

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

v.

JESSICA RICHMAN, et al.,

Defendants.

Case No. 21-cv-01911-CRB

**ORDER DENYING MOTION TO
DISMISS**

The SEC alleges that Defendants Jessica Richman and Zachary Apte, co-founder's of uBiome, misled investors about fundamental aspects of uBiome's business model during the company's Series C funding round. Complaint ("Compl.") (dkt. 1). Defendants move to dismiss the complaint, primarily arguing that the SEC fails to support its allegations with the required specifics. Motion to Dismiss ("MTD") (dkt. 38). After carefully reviewing the parties' briefs, the Court concludes that oral argument is not necessary. For the reasons set forth below, the Court denies Defendants' motion to dismiss.

I. BACKGROUND

uBiome was a biotechnology company that focused on the human microbiome. Compl. ¶¶ 14–15. The company developed tests that individual consumers could use to receive diagnostics on the microorganisms present in their gut and genitals. Id. ¶ 15. The test results could purportedly assist with the diagnosis and treatment of a range of medical conditions, including inflammatory bowel disease and sexually transmitted infections. Id.

1 Richman and Apté co-founded uBiome in October 2012. Id. ¶¶ 12–14. During the
2 life of the company, Richman served as CEO and President, and Apté served as Chief
3 Scientific Officer and, at times, co-CEO.¹ Id. Richman and Apté were hands-on managers
4 who “closely monitored and managed every aspect of uBiome’s operations together.” Id. ¶
5 16. No “decision about a significant aspect of uBiome’s business was made without the
6 knowledge and approval of at least one of Richman or Apté.” Id.

7 The charges against Richman and Apté stem from events that began in 2015. Id. ¶¶
8 17–18. Prior to 2015, uBiome developed and marketed tests for consumers, which
9 consumers paid for out of pocket. Id. ¶ 14. In 2015, uBiome shifted focus to developing
10 tests that could be billed to insurers because “uBiome would be able to charge insurers
11 significantly more money for the tests than it charged consumers.” Id. ¶¶ 17–18. Over the
12 next two years, uBiome developed and released SmartGut and SmartJane, both of which
13 the company described as covered by health insurance. Id. ¶ 19.

14 A. The Alleged Insurance Fraud

15 The thrust of the complaint is that Richman and Apté implemented and oversaw
16 certain improper practices to create the false appearance that SmartGut and SmartJane
17 qualified for insurance reimbursement and that, as a result, uBiome had strong prospects
18 for growth. The allegedly improper practices generally fall into two categories: (1) issues
19 related to uBiome’s doctor network and (2) misrepresentations to insurers. The complaint
20 alleges that Defendants knew or were reckless in not knowing that once these practices
21 came to light, insurers would “reject reimbursement claims for uBiome’s clinical tests,”
22 delivering a body blow to the company’s business model. Id. ¶ 21.

23 1. Doctor Network

24 The first set of allegedly improper practices centers around uBiome’s doctor
25 network. Id. ¶ 23. To qualify for reimbursement, insurers generally require that a
26 diagnostic test be ordered by a doctor. Id. ¶ 22. To meet this requirement, uBiome created
27

28 ¹ Richman and Apté were also members of the company’s Board of Directors. Compl. ¶ 16.

1 an online portal through which patients could connect with doctors to determine the
2 appropriateness of uBiome's tests. Id.

3 The doctor network allegedly fell short of insurer standards in two ways. First, the
4 "default" set up was for doctors in the network to prescribe uBiome's tests "based solely
5 on online questionnaire responses" without any live consultation. Id. ¶ 23. Prescribing
6 tests based solely on online questionnaires raised concerns about whether doctors were
7 prescribing tests without first establishing the requisite doctor-patient relationship. Id.

8 Shortly after the doctor network went live in July 2017, uBiome employees raised
9 this concern with Defendants. Id. ¶ 21. In summer of 2017, for example, the company's
10 general counsel emailed defendants that "any tests prescribed based solely on consumers'
11 questionnaires, versus a live consultation between consumer and doctor, would be a
12 reimbursement risk." Id. ¶ 23. Not only did Defendants continue to use the doctor
13 network despite these concerns, they also allegedly "concealed" the network's continued
14 use "from the general counsel and the uBiome board." Id.

15 The second issue with the doctor network concerned tests of "dubious clinical
16 utility." Id. ¶ 24. The tests of "dubious" utility involved re-testing of old samples that
17 consumers previously submitted. Id. Defendants allegedly orchestrated a scheme whereby
18 consumers were "broadly" advertised the option of retesting their samples. Id. When
19 consumers elected to retest an old sample, the consumer's request was made to "appear to
20 be requests for tests on new samples" to network doctors. Id. As a result, "at Defendants'
21 direction, uBiome resubmitted consumers' originally reported symptoms to the doctors
22 reviewing retest requests as if they were newly reported symptoms." Id.

23 The practice of presenting retests as requests for new tests also raised concerns
24 among employees. Id. ¶ 24. In 2017, for example, uBiome's former lab director warned
25 that the "retests lacked 'current clinical relevance' and could be fraudulent." Id. Again,
26 Defendants allegedly disregarded the concerns and continued the practice of retesting old
27 samples "from at least late 2017 through 2018." Id.

1 **2. Misrepresentations to Insurers**

2 The second set of alleged improper practices involved misrepresentations to
3 insurers. The complaint includes specific and general examples of these alleged
4 misrepresentations. Specifically, Defendants learned in May 2018 that certain insurers
5 were requesting medical records “reflecting that doctors had contemporaneously consulted
6 with patients for the billed tests.” Id. ¶ 25. uBiome did not have such records, so
7 Defendants “directed company employees to create and backdate records to make it seem
8 as though doctor-patient consultations had occurred, and then to submit those fake records
9 to insurance companies.” Id.

10 More generally, the complaint alleges that Defendants engaged in various forms of
11 deceptive practices to obtain reimbursement from insurers. Id. ¶¶ 25–26. These practices
12 included billing for tests that had not been performed and “might never be performed
13 because the version of the test to be used had not been proved to work.” Id. ¶ 26. In
14 addition, Defendants oversaw the manipulation of billing codes, including directing
15 employees “to use incorrect insurance billing codes and/or vary the codes when billing for
16 the same type of test to avoid claims rejection, even though there was no legitimate basis
17 for doing so.” Id.

18 As with the doctor network and the practice of retesting old samples, employees
19 expressed worries about the legitimacy of the company’s practices with insurers, but
20 Defendants did not address the issues. Id. The concerns eventually began to extend
21 beyond employees, as multiple insurers began to challenge uBiome’s practices, including
22 one that alleged that the company was engaging in “fraud and abuse.” Id. ¶ 44.

23 **B. The Series C Funding Round**

24 The various forms of alleged insurance fraud were all underway when the company
25 began its Series C funding round in May 2018. Id. ¶ 34. And the complaint alleges that
26 Defendants’ false and misleading statements to investors during the Series C funding
27 round enabled the company to raise, and Defendants to make, millions of dollars.

28 Defendants’ alleged Series C misrepresentations generally fall into two buckets.

1 First, Defendants told investors that insurance-covered tests were driving the company’s
2 revenue growth. Id. ¶ 27. For example, Richman provided the lead Series C investor with
3 information showing that “uBiome generated nearly 91% of its revenue from health
4 insurance reimbursements by the first quarter of 2018” and that it “projected billing for its
5 clinical tests to increase to approximately 97 percent of its total revenue by 2020.” Id.; see
6 also id. ¶ 39 (Richman told Series C investors that uBiome would generate more than
7 “\$100 million total revenue for 2018”). Highlighting current and projected revenue
8 growth helped assure investors that the company had a strong business model and the
9 ability to generate and grow revenue through insurer reimbursements. Id. ¶ 33.

10 In addition to highlighting the company’s strong growth prospects, Defendants
11 allegedly misled investors about the company’s ability to obtain insurance reimbursement
12 for its tests. Id. ¶¶ 38–41. Throughout May and September 2018, Defendants prepared
13 and provided pitch decks and “other promotional materials” to investors that repeatedly
14 emphasized that uBiome’s clinical tests were “ordered by doctors, reimbursed by
15 insurance.” Id. ¶ 33. The purpose of these alleged misrepresentation was to reassure
16 investors that uBiome’s business model rested on a solid foundation that would enable
17 continued growth. See id. ¶ 42.

18 The Series C funding round ultimately closed in September 2018, with uBiome
19 successfully raising \$59M from a group of twenty-seven investors.² Id. ¶¶ 28–30. As part
20 of the Series C offering, both Richman and Apte sold \$5 million worth of shares in the
21 company, taking home \$5 million apiece. Id.

22 **C. uBiome’s Bankruptcy**

23 uBiome’s fortunes took a sharp turn south following the Series C funding round.
24 By April 2019, “at least 18” insurers had challenged the legitimacy of uBiome’s business
25 and billing practices. Id. ¶ 44. Several insurers sought to clawback their reimbursement
26 payments from the company. Id. That same month, the FBI executed a search warrant of

28 ² Six investors also purchased convertible promissory notes for more than \$2 million. Compl. ¶
28. The notes could be converted into uBiome stock. Id.

1 uBiome's San Francisco headquarters. Id. ¶ 45. Both Richman and Apte were fired
2 approximately two months later. Id.

3 In September 2019, in the wake of the FBI raid and termination of the company's
4 two co-founders, uBiome suspended its operations and filed for bankruptcy protection. Id.
5 ¶ 46. Currently, the company is "undergoing Chapter 7 bankruptcy liquidation." Id.

6 **D. Procedural History**

7 The SEC filed a complaint against Defendants on March 18, 2021. See generally
8 Compl. The complaint alleges two causes of action against Defendants: (1) violations of
9 Section 17(a) of the 1933 Securities Act and (2) violations of Section 10(b) of the 1934
10 Exchange Act and Rule 10b-5 promulgated thereunder. Id. ¶¶ 47–52. Defendants have
11 filed a joint motion to dismiss the complaint. See generally MTD. The SEC opposes the
12 motion. Opp. to MTD ("Opp.") (dkt. 47).

13 **II. LEGAL STANDARD**

14 To survive a motion to dismiss, a complaint must contain sufficient factual matter to
15 state a claim that is facially plausible. Fed. R. Civ. P. 12(b)(6); Ashcroft v. Iqbal, 556 U.S.
16 662, 678 (2009). A claim is facially plausible when "the plaintiff pleads factual content
17 that allows the court to draw the reasonable inference that the defendant is liable for the
18 misconduct alleged." Ashcroft, 556 U.S. at 678. The court "must take all of the factual
19 allegations in the complaint as true," but it is "not bound to accept as true a legal
20 conclusion couched as a factual allegation." Id. The plausibility standard does not impose
21 a "probability requirement, but it asks for more than a sheer possibility that a defendant
22 acted unlawfully." Id. (citation omitted).

23 A complaint alleging fraud must also "state with particularity the circumstances
24 constituting fraud." Fed. R. Civ. P. 9(b); Kearns v. Ford Motor Co., 567 F.3d 1120, 1125
25 (9th Cir. 2009). In particular, Rule 9(b) requires a plaintiff to set forth the "who, what,
26 when, where, and how" of the alleged fraud. Vess v. Ciba Geigy Corp. USA, 317 F.3d
27 1097, 1106 (9th Cir. 2003). The purpose of Rule 9(b)'s heightened pleading requirement
28 is to provide notice to defendants of the specific fraudulent conduct against which they

1 must defend. Bly-Magee v. California, 236 F.3d 1014, 1018 (9th Cir. 2001); Semegen v.
2 Weidner, 780 F.2d 727, 732 (9th Cir. 1895) (the complaint “must be specific enough to
3 give defendants notice of the particular misconduct which is alleged to constitute fraud”).

4 III. DISCUSSION

5 The SEC alleges that Defendants violated Section 17(a) and Section 10(b) and Rule
6 10(b)-5 thereunder. Claims for violation of Section 17(a) and Section 10(b) “require that
7 the SEC plead much of the same elements.” S.E.C. v. Trabulse, 526 F. Supp. 2d 1001,
8 1004 (N.D. Cal. 2007). For both claims, the SEC must plead facts showing: “(1) a
9 material misstatement or omission (2) in connection with the offer or sale of a security (3)
10 by means of interstate commerce.” S.E.C. v. Phan, 500 F.3d 895, 907–08 (9th Cir. 2007).
11 Claims based on a violation of Section 17(a)(1) and Section 10(b) also require sufficient
12 allegations to show scienter while claims for violation of Section 17(a)(2) and (3) require a
13 showing of negligence. Id.

14 The through line of Defendants’ motion to dismiss is that the complaint “lacks the
15 required particularity to adequately allege any actionable securities fraud.” MTD at 5.
16 Defendants make a series of arguments along this line, none of which are persuasive.
17 Contrary to Defendants’ claims, the complaint sets forth a clear theory of fraud with the
18 required particularity. Try as they might, Defendants cannot win dismissal by burying
19 their heads in the sand and feigning ignorance of the claims against them.

20 A. Rule 9(b) Pleading Requirements

21 Defendants make several arguments about why the complaint falls short of Rule
22 9(b) pleading requirements. See MTD at 5–6 (the complaint constitutes impermissible
23 shotgun pleading); id. at 8 (the complaint fails to identify specific statements); id. at 10
24 (the complaint “consistently fails to distinguish” between defendants). None of these
25 arguments are persuasive.

26 Rule 9(b) does impose a heightened pleading standard for fraud claims, but it does
27 not require the granular details that Defendants appear to call for. Instead, Rule 9(b) “only
28 requires the identification of the circumstances constituting fraud so that the defendant can

1 prepare an adequate answer from the allegations.” Walling v. Beverly Enterprises, 476
2 F.2d 393, 397 (9th Cir. 1973). It “does not require nor make legitimate the pleading of
3 detailed evidentiary matter.” Id.; S.E.C v. Levin, 232 F.R.D. 619, 624 (C.D. Cal. 2005).

4 Applying this standard, Defendants’ arguments fail. Defendants claim that the
5 complaint constitutes improper “shotgun” pleading because each count “incorporates all
6 allegations” of the complaint. MTD at 6. But the SEC’s decision to “set out all of their
7 fact allegations and then follow such allegations with their legal claims” provides no basis
8 for dismissal here because the complaint sets forth a clear theory of fraud enabling
9 Defendants to understand how the alleged facts relate to the claims against them. See .
10 S.E.C. v. Daifotis, No. C 11-00137 WHA, 2011 WL 2183314, at *3 (N.D. Cal. June 6,
11 2011). Given the detailed nature of the allegations, Defendants’ claim that the complaint
12 “makes it impossible for Dr. Richman and Dr. Apte to respond to the claims brought
13 against them” is simply incredible. MTD at 6.

14 Defendants also contend that the complaint should be dismissed because it fails to
15 identify all of the alleged misrepresentations. MTD at 8. But “the SEC is not required to
16 plead detailed evidence concerning each and every fraudulent act alleged.” Levin, 232
17 F.R.D. 619, 624 (C.D. Cal. 2005). The complaint includes both specific examples and
18 general categories of allegedly false and misleading statements that Defendants allegedly
19 made during a specific time period (the Series C funding round) to a particular persons (the
20 Series C investors). See also SEC v. Med. Cap. Holdings, Inc., 2010 WL 809406, at *3
21 (C.D. Cal. Feb. 24, 2010) (“the SEC is not required under Rule 9(b) to plead which
22 particular investors were injured by their reliance on the false statements”). As discussed
23 more in the next section, the complaint provides sufficient notice of the nature of the
24 alleged misrepresentations so that Defendants can prepare a defense against them.

25 Defendants’ claim that the complaint “consistently” fails to distinguish between
26 Defendants similarly fails. MTD at 10. Contrary to this claim, the complaint in fact does
27 consistently distinguish between Defendants. See Opp. at 9–10 (providing multiple
28 examples of how the complaint distinguishes between actions that Defendants performed

1 jointly and individually). Moreover, it alleges sufficient facts to put Defendants on notice
2 of the conduct that forms the basis of the SEC’s claims. As with the others, this argument
3 also provides no grounds for dismissal.

4 **B. Sufficient Particularity**

5 Defendants primarily argue that the complaint fails to plead its claims with the
6 required particularity. See MTD 7–20. They make two main arguments in this regard,
7 namely that the complaint fails to adequately allege the misrepresentations (id. at 8–10)
8 and that the complaint fails to plead falsity and materiality (id. at 10–19).

9 Both of Defendants’ arguments fail for the same reason—the bar for pleading
10 Section 17 and Section 10(b) fraud claims is not nearly as high as Defendants would like it
11 to be. While Defendants repeatedly fault the SEC for failing to include certain details,
12 their attacks do not change the fact that the complaint presents a clear and cohesive theory
13 of fraud supported by the required specifics.

14 **1. Misrepresentations**

15 Defendants’ first main argument is that the complaint fails to allege the “who, what,
16 when, where, and how” of the alleged fraud. MTD at 8. Rulings in analogous cases make
17 clear why this argument fails.

18 A complaint sufficiently alleges fraud when it contains “sufficient detail to put
19 defendant on notice of the claims against him.” SEC v. Tabulse, 526 F. Supp. 2d 1001,
20 1005 (N.D. Cal. 2007). In Trabulse, the defendant managed a hedge fund for several years
21 and allegedly lied to investors about the fund’s performance by overstating its profits and
22 understating its losses. Id. 1002–03. As with the Defendants here, the defendant in
23 Tabulse moved to dismiss the SEC’s complaint against him, arguing that “the SEC failed
24 to state with particularity each of the statements that it believed to be materially
25 misleading.” Id. at 1004. The court rejected this argument because “the examples
26 provided by the SEC do provide times, dates, places, benefits received, and other details of
27 the alleged fraud.” Id. The examples included “account statements” and “newsletters”
28 sent to investors during specific time periods that allegedly misrepresented the fund’s

1 performance. Id. at 1002–03. Based on these examples, the court found that the complaint
2 sufficiently set forth “the circumstances of the alleged fraud—the period in which it
3 occurred, who Trabulse communicated to, how he communicated to them, the content of
4 the communications, and the benefits reaped from his actions.” Id. at 1005.

5 In addition, a complaint adequately alleges that a defendant may be liable for a
6 misstatement where it shows that the defendant was “substantially” or “intricately”
7 involved with the preparation of the alleged misrepresentations. Daifotis, 2011 WL
8 2183314, at *4. In Daifotis, the defendants allegedly made false and misleading
9 statements about the risks and performance of a bond fund they managed. Id. at 1–2.
10 Defendants moved to dismiss, arguing that the SEC’s complaint failed to show “substantial
11 participation in the preparation of the allegedly false statements.” Id. at 3. The statements
12 at issue were made in “press releases,” a “website,” “sales materials,” and “filings,” and
13 the defendants argued the statements were “not directly attributable” to them. Id. The
14 court rejected the argument, finding that a defendant may be liable for a statement if they
15 “substantially participated” or were “intricately involved” in its preparation. Id. at 4
16 (quoting Howard v. Everex Sys., Inc., 228 F.3d 1057, 1061 n. 5 (9th Cir. 2000)) (cleaned
17 up). Given that the complaint adequately alleged substantial involvement, defendants’
18 motion to dismiss on this ground was denied. Id. at 7.

19 The complaint here adequately alleges the “circumstances of the alleged fraud.”
20 Tabulse, 526 F. Supp. 2d at 1005. Specifically, the complaint alleges that Defendants
21 made specific misrepresentations (i.e. statements about sustainable revenue growth and
22 insurer-covered tests) to a specific audience (i.e. Series C investors) during a particular
23 time period (i.e. the Series C funding round from May 2018 to September 2018). The
24 complaint includes both specific and general examples of how these misrepresentations
25 were made. It refers to specific emails that Richman sent to investors (e.g. Compl. ¶¶ 38–
26 39) and general pitch decks that both Richman and Apte authored and presented (e.g. id. ¶¶
27 32, 34, 41). The complaint further adequately alleges that Richman and Apte—who co-
28 founded the company, managed it closely, and interacted directly with investors—made

1 and substantially participated in the making of the allegedly misleading statements.
2 Daifotis, 2011 WL 2183314, at *4. And it adequately alleges that Richman and Apte knew
3 or should have known that the statements made to investors about the company's revenue
4 growth and eligibility for insurance reimbursement were false and misleading because they
5 omitted serious concerns that had been raised about the company's business practices.
6 Compl. ¶¶ 22–26. The complaint also includes sufficient allegations regarding Richman
7 and Apte's motives for the alleged fraud, namely both sought to raise and make millions of
8 dollars from investors. Id. ¶¶ 28–30. Thus, the complaint contains sufficient detail to put
9 Defendants on notice of the claims against them. Tabulse, 526 F. Supp. 2d at 1005. No
10 more particularity is required.

11 Defendants' reliance on Francisco is not persuasive. MTD at 8 (citing SEC v
12 Francisco, 262 F. Supp. 3d 985, 987–88 (C.D. Cal. 2017)). In Francisco, the defendant
13 raised millions of dollars from foreign investors over a three-and-a-half year period across
14 multiple fund-raising rounds. Francisco, 262 F. Supp. 3d 985, 987–88 (C.D. Cal. 2017).
15 The purpose of the money was to fund EB-5 investments that would enable the foreign
16 investors to qualify for EB-5 visas. Id. The SEC's complaint alleged that the defendant
17 embezzled millions of dollars from the funds and deceived investors by making
18 misrepresentations during the funding rounds. Id. The court dismissed the complaint
19 because it failed to specify the nature of the misrepresentations that were made during any
20 of the particular funding rounds, instead alleging in blanket fashion that certain unspecified
21 fraud occurred across all of the funding rounds. Id. at 989–90 (the complaint did not
22 “clearly present” defendant's role in the fraud and did “not delineate the nature of the fraud
23 in each particular offering”).

24 In contrast to Francisco, there was only one funding round at issue here—the Series
25 C funding round that took place from May 2018 through September 2018. And unlike
26 Francisco, the nature of the alleged fraud that took place during that funding round is clear:
27 Defendants touted the strength and promise of their business to investors while failing to
28 disclose facts suggesting that their business was in serious jeopardy. The allegations in

1 Francisco were overly vague, while those here are sufficiently specific.

2 **2. Falsity and Materiality**

3 Defendants next argue that the complaint fails to adequately allege that any of the
4 statements made to investors were materially false or misleading. MTD at 10–19. In
5 particular, Defendants contend that the complaint fails to allege sufficient facts to show
6 that the statements that uBiome’s tests were “ordered by doctors” (see MTD at 11–13) and
7 were “reimbursed by insurance” (see MTD at 13–19) were materially false and misleading.

8 Rule 10b-5 prohibits “misleading and untrue statements,” but it does not prohibit
9 statements that are “incomplete.” Brody v. Transitional Hosps. Corp., 280 F.3d 997, 1006
10 (9th Cir. 2002). For a statement to be misleading, it must “affirmatively create an
11 impression of a state of affairs that differs in a material way from the one that actually
12 exists.” Id. A misrepresentation “is material if there is a substantial likelihood that a
13 reasonable investor would have acted differently if the misrepresentation had not been
14 made or the truth had been disclosed.” Livid Holdings Ltd. v. Salomon Smith Barney,
15 Inc., 416 F.3d 940, 946 (9th Cir. 2005).

16 Case law again makes clear why the complaint here adequately alleges materially
17 false and misleading statements. In American West, the Ninth Circuit found that
18 “optimistic statements regarding [defendant’s] financial condition” were materially
19 misleading because the defendant failed to disclose various operational challenges that
20 were negatively affecting the company. No. 84 Emp.-Teamster Joint Council Pension Tr.
21 Fund v. Am. W. Holding Corp., 320 F.3d 920, 935 (9th Cir. 2003). In Warshaw, the Ninth
22 Circuit found that the defendant’s statements touting a drug’s likelihood of FDA approval
23 were materially misleading because defendant failed to disclose that “serious doubts” had
24 been raised about the drug’s “effectiveness and the chances for prompt FDA approval.”
25 Warshaw v. Xoma Corp., 74 F.3d 955, 957–60 (9th Cir. 1996).

26 As in American West and Warshaw, Defendants allegedly deceived investors by
27 making optimistic statements about their company without disclosing the significant risks
28 to the very viability of the business. During the Series C funding round, Defendants touted

1 their business to investors, pointing to optimistic revenue forecasts and reassuring
2 investors that their business model was fundamentally sound. Compl. ¶¶ 33–34, 38–41.
3 These misrepresentations were misleading because Defendants failed to disclose the
4 serious concerns that had been raised about the viability of uBiome’s business model. See
5 Warshaw, 74 F.3d at 960 (defendants made “optimistic statements” without disclosing the
6 “unflattering facts”). Defendants represented that their tests were “ordered by doctors”
7 despite allegedly knowing (1) that tests ordered through the doctor network were at risk of
8 reimbursement denial because the doctors lacked the required doctor-patient relationship
9 (Compl. ¶ 23) and (2) that retests were potentially subject to insurer denial because key
10 information was omitted from doctors ordering the tests (id. ¶ 24). Similarly, Defendants
11 claimed that their tests were reimbursed by insurers despite knowing that (1) in May 2018,
12 at the start of the Series C funding round, the company had to falsify documentation in
13 response to insurer inquiries (id. ¶ 25) and (2) during the Series C funding round, insurers
14 challenged the company’s practices, including allegations of “fraud and abuse” (id. ¶ 37).

15 In sum, Defendants boasted about their revenue growth but failed to disclose that
16 serious questions had been raised by employees and insurers about the legitimacy of the
17 practices that fueled that growth (see id. ¶ 27). Thus, it is fair to conclude at the pleading
18 stage that a “reasonable investor would have acted differently” if they had known about the
19 various undisclosed risks to uBiome’s business model. Livid Holdings, 416 F.3d at 946.

20 **C. Scheme Liability**

21 Defendants also move to dismiss the complaint on the ground that it fails to plead
22 scheme liability. MTD at 21–22.

23 To state a claim for scheme liability under Section 17(a)(1) or (a)(3) or Rule 10b–
24 5(a) or (c), “the SEC must allege that the defendant ‘engaged in conduct that had the
25 principal purpose and effect of creating a false appearance of fact in furtherance of the
26 scheme’ in the offer or sale (for Section 17(a)) or in connection with the purchase or sale
27 (for Section 10(b)) of a security.” Sec. & Exch. Comm’n v. Sidoti, 2021 WL 1593253, at
28 *9 (C.D. Cal. Mar. 19, 2021) (citing 15 U.S.C. § 77q(a); 17 C.F.R. § 240.10b–5). These

provisions “capture a wide range of conduct.” Lorenzo v. SEC, 139 S. Ct. 1094, 1101 (2019).

Defendants argue that “[f]or the same reasons that the Complaint fails to detail the falsity of the alleged misrepresentations, the Complaint fails to allege a scheme with particularity.” MTD at 21. The opposite is true. As discussed above, the complaint adequately alleges that Defendants made actionable misrepresentations to investors during the Series C funding round. For the same reasons, the complaint adequately alleges scheme liability—specifically, Defendants allegedly created false appearances of fact by misleading Series C investors about the strength and sustainability of the company’s business model when they allegedly knew that the walls were closing in around them.

IV. CONCLUSION

For the foregoing reasons, Defendants’ motion to dismiss is denied.

IT IS SO ORDERED.

Dated: November 3, 2021



CHARLES R. BREYER
United States District Judge