directly caused the claimed losses." *SEC v. Berger*, 322 F.3d 187, 193 (2d Cir. 2003) (internal citations and quotations omitted).

With citation to Scoville's own testimony, the Commission's TRO Motion demonstrated that (1) Scoville was the sole owner and controlling person of Traffic Monsoon; (2) he ran the company by himself out of his Murray, Utah residence; (3) he has no employees and outsourced all company functions to, among others, a web hosting company in North Carolina that facilitated all transactions, including sales of AdPacks, with investors; and (4) he had three call centers, one of which was located in Florida and another in North Carolina. *See* Doc. No. 3, TRO Motion, p. 5, and Exhibit A attached thereto (5/17/2016 Testimony of Charles D. Scoville ("Scoville Test.") at pp. 35, 39-41. Indeed, the physical address of Traffic Monsoon, as set forth

by Scoville on Traffic Monsoon's own website, listed Scoville's Murray, Utah, residential address.

Moreover, with respect to the North Carolina web hosting company, "Snoork," that Traffic Monsoon used to process all Traffic Monsoon transactions and store all information on its locally-based servers, Scoville testified:

> Q. Was that Snoork –
>
> A. Yes, Snoork.
>
> Q. -- your web host?
>
> A. Uh-huh.
>
> Q. I had thought you used your programmer in Russia to do that.
>
> A. No, not that time.
>
> Mr. Frost: When you say you downloaded it to your own server, what is that?
>
> The Witness: Well, my hosting company, their method of sending it to me was they pulled it from their side and then put it on my server for me to be able to download.
>
> Mr. Frost: When you say your server, you mean – do you have a standalone computer server somewhere, or is it still your host?
>
> The Witness: The hosting company, what they offer is hosting. So that's like file space. But what I have are dedicated servers that no one else is sharing, just me. And so they put it onto one of my dedicated servers.
>
> By Ms. Okinaka:
>
> Q. Those are servers at Snoork?
>
> A. Uh-huh.
>
> Q. Yes?
>
> A. That's right, yes.
>
> * * * * *
>
> Q. Let me show you – oh, well, I just wanted to ask you briefly about Snoork again.
>
> A. Okay.
>
> Q. I know we talked about that when you came in before. But it's your web host; is that right?

A. That's right. They're a hosting company.

Q. And what data does it host?

A. Everything with my website, yeah.

Q. And does it also host any back office administrative data that you have?

A. Well, what it is is when you have a server that contains everything. So when I log in to my site, I am accessing a – the information that's in the database is in their servers.

Q. Uh-huh. So do you have – you have an admin panel, don't you?

A. Yes, I do.

Q. What do you see on there?

A. When I log in, I can see all of the members; I can see what their balances are; I can look at their addresses, phone numbers, the information that they've entered. Pretty much anything. I can see everything except for certain things that I didn't think about having my programmer ask. So that's when I just have him build something in if I need to have him pull records or whatever.

Q. I think we talked about his before, too, but I think you said you don't keep financial statements as such for Traffic Monsoon. Is that right?

A. Like, what kind of statements.

Q. Like a balance sheet and an income statement.

A. It's all in the database, so it's all saved in that cash table. So everything that's in–out, it's there. And then the payments coming in for purchases of serve are on that pay-ins table.

Doc. No. 3, TRO Motion, Ex. A, Scoville Test., pp. 34-35, 84-86.

Based on Scoville's testimony, it is clear that "the fraudulent scheme was masterminded and implemented by [Scoville] in the United States," *Berger*, 322 F.3d at 194, and that all material transactions were conducted through, and information was stored and housed on, computer servers that were provided by a web hosting company located in the United States. Accordingly, in light of these uncontroverted facts, Scoville's and Traffic Monsoon's operation of a Ponzi scheme included action "within the United States that constitute[d] significant steps in furtherance of the violation" of the securities laws. As such, this Court has jurisdiction, and the

federal securities laws therefore apply, to this conduct pursuant to Section 22(c) of the Securities Act and 27(b) of the Exchange Act.

In addition, even if *Morrison* did apply, this Court would still have jurisdiction and authority to hear this case. Because the transactions were facilitated exclusively through servers located in the United States, by a United States company, they were "domestic transactions" under *Morrison*. *See Absolute Activist Value Master Fund Ltd.*, 677 F.3d 60, 68 (2d Cir. 2012). Under *Absolute Activist*, in order to allege a domestic transaction for purposes of establishing application of the federal securities laws, the Commission is obligated to "allege facts leading to the plausible inference that the parties incurred irrevocable liability within the United States; that is, that the purchaser incurred irrevocable liability within 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." *Id.* Importantly, and contrary to the defendant's arguments in his Opposition, the location and residency of the purchaser is not relevant to the question of whether a domestic transaction has occurred. "A purchaser's citizenship or residency does not affect where a transaction occurs; a foreign resident can make a purchase within the United States, and a United States resident can make a purchase outside the United States." *Id.* at 69.

In this case, Traffic Monsoon's sale of AdPacks constituted domestic transactions. By Scoville's own admission, the sales were facilitated exclusively through servers housed in North Carolina, by a U.S.-based company, operated by a United States citizen. *Supra*, pp. 15-16. As such, Traffic Monsoon "incurred irrevocable liability within the United States to deliver a security." *Absolute Activist*, p. 68. The laws of the United States would apply in the event that there had been a breach of contract, or failure to deliver, by Traffic Monsoon. Therefore, by conducting the sales through its U.S.-based servers, Traffic Monsoon incurred irrevocable liability within the United States to deliver its securities to Traffic Monsoon investors, which subjects it to liability under *Morrison* and *Absolute Activist*.

For all of the above reasons, this Court has jurisdiction to adjudicate the Commission's claims in this matter. Scoville's and Traffic Monsoon's unlawful Ponzi scheme is subject to the federal securities laws.

III. THE ADPACK IS A SECURITY, AND THE MANNER IN WHICH SCOVILLE OPERATED TRAFFIC MONSOON CONSTITUTED A PONZI SCHEME.

Traffic Monsoon's second argument against the entry of a Preliminary Injunction essentially boils down to 1) the sale of AdPacks was not illegal because they did not constitute a security; and 2) Scoville did not act with scienter because (a) he was not operating a Ponzi scheme and (b) the State of Utah had previously declined to initiate enforcement proceedings against him on a previous iteration of the Traffic Monsoon sales model. Scoville's arguments are without merit. First and foremost, AdPacks are securities because they satisfy the three-part test for investment contracts outlined in *SEC v. W.J. Howey & Co.*, 328 U.S. 293, 301 (1946). Second, scienter is satisfied as a result of his running an illegal Ponzi scheme. Whether the State of Utah opined (or remained silent) as to a previous business undertaking, not related to Traffic Monsoon, is irrelevant.

A. Traffic Monsoon's Sale of AdPacks Constituted the Sale of Securities.

Traffic Monsoon's $50 AdPack, with its profit-sharing component that paid investors a 10% return after 55 days, was a security under *Howey*. Traffic Monsoon's sale of AdPacks to investors involved (1) an investment of money, (2) in a common enterprise, (3) with a profit derived from the efforts of others. *Id.* Neither Scoville's attempt to embed $11 worth of imaginary "advertising services" within the $50 investment, nor his requirement that investors click on other banner ads for 4 minutes per day irrespective of the number of AdPacks purchased, changed the nature of what he was selling – the opportunity to receive a return, based on the initial investment of money, that was to be drawn from the sales of Traffic Monsoon's products.

Traffic Monsoon investors were investing money in a common enterprise by purchasing AdPacks. Scoville attempts to avoid this conclusion by arguing that the AdPack was primarily composed of the sale of advertising services that had only a minor component of a possibility of receiving profit sharing payments, if profits were available. The purchase was a "payment for services," Scoville argues. Opposition, p. 24. In so arguing, Scoville disregards the economic realities of the transaction, which constitutes the primary consideration in determining whether the funds were invested in a "common enterprise" under *Howey*. *See McGill v. American Land & Exploration Co.*, 776 F.2d 923, 925 (10th Cir. 1985).

The advertising services that Scoville bundled in the $50 AdPack were available for approximately $11 if purchased separately. *See* TRO Motion, pp. 15-16 and Exhibit B attached thereto, Declaration of Scott R. Frost ("Frost Decl."), ¶ 19. Therefore, the lion's share of the purchase price of the AdPack, approximately $39, was attributable exclusively to the profit sharing position. There was nothing else in the AdPack product that the investor received from the purchase of the AdPack separate from the afore-mentioned services and the profit-sharing position. In other words, even giving credit for the $11 purchase of advertising services (which were largely imaginary as Traffic Monsoon had only "delivered" approximately 10% of the promised services, *see* TRO Motion, p. 15, Frost Decl., ¶¶ 26-28), Traffic Monsoon investors still paid $39 for an investment contract that provided them with a $5 return after 55 days. When viewed in this way, the $5 payment constituted an even greater than 10% return when the advertising services portion of the AdPack is excluded. The economic reality of the transaction is clear – Traffic Monsoon investors invested funds into a common enterprise, acquiring an investment contract in return, that provided them with a 10%-12.8% after 55 days.

The third factor of the *Howey* test is also met because the Traffic Monsoon investors are receiving profits based on the efforts of others. The efforts made by Traffic Monsoon and Scoville in the program were the "undeniably significant ones, those essential managerial efforts

which affect the failure and success of the enterprise." *See SEC v. Glenn W. Turner Enters., Inc.*, 474 F.2d 476, 482 (9th Cir. 1973). Scoville does not contest the fact that investors have no role in managing Traffic Monsoon and rely on Traffic Monsoon to operate the traffic exchange, collect revenue, supplement the revenue from its reserve fund, and distribute it to members. Traffic Monsoon also sets up the banner ad rotator and tracks clicks by members seeking to qualify to share in profits. These are the significant efforts needed to generate the returns, none of which are performed by individual investors.

The fact that investors are required to contribute 4.1 minutes of time per day in clicking on 50 ads for 5 seconds per ad in order to qualify for profit-sharing does not take the AdPack outside the realm of securities.[4] The Ninth Circuit held in *Glenn Turner* that although investors were required to expend some efforts, i.e., recruit other investors, "the *sine qua non* of the scheme" or the efforts that kept the scheme going, were the efforts of the company in generating more business. *Glenn Turner*, 474 F.2d at 483. The investor's efforts in clicking 50 times, for 4.1 minutes per day, cannot be viewed as significant, especially since the investor only has to click on 50 banner ads per day regardless of how many AdPacks he owns – whether one or 1,000. *See also United States v. Bowdoin*, 770 F. Supp. 2d 142, 151-52 (D.D.C. 2011).

Because investors were investing money into Traffic Monsoon with the expectation of earning a return, Scoville was selling securities.

[4] Scoville attempts to minimize the 10% return provided to investors by breaking it down to a daily analysis of the amount of time Traffic Monsoon investors contributed to qualify for the $ .09 per day ($5 divided by 55 days) per AdPack that constituted the $5 return after 55 days. In Scoville's determination, 4.1 minutes per day is more than enough of a contribution to justify the $5 return provided from the purchase of an AdPack. The reality, however, is that Traffic Monsoon investors were never obligated to contribute more than this 4.1 minutes of effort per day, notwithstanding the number of AdPacks purchased. By paying a 10% return every 55 days, investors were provided with the opportunity to earn a return of 60% per year. Scoville may attempt to minimize this magnitude of this return, but he can't escape the reality that this is an unreasonably high return to earn for 4.1 minutes of effort per day.

B. Scoville Acted with Scienter

Scoville also argues that he didn't act with scienter because 1) the Utah Division of Securities apparently expressed an opinion that one of Scoville's unrelated previous business undertakings did not involve a security, and 2) Traffic Monsoon did not constitute a Ponzi scheme because he did not *promise* unreasonably high returns, he only paid them. Both arguments are without merit. Because Scoville was operating an illegal Ponzi scheme, he is determined to have possessed the requisite level of scienter to sustain the Commissions Section 10(b) and 17(a) causes of action.

As explained in greater detail in its TRO Motion, more than 98% of Traffic Monsoon's revenue was derived from the sale of its profit-sharing AdPack. Scoville does not contest that returns to individuals who purchase AdPacks are dependent upon new investors purchasing new AdPacks. Indeed, he admits to as much in his Traffic Monsoon website videos, and again admits this fact in his Opposition. (Opposition, p. 20). As new investors purchase new or additional AdPacks, the profits are then distributed to earlier investors in the form of returns. As further discussed in the Commission's TRO Motion and above, the AdPack constitutes a security and is subject to the federal securities laws. Because Scoville and Traffic Monsoon are selling securities, and because they are paying returns to investors who purchased those securities solely through the sale of new securities, Traffic Monsoon is operating a classic Ponzi scheme. And because Scoville was operating a Ponzi scheme, the "question of intent to defraud is not debatable." *Conroy v. Shott*, 363 F.2d 90, 92 (6th Cir. 1966); *see also In re Agricultural Research and Technology Group, Inc.*, 916 F.2d 528, 535 (9th Cir. 1990) ("debtor's actual intent to hinder, delay or defraud its creditors may be inferred from the mere existence of a Ponzi scheme"). By operating a Ponzi scheme, Scoville acted with scienter.

Notwithstanding the fact that Scoville operated a Ponzi scheme, Scoville argues that he didn't act with scienter because, while operating a previous business called AdHitProfits in 2014,

which he contends "sold a product virtually identical to AdPacks" (Opposition, p. 3), the Utah State Division of Securities declined to initiate an action against him because, the Division apparently concluded, "a security was not involved." Opposition, p. 17. Neither AdHitProfits, nor any facts relating to what information the Utah State Division of Securities considered with respect to AdHitProfits, are properly before this Court. In raising it as a defense, Scoville is asking this Court to speculate as to how the unrelated business was operated, what products it sold, how those products were structured, what facts were considered by the Division, whether it was looking at the product itself or some other aspect of the business, and what conclusions it reached and conveyed to Scoville. Any discussion of a business entirely independent of Traffic Monsoon, and what the Division's investigation did or did not conclude, is irrelevant to these proceedings and unhelpful to the analysis being conducted by the Court in reference to Traffic Monsoon. It is a red herring that has no bearing on whether Scoville acted with scienter here.

Also irrelevant is Scoville's argument that he didn't promise unreasonably high returns, he simply paid them. Opposition, pp. 21-23. Scoville does not contest the Commission's factual allegation that Traffic Monsoon investors were paid a $5 return after 55 days on the purchase of an AdPack. Although Scoville contends that he did not verbally promise such a return, it was indisputably Traffic Monsoon's established practice. Investors relied on this established practice in choosing to purchase initial or additional AdPacks. Failure to verbalize by way of a promise what it carried out in practice in no way immunizes Traffic Monsoon from liability as a Ponzi scheme. Traffic Monsoon operated as a Ponzi scheme. That is where the focus properly lies.

Based on the fact that Scoville operated a Ponzi scheme, together with the other pertinent and relevant facts and considerations set forth in the Commissions TRO Motion, Scoville's scienter is established for purposes of Section 17(a)(1) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

CONCLUSION

Based on the foregoing, the Commission respectfully requests that this Court grant the Commission's request for a preliminary injunction against Scoville's and Traffic Monsoon's future violations of the federal securities laws.

Respectfully submitted this 7th day of October, 2016.

/s/ Daniel J. Wadley
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