

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

MEMORANDUM

Case No. CV 17-4825 DSF (SSx)

Date 10/10/17

Title Kathy Wu v. Sunrider Corporation, et al.

Present: DALE S. FISCHER, United States District Judge
The Honorable

Debra Plato

Not Present

Deputy Clerk

Court Reporter

Attorneys Present for Plaintiffs

Attorneys Present for Defendants

Not Present

Not Present

Proceedings: (In Chambers) Order GRANTING in PART and DENYING in PART Plaintiff's Motion to Dismiss (Dkt. 35)

I. INTRODUCTION

Plaintiff Kathy Wu seeks to represent a putative class against Defendants Sunrider Corporation, Tei-Fu Chen and Oi-Lin Chen. Plaintiff alleges that all Defendants violated: California's Endless Chain Scheme Law (ECL), Cal. Penal Code § 327; California's Unfair Competition Law (UCL), Cal. Bus. & Prof. Code § 17200; California's False Advertising Law (FAL), Cal. Bus. & Prof. Code § 17500; and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, 5 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5. She also alleges that Sunrider violated Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 771(a)(2). Finally, Plaintiff alleges claims for unjust enrichment and conversion against Tei-Fu and Oi-Lin. (Individual Defendants).

The Court deems this matter appropriate for decision without oral argument. See Fed. R. Civ. P. 78; Local Rule 7-15. The hearing set for October 16, 2017 is removed from the Court's calendar. For the reasons stated below, the motion is GRANTED in PART and DENIED in PART.

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II. FACTUAL ALLEGATIONS

Sunrider, which sells herbal foods, herbal concentrates, skin care products, and cosmetics, was founded in 1982 by Tei-Fu. First Am. Compl. (FAC) ¶¶ 24, 26, 32. Plaintiff alleges that Sunrider makes grandiose claims about the health benefits of its products. Id. ¶¶ 43-44. An individual may become a vendor of Sunrider products, known as an independent business owner (IBO), if he or she purchases a start-up kit for a fee of approximately \$100 to \$150. Id. ¶¶ 3, 32. An IBO's account is limited to a term of twelve months and is automatically renewed each year. Id. ¶ 86.

Sunrider is comprised of a hierarchy of IBOs, with the various levels determining eligibility for discounted Sunrider products and other benefits. This hierarchy is comprised of fourteen rank levels with nine different bonus levels. Id. ¶ 40. Sunrider recruits potential IBOs by promising that its income potential is “unlimited,” and does not require much work. Id. ¶¶ 36, 46-47. If an IBO recruits another IBO, the recruit becomes a “downline” IBO and the recruiter becomes an “upline” IBO. Upline IBOs receive revenue whenever a downline IBO makes purchases or recruits a new IBO. Id. ¶ 48. IBOs earn points, which are significant because they make the IBO eligible for greater discounts on Sunrider products. Id. ¶ 52. Wholesale commissions and other bonuses are payable only if an IBO has recruited new IBOs. Id. ¶ 54. Sunrider restricts IBOs from selling the products on the Internet and in most brick-and-mortar establishments. Id. ¶ 57. Rather, IBOs are encouraged to sell products privately, such as in the IBO's or a friend's home. Id.

In November 2007, Plaintiff became a Sunrider IBO. Id. ¶ 81. Plaintiff purchased a \$150 starter pack and paid approximately \$650 toward the mandatory purchase of products required to be an IBO. Id. Between 2008 and 2013, Plaintiff spent an additional \$1,500. Id. Despite Plaintiff's best efforts to sell Sunrider products, she received no revenue. Id. In June 2014, Sunrider elevated Plaintiff's rank from IBO to “Trainer,” and paid her \$29.70. Id. ¶ 83. In total, Plaintiff has paid Sunrider approximately \$3,000, and received \$29.70 in revenues. Id. ¶¶ 89, 93.

Plaintiff alleges she discovered Defendants were operating a pyramid scheme in January 2017, when she learned about Sunrider's criminal past and a decision out of Utah that it could be considered a pyramid scheme. She also had exhausted her efforts to succeed in the business. Id. ¶¶ 96, 99. The Complaint and First Amended Complaint followed that discovery.

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III. LEGAL STANDARD

“Federal Rule of Civil Procedure 8(a)(2) requires only a short and plain statement of the claim showing that the pleader is entitled to relief. Specific facts are not necessary; the statement need only give the defendant fair notice of what the . . . claim is and the grounds upon which it rests.” Erickson v. Pardus, 551 U.S. 89, 93 (2007) (ellipsis in original; internal quotation marks omitted). But Rule 8 “requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do.” Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 555 (2007).

Federal Rule of Civil Procedure 12(b)(6) allows an attack on the pleadings for failure to state a claim upon which relief can be granted. “[W]hen ruling on a defendant’s motion to dismiss, a judge must accept as true all of the factual allegations contained in the complaint.” Erickson, 551 U.S. at 94. However, allegations contradicted by matters properly subject to judicial notice or by exhibit need not be accepted as true, Sprewell v. Golden State Warriors, 266 F.3d 979, 988 (9th Cir. 2001); and a court is “not bound to accept as true a legal conclusion couched as a factual allegation.” Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009) (internal quotation marks omitted). “Nor does a complaint suffice if it tenders naked assertion[s] devoid of further factual enhancement.” Id. (alteration in original; citation and internal quotation marks omitted). A complaint must “state a claim to relief that is plausible on its face.” Twombly, 550 U.S. at 570. This means that the complaint must plead “factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.” Iqbal, 556 U.S. at 678. “The plausibility standard is not akin to a ‘probability requirement,’ but it asks for more than a sheer possibility that a defendant has acted unlawfully.” Id.

Ruling on a motion to dismiss will be “a context-specific task that requires the reviewing court to draw on its judicial experience and common sense. But where the well-pleaded facts do not permit the court to infer more than the mere possibility of misconduct, the complaint has alleged – but it has not show[n] – that the pleader is entitled to relief.” Id. at 679 (alteration in original; internal quotation marks and citation omitted).

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IV. DISCUSSION

A. Counts I-III: Endless Chain Scheme, Unfair Competition Law, and False Advertising Law

Defendants contend that Plaintiff's California statutory and common law claims should be dismissed because: (1) they are time barred; (2) Plaintiff lacks standing; and (3) Plaintiff fails to plead her claims with particularity, as required by Rule 9(b).

1. Time Barred

Plaintiff first purchased Sunrider products in 2007, but did not file this lawsuit until May 31, 2017. Defendants contend Plaintiff's ECL, UCL, FAL, unjust enrichment, and conversion claims are barred by the applicable limitations periods.¹ Plaintiff responds that she has purchased Sunrider products within three years of May 2017, that the applicable statutes of limitations start from the last transaction, that the discovery rule tolls the statutes, and that pursuant to the continuing violations doctrine, her claims are not barred.

The FAC does not clearly allege when Plaintiff paid money to Sunrider. In November 2007, Plaintiff made purchases entitling her to be a Sunrider IBO. FAC ¶ 80. From 2008 to 2013, Plaintiff continued to be an IBO because she or her upline paid the renewal fee or purchased the minimum products, but the FAC does not specify the precise year(s) in which Plaintiff made any payment. See id. ¶ 81. In June 2014, Plaintiff paid Sunrider \$600, and was promoted from IBO to Trainer, but from 2015 to 2017, Plaintiff's upline paid the renewal fee. Id. ¶¶ 82, 85.

Nevertheless, the FAC does allege that Plaintiff paid fees and purchased products from Sunrider after May 31, 2014 – within the applicable limitation periods. The Court declines to resolve, at this stage, how far back Plaintiff's claims go, especially because the FAC – read liberally – could permit Plaintiff to prove that the statutes were tolled.

¹ FAL, unjust enrichment, and conversion claims are subject to a three-year limitations period. UCL claims are subject to a four-year limitations period. Defendants contend the limitation period for an ECL claim is three years; Plaintiff argues it is either four years or has none at all. The Court finds a four-year limitation period more likely applies. See Webster v. Omnitrition Intern. Inc., 79 F.3d 776, 788 (9th Cir. 1996) (“The operation and promotion of an Endless Chain scheme . . . [is] actionable under § 17500,” which is subject to a four-year limitation).

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See Cervantes v. Countrywide Home Loans, Inc., 656 F.3d 1034, 1045 (9th Cir. 2011). The Court's ruling at this stage is without prejudice to future motion practice based on evidence developed during discovery. Defendants' motion to dismiss on this basis is DENIED.

2. Standing

Defendants argue that Plaintiff fails to allege she relied on Defendants' alleged representations, or that any such representation caused her loss, and she therefore lacks standing to bring her ECL, UCL, and FAL claims. Under the UCL, a plaintiff must allege that he or she "has suffered injury in fact and has lost money or property as a result of the unfair competition." Cal. Bus. & Prof. Code § 17204. The FAL requires that a plaintiff suffer an "injury in fact and has lost money or property as a result of a [FAL] violation." Id. § 17535. In short, these claims require (1) injury and (2) causation.

Plaintiff's FAC alleges that she (and others) paid Defendants thousands of dollars based on misleading representations that she (and they) would become fabulously wealthy, but she received less than \$20 in revenues. See FAC ¶¶ 3, 32, 59, 81, 89, 93, 143-45. This is sufficient to show standing; Defendants' motion to dismiss on this basis is DENIED.

3. Failure to Satisfy Rule 9(b)

Defendants argue that Rule 9(b)'s particularity requirement applies to Plaintiff's state law and common law claims. Plaintiff does not directly dispute this, although she implies that fraud is not required to establish her ECL and UCL claim.

"In some cases, the plaintiff may allege a unified course of fraudulent conduct and rely entirely on that course of conduct as the basis of a claim. In that event, the claim is said to be 'grounded in fraud' or to 'sound in fraud,' and the pleading of that claim as a whole must satisfy the particularity requirement of Rule 9(b)." Vess v. Ciba-Geigy Corp. USA, 317 F.3d 1097, 1103-04 (9th Cir. 2003). "In other cases, however, a plaintiff may choose not to allege a unified course of fraudulent conduct in support of a claim, but rather to allege some fraudulent and some non-fraudulent conduct. In such cases, only the allegations of fraud are subject to Rule 9(b)'s heightened pleading requirements." Id. at 1004.

Plaintiff repeatedly alleges that Defendants' scheme was perpetuated through – and successful because of – misleading representations regarding compensation. See, e.g.,

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FAC ¶ 59 (“Sunrider also makes false and/or inadequate income disclosures . . . or provides statements of income that are false.”). However, at least some of Plaintiff’s state law claims are not based on fraud. Specifically, Plaintiff’s ECL, unjust enrichment, and conversion claims neither mention the word “fraud,” nor allege facts that would constitute fraud. See FAC ¶¶ 124-32, 205-19. Plaintiff’s UCL claim predicated on “unlawful” conduct also does not aver fraud. See FAC ¶ 138 (“Sunrider’s business practices are unlawful under § 17200 because they constitute an illegal ‘endless chain.’”). Defendants do not otherwise allege that Plaintiff’s ECL and UCL claim fail to state claims on which relief can be granted.

But Plaintiff’s FAL claim certainly avers fraud. So does her UCL claim to the extent it is predicated on “fraudulent” or “unfair” conduct. See FAC ¶ 158. The Court agrees with Defendants that the FAC does not satisfy the heightened pleading requirements of Rule 9(b) with respect to these claims.

To allege fraud with particularity, a plaintiff must set forth what is false or misleading about a statement, and why it is false. In other words, Rule 9(b) requires a plaintiff to state “the who, what, where, when and how of the misconduct charged.” Vess, 317 F.3d at 1005. The FAC does not satisfy this standard. Although the FAC identifies several alleged misstatements, see, e.g., FAC ¶¶ 41, 44, 47, Plaintiff does not specify when she was exposed to them or which ones she found material. Plaintiff also fails to specify which sales materials she relied on in making her decision to join Sunrider. Plaintiff does allege that Sunrider and her upline made “the representations (or in similar form) as reflected in ¶¶ 34-46 of this [FAC] in written presentations, disclosures, online materials, online, orally, at various times in 2007 [through] 2016.” FAC ¶ 91. Plaintiff does not, however, specify precisely who made these statements, what statements were made, and which ones she relied on. Instead, Plaintiff simply includes pages and pages of Sunrider marketing material. Plaintiff thus fails to articulate the who, what, when, where, and how of the misconduct alleged. See Kearns v. Ford Motor Co., 567 F.3d 1120, 1126-27 (9th Cir. 2009) (complaint properly dismissed under Rule 9(b) where plaintiff did not specify what the sales materials stated, when he was exposed to them, which ones he found material, or which ones he relied on).

Defendants’ motion to dismiss based on Rule 9(b) is DENIED as to Plaintiff’s ECL, unjust enrichment, and conversion claims, as well as to Plaintiff’s UCL claim, to the extent it is predicated on “unlawful” conduct. Defendants’ motion is GRANTED with leave to amend as to Plaintiff’s FAL claim, as well as to Plaintiff’s UCL claim, to the extent it is predicated on “fraudulent” or “unfair” conduct.

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B. Counts IV-V: Securities Fraud

Defendants argue that Plaintiff's securities fraud claims fail because (1) Plaintiff did not purchase securities; (2) any securities claims are time-barred; (3) Plaintiff does not satisfy the element of loss causation; and (4) Plaintiff's claim is not pleaded with sufficient particularity.

Because §§ 10(b) and 12(2) claims sound in fraud, plaintiffs must satisfy the heightened pleading requirements of Rule 9(b). See Yourish v. California Amplifier, 191 F.3d 983, 993 (9th Cir. 1999) ("Our precedents make clear that Rule 9(b) applies to actions brought under the federal securities law.") As described above, the FAC fails to plead "the who, what, when, where, and how" with respect to each statement alleged to be false. See Vess, 317 F.3d at 1104. Defendants' motion to dismiss Counts IV and V is GRANTED with leave to amend. The Court does not reach Defendants' other arguments on these claims.

C. Count VI: Unjust Enrichment

Defendants argue that Plaintiff's unjust enrichment claim fails because unjust enrichment (1) is not a cause of action and (2) cannot stand where there is an actual contract.

Defendants rely on outdated precedent. As the Ninth Circuit noted, the California Supreme Court has recently clarified that unjust enrichment may be sustained as a stand-alone cause of action. Bruton v. Gerber Prods. Co., __ Fed.Appx. __, No. 15-15174, 2017 WL 3016740, at *1 (citing Hartford Cas. Inc. Co. v. J.R. Mktg., LLC, 61 Cal. 4th 988, 1000 (2015)). Defendants' second argument fails because Tei-Fu and Oi-Lin are not parties to the Sunrider contracts and they have not otherwise shown that they should be considered contracting parties. The unjust enrichment claim is thus not barred by an express contract. None of the cases cited by Defendants holds that a party is entitled to dismissal of an unjust enrichment claim where it is not a contracting party. Defendants' motion to dismiss this claim is DENIED.

D. Count VII: Conversion

Finally, Defendants contend that Plaintiff does not plead sufficient facts to support a conversion claim. A claim for conversion has three elements: (1) ownership or right to possession of property; (2) wrongful disposition of the property right of another; and (3)

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damages. See G.S. Rasmussen & Assoc., Inc., v. Kalitte Flying Serv., Inc., 958 F.2d 896, 906 (9th Cir. 1992).

Plaintiff identifies the \$3,000 she paid to Sunrider as the property converted.² FAC ¶ 216; Opp'n at 25. However, "California cases permitting an action for conversion of money typically involve those who have misappropriated, commingled, or misapplied specific funds held for the benefit of others." PCO, Inc. v. Christensen, Miller, Fink, Jacobs, Glaser, Weil & Shaprio, LLP, 150 Cal. App. 4th 384, 396 (2007). Plaintiff does not allege that Sunrider had some duty to retain or apply funds on her behalf. Instead, the basis of Plaintiff's conversion claim is a commercial transaction by which Plaintiff paid Sunrider for products and the ability to be an IBO. See McKell v. Washington Mut., Inc., 142 Cal. App. 4th 1457, 1491-92 (2006) (dismissing conversion claim where plaintiffs did not allege that defendants were holding their payments on behalf of another). Defendants' motion to dismiss the conversion claim is GRANTED with leave to amend.

V. CONCLUSION

Defendants' motion to dismiss is GRANTED with leave to amend as to the FAL claim, the UCL claim to the extent it is predicated on "fraudulent" or "unfair" conduct, the securities fraud claims (§§ 10(b) and 12(2)), and the conversion claim. The motion is DENIED as to the ECL claim, the UCL claim to the extent it is predicated on "unlawful" conduct, and the unjust enrichment claim. An amended complaint may be filed and served no later than November 13, 2017. The Court does not grant leave to add new defendants or new claims. Leave to add defendants or claims must be sought by a separate, properly noticed motion. Plaintiff is ordered to provide a "red-lined" copy of the complaint to chambers email in addition to a paper chambers copy.

IT IS SO ORDERED.

² Plaintiff's additional claim that Sunrider converted her \$19.63 credit balance is not plausible considering that *Plaintiff* chose not to cash Sunrider's check for that amount. See FAC ¶ 88.