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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 POST-HEARING BRIEF IN SUPPORT OF ITS 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 Post-Hearing Brief in Support of Its Motion for Preliminary Injunction as directed by the Court at the close of the Evidentiary Hearing on November 3, 2016 ("Post-Hearing Brief"). This Post-Hearing Brief addresses the two issues requested by the Court: (1) the legal significance, if any, of the statements made by Mr. Scoville on the Traffic Monsoon website; and (2) where the transaction occurred when an investor

purchased an AdPack from Traffic Monsoon. The Commission incorporates by reference its briefing submitted prior to the evidentiary hearings held on November 1 and 3, 2016.

First, there is no legal significance to the statements on the Traffic Monsoon website. By its design and function, Traffic Monsoon operated as a Ponzi scheme. The Commission's Complaint alleges that Traffic Monsoon operated as a scheme and course of business fraud under Section 17(a)(1) and (3) of the Securities Act and Section 10b-5(a) and (c) of the Securities Exchange Act. As such, any statements made by Traffic Monsoon on its website are legally irrelevant. Even when considered, however, the statements only reinforce the fraudulent nature of Traffic Monsoon's operation. By reassuring investors that he was not running a Ponzi scheme, a pyramid scheme, or a HYIP, Scoville explicitly deceived investors as to the true nature of his operation, thereby obtaining new investor funds to pay returns to earlier investors.

Second, the location of the transaction between individuals who purchased AdPacks and Traffic Monsoon is no longer the determining factor for the applicability of the federal securities laws as the Dodd-Frank Act restored the conducts and effects test for enforcement actions brought by the Commission. However, to the extent the location of the transaction is relevant, the transaction between Traffic Monsoon and its individual members occurred within the United States, where the servers hosting the Traffic Monsoon website were located. All transactions were conducted exclusively through the U.S.-based Traffic Monsoon servers. Traffic Monsoon had no business operations or presence outside of the United States. Accordingly, the AdPack sales constituted domestic securities transactions, thereby subjecting Traffic Monsoon's and Scoville's operations to the federal securities laws.

Therefore, as set forth below, the Commission respectfully requests that the Court grant its Motion for Preliminary Injunction.

ARGUMENT

I. TRAFFIC MONSOON WAS OPERATING AS A PONZI SCHEME AND THE STATEMENTS ON ITS WEBSITE ARE OF NO LEGAL CONSEQUENCE

The Commission's Complaint against Traffic Monsoon and Mr. Scoville alleges claims under Section 10b-5(a) and (c) of the Securities Exchange Act ("Exchange Act") and Section 17(a)(1) and (3) of the Securities Act. (Docket. No. 2, pp. 16-17). These claims are based upon a scheme and course of business fraud, not on misrepresentations that would be actionable under Section 10b-5(b) and Section 17(a)(2). As such, any representations made by Mr. Scoville on the Traffic Monsoon website – whether they are accurate or are misrepresentations – are legally irrelevant to the claims brought by the Commission. *See* Plaintiff's Surreply in Opposition to Motion to Set Aside Receivership. (Docket No. 53 at 3-5). As the Commission has previously argued, representations to investors as to amounts that will or could be paid are not an essential element in determining whether an enterprise is operating as a Ponzi scheme. Rather, to establish an ongoing Ponzi scheme it is enough to find that new investor funds are being used to finance returns to earlier investors, which is precisely the case here, irrespective of what the investors may be told regarding whether, and in what amounts, those returns would be paid.

However, to the extent that the representations on the Traffic Monsoon website are somehow relevant to the Commission's scheme and course of business claims, Mr. Scoville's statements on the website that Traffic Monsoon was not a Ponzi scheme, a pyramid scheme, or a HYIP, and his statements about the nature and structure of Traffic Monsoon are directly contrary to the true nature of his business operations. In fact, because Traffic Monsoon was using new investor funds to pay returns to earlier investors, it was an operating Ponzi scheme. The statements are, therefore, misleading.

For instance, one of the Frequently Asked Questions on the Traffic Monsoon website states "Is Traffic Monsoon a hyip, ponzi, pyramid scheme, or illegal?" Exhibit 3 to Hearing Exhibit 1 at p. 18 (also filed as Docket No. 55-3 at p. 18). Scoville states that "Traffic Monsoon offers only ad services. Nothing else is for sale other than ad service . . . New sales of advertising service generate new earnings. . . That's not a ponzi." What Scoville doesn't inform investors is that Traffic Monsoon was, in fact, operating as a Ponzi scheme. As this Court has recognized

> A Ponzi scheme cannot work forever. The investor pool is a limited resource and will eventually run dry. The perpetrator must know that the scheme will eventually collapse as a result of the inability to attract new investors. . . . He must know all along, from the very nature of his activities, that investors at the end of the line will lose their money.

SEC v. Management Solutions, Inc., 2013 WL 450108 *16 (D. Utah Aug. 22, 2013) (unreported) (quoting *In re Independent Clearing House Co.*, 77 B.R. 843 (D. Utah 1987)). By relying on new investor funds to pay ever-increasing amounts to earlier investors, as is the case with all Ponzi schemes, there would inevitably be a point in time when Traffic Monsoon would be unable to meet its obligations and the investors "at the end of the line" would lose their money, never actually receiving any of the "profit sharing" payments that they purchased with the AdPack. Contrary to this reality, Scoville consciously ignored disclosing this fact to investors, and in doing so lured in new victims who would be left holding the bag when then operation collapsed.

Moreover, Scoville never informed investors that over 98% of Traffic Monsoon revenue was derived exclusively through the sale of one product – the revenue sharing AdPack. Rather, he stated that revenue was generated through a host of Traffic Monsoon products, even falsely claiming that the revenue sharing AdPack was "lower in demand" and that it shared "profits from the services with HIGER demand." *See* Ex Parte Motion for Temporary Restraining Order, Order Appointing Receiver, Freezing Assets and Other Ancillary Relief and Memorandum in

Support (Docket No. 3 at Ex. 12). This statement was demonstrably false. As evidence by the uncontroverted evidence, none of the other Traffic Monsoon products were in any demand, and none were the source of the revenues from which Scoville made his "profit sharing" payments. The only product that Traffic Monsoon actually sold, and thus the only one in demand, was the AdPack. The AdPack revenue payments – the returns that were in fact paid to earlier Traffic Monsoon members – were therefore paid exclusively from the sale of new AdPacks. Hearing Transcript, pp. 27, 249, 288, 297. The Traffic Monsoon reality – that it was an operating Ponzi scheme – directly contradicted the representations Scoville made on the Traffic Monsoon website.

A second example is contained in the Terms and Conditions on the Traffic Monsoon website. There, Mr. Scoville states that "[a] purchase of advertising service with us is not considered a deposit, nor investment" and "[y]ou agree to recognize Traffic Monsoon as a true advertising company which shares its revenues, and not as any form of investment of any kind." Docket No. 3-3 at p. 111, 113. In other words, Scoville was seeking a collective agreement between and among Traffic Monsoon and its members that he and Traffic Monsoon weren't selling securities, just advertising services. However, this statement, like his statement that Traffic Monsoon wasn't a Ponzi scheme, also is contradicted by the true economic reality of Traffic Monsoon. Investors purchase of an AdPack was a purchase of a security, and therefore an investment as set forth in *SEC v. W.J. Howey & Co.*, 328 U.S. 293, 301 (1946), and those purchasing AdPacks were purchasing them precisely for the purpose of investment. *See* Ex Parte Motion for Temporary Restraining Order, Order Appointing Receiver, Freezing Assets and Other Ancillary Relief and Memorandum in Support (Docket No. 3 at pp. 15-16, 22-24); *see also* Plaintiff's Reply in Support of Motion for Preliminary Injunction (Docket No. 38 at pp. 18-20).

As evidenced by Scoville's own witnesses' statements at the hearing, although some Traffic Monsoon members may have initially been searching for internet website traffic, their relationship with Traffic Monsoon quickly transformed into an investment opportunity that dwarfed any other motivation. *See, e.g.,* November 1, 2016 Hearing Transcript at pp. 180-86. Purchasing and managing AdPacks became a business undertaking all unto itself, bringing in and paying out tens of thousands of dollars to Traffic Monsoon members. Purchasing AdPacks in order to obtain a return – the quintessential element in the *Howey* test – became the overriding motivation among Traffic Monsoon customers. Hearing Transcript, pp. 74-76, 84-85.

Evaluating whether a transaction constitutes an investment into a security is a substantive legal analysis that takes into consideration the economic realities of the transaction. As explained in the Commission's Surreply in Opposition to Set Aside Receivership (Doc. No. 53), the considerations included in this legal analysis (the three part test) *do not include* what label the seller places upon the instrument or what the buyer agrees it should be called. Because the AdPack satisfies all three prongs of the *Howey* test, it is legally irrelevant whether Scoville insisted that it be called an advertising product, or whether he can identify one or many investors who are willing to agree that they didn't consider themselves investors. He was selling securities. Traffic Monsoon members were investors. As such, his statements to the contrary on Traffic Monsoon's website are misleading.

Although Mr. Scoville made many statements on the Traffic Monsoon website, he failed to disclose that the structure and economic reality of Traffic Monsoon was, in fact, a Ponzi scheme and that members who purchased AdPacks were, in fact, investors. As such, to the extent that the statements on the Traffic Monsoon website are of any legal relevance to the

Commission's claims (which, because a Ponzi finding is not dependent upon a showing of misrepresentations, they are not), they do not absolve Mr. Scoville of liability here.

II. THE TRANSACTIONS BETWEEN TRAFFIC MONSOON AND THE INDIVIDUALS WHO PURCHASED ADPACKS ARE DOMESTIC TRANSACTIONS THAT OCCURRED IN THE UNITED STATES.

The Commission may bring an enforcement action against Traffic Monsoon under the conduct or effects test as restored by Section 929P(b) of Dodd-Frank following the Supreme Court's decision in *Morrison v. National Australia Bank Ltd.*, 561 U.S. 273 (2010). *See* Plaintiff's Reply in Support of Motion for Preliminary Injunction (Docket No. 38 at pp. 4-13). However, even if the transactional test set forth in *Morrison* did apply in this case, the conduct of the Defendants is still subject to the federal securities laws of the United States.[1]

Following *Morrison,* the Second Circuit held in *Absolute Activist Value Master Fund Ltd. v. Ficeto* that the purchase or sale of an unlisted security takes place in the United States when "irrevocable liability was incurred or [] title was transferred within the United States." 677 F.3d 60, 62 (2d Cir. 2012). The Second Circuit explained that the "irrevocable liability" test was satisfied when "the purchaser incurred irrevocable liability within the United States to take and pay for a security, or . . . the seller incurred irrevocable liability within the United States to deliver a security." *Id.* at 68. "[A] purchaser's citizenship or residency does not affect where a

[1] In considering a challenge to the scope of the federal securities laws that, in effect, constitutes a motion to dismiss, Courts view the facts in the light most favorable to the Commission. *See, e.g., SEC v. Chicago Conv. Ctr., LLC*, 961 F.Supp.2d 905, 918 (N.D. Ill. 2013) ("Rather, viewing the facts in the light most favorable to the SEC, the SEC has sufficiently alleged a 'domestic transaction' under *Morrison*."). In this case, as explained here and in earlier briefing, when considering the facts underlying Traffic Monsoon's sale of AdPacks to members around the world in the light most favorable to the Commission, certainly the sale by a Utah-based business, founded and operated by a U.S. citizen, utilizing U.S.-based servers to effect the transactions and store and manage all data relating to the Traffic Monsoon customers, constitutes domestic transactions under *Morrison*. There was simply no aspect of Traffic Monsoon's business that was conducted outside of the United States, and Scoville has failed to identify any evidence to contradict this conclusion.

transaction occurs; a foreign resident can make a purchase within the United States . . ." *Id.* at 69.

Traffic Monsoon conducted its business through the internet website www.trafficmonsoon.com. Individual members who purchased AdPacks did so through an internet connection and a browser (*e.g.*, Chrome or Internet Explorer) on their own personal device (e.g., a smart phone, tablet, or computer). This internet connection and browser provided a means for the individual member to interface with the information contained on the Traffic Monsoon server. As Mr. Scoville testified to the Commission, all data and information relating to Traffic Monsoon was housed exclusively on the Traffic Monsoon servers, which were run by the hosting company Snoork. Hearing Exhibit 4 at pp. 84-85. The Receiver confirmed that all of the transactions conducted by Traffic Monsoon, and all information regarding Traffic Monsoon's business activities, was processed through and stored on the Snoork servers. November 1, 2016 Hearing Transcript at pp. 51-52. In other words, everything pertaining to Traffic Monsoon's business was conducted on the Snoork servers. Snoork itself is located in North Carolina and the servers it uses for Traffic Monsoon are located in Atlanta and Los Angeles. *Id.*

Here, irrevocable liability to deliver the securities was incurred by Traffic Monsoon when the individual member's purchase of an AdPack was recorded on the Traffic Monsoon servers located in the United States. Contrary to the assertion of the Defendant, the geographic location of the individual member making the purchase is not relevant.

To illustrate this point, consider a hypothetical, but instructive, situation in which the individual member clicked on the Traffic Monsoon website to purchase an AdPack, but something happened (such as a lost internet connection or a frozen browser) and the communication with the Traffic Monsoon server in the United States was interrupted such that

the purchase was not received or processed by the server. In this circumstance, although the individual member had clicked on the website to make the AdPack purchase, no information about that purchase was recorded on the Traffic Monsoon server. As such, there was no irrevocable liability created on the part of Traffic Monsoon. Indeed, the Traffic Monsoon server, and thus by extension Traffic Monsoon itself, did not even know that the transaction had been attempted and no money was exchanged or credit given.

Likewise, consider another hypothetical situation in which the Traffic Monsoon server crashed or was otherwise unavailable. If an individual member had clicked to purchase an AdPack, but the Traffic Monsoon server in the United States had crashed at or near that same time,[2] then the information about that purchase again would not be received and/or processed by the Traffic Monsoon server. Because that information had not been recorded on the Traffic Monsoon server, Traffic Monsoon would not incur irrevocable liability for that purchase.

Under both scenarios, it wasn't the click by the individual member that created irrevocable liability for Traffic Monsoon. Rather, it was the recording of the transaction on the Traffic Monsoon servers located in the United States that created the irrevocable liability on the part of Traffic Monsoon. Unless and until an AdPack purchase was actually recorded on the Traffic Monsoon servers located in the United States, Traffic Monsoon did not incur irrevocable liability for any AdPack purchase.

Therefore, under *Morrison*, the sale of an AdPack by Traffic Monsoon to its individual members is a domestic transaction in the United States and is subject to the federal securities laws. Accordingly, both the Dodd-Frank conduct or effects test, and the *Morrison* domestic securities transaction test, are satisfied in this case. Traffic Monsoon's illegal Ponzi scheme is

[22] Mr. Scoville testified that the Traffic Monsoon server had crashed at least once previously. Hearing Exhibit 4 at p. 109.

subject to the federal securities laws, irrespective of where the individual Traffic Monsoon members reside.

CONCLUSION

Based on the foregoing, the Commission respectfully requests that this Court grant its Motion for Preliminary Injunction.

Respectfully submitted this 28th day of November, 2016.

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CERTIFICATE OF SERVICE

I hereby certify that on November 28, 2016, I caused to be filed the forgoing using the Court's CM/ECF System. A true and correct copy of the document was served on all parties entitled to service through the Court's CM/ECF System.

/s/ Marlea Furlong
Marlea Furlong