Republic of the Philippines
Department of Finance
Securities and Exchange Commission
SEC Building, EDSA, Greenhills, Mandaluyong City

In the matter of:
KLIKMART SHOPPING CLUB CORP. and
KLIKMART DRAGON, INC.
(also known as "KLIKMART REWARDS")

SEC CDO Case No. 09-15-023

ENFORCEMENT AND INVESTOR
PROTECTION DEPARTMENT,
Movant.

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RESOLUTION

This resolves the *Motion to Lift Cease and Desist Order*[1] (**Motion to Lift**) filed on 30 October 2015 by the KLIKMART SHOPPING CLUB CORP. and KLIKMART DRAGON INC. (*for brevity* "**Respondents**") praying that the Commission lift its *Cease and Desist Order* dated 16 October 2015 (**Assailed CDO**), the dispositive portion reads as follows:

> "WHEREFORE, premises considered, KLIKMART SHOPPING CLUB CORPORATION, KLIKMART DRAGON CORPORATION, KLIKMART REWARDS, KLIKMART DISTRIBUTION AND MARKETING SERVICES, their partners, officers, directors, agents, representatives, conduits, assigns, AND ANY AND ALL PERSONS CLAIMING AND ACTING FOR AND IN THEIR BEHALF are hereby ordered to IMMEDIATELY CEASE AND DESIST, UNDER PAIN OF CONTEMPT, from engaging in activities of selling and/or offering for sale securities in the form of investment contracts or any others of the same nature, as discussed in this *Order*, until the requisite registration statement is duly filed with and approved by the Commission and the corresponding to offer/sell is issued.
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> Furthermore, the subject corporations are directed to cease its internet presence relating to above-stated investment activities. The Commission will institute the appropriate administrative and criminal action against any persons or entities found to act as solicitors, information providers, salesmen, agents, brokers, dealers or the like for and in behalf of the subject corporations."

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[1] Dated 26 October 2015.

The facts of the case are as follows:

Klikmart Shopping Club Corp. is a stock corporation registered with the Commission on 31 March 2015 with Company Registration No. CS201506576. Its principal office is located at Unit 1B, Forab Building, Kamuning Road, Brgy. Kamuning, Quezon City. It is engaged in the business of marketing and distribution of goods[2]. On the other hand, Klikmart Dragon Inc. is a stock corporation registered with the Commission on 05 February 2015 with Company Registration No. CS201502022. Its principal office is located at Unit II, Pearl Road, Balibago Complex, Brgy. Balibago, Sta. Rosa, Laguna. It is engaged in the business of buying and selling of goods[3].

On 21 October 2015, Respondents received a copy of the Commission's Assailed CDO[4]. Then, on 30 October 2015, they filed a *Motion to Lift* alleging among others, the following:

1. There is no substantial evidence to conclude that Respondents are engaged in investment contracts. The results of the Commission's investigation is not Respondents' marketing strategies but individual strategies of their members who do not have the proper training[5];
2. They are multi-level marketing companies engaged in giving bonuses, incentives, commission, and product formulation[6];
3. That as part of Respondents' strategy, they created a sales scheme of selling bulk products to each member which was called "Entry Package". By placing the amount of Php 1,500.00, a member receives two (2) boxes of organic coffee (299/box) and one (1) premium beauty soap (199/bar). This package only signifies that every member must avail of such products to be a legitimate member of the company[7];
4. That the Bureau of Food and Drugs (BFAD) directed Respondents to first secure a license before they distribute food products. For this reason, Respondents did not distribute products from March to September 2015. Thus, it was assumed that Respondents are engaged in a mere money-making scheme and not legitimate shopping companies[8];

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[2] Klikmart Shopping Club Corp.'s primary purpose - *"To engage in the business of marketing and distribution of goods, such as but not limited to soap and perfumes, wares and merchandise of every kind and description in wholesale and retail basis."*

[3] Klikmart Dragon Inc.'s primary purpose is *"To engage in, conduct and carry on the business of buying, selling, distributing, marketing at retail and wholesale insofar as may be permitted by law, all kinds of goods, wares and merchandise of every kind and description; to enter into all kinds of contracts for the export, import, purchase, acquisition, sale at manufacturer's representative, merchandise broker, indentor, commission merchant, factors or agents upon consignment of all kinds of goods, equipments, wares, merchandise or products whether natural or artificial without acting as stock broker or dealer in securities, government securities eligible dealer (GSED), investment house, transfer agent, commodity/financial futures exchange/broker/merchant, financing company, and time shares/club shares/membership certificate issuers or selling agents thereof."*

[4] Paragraph 1 of the Motion to Lift.

[5] Paragraph 3 of the Motion to Lift.

[6] Paragraph 4 of the Motion to Lift.

[7] Paragraph 5 of the Motion to Lift.

[8] Paragraph 6 of the Motion to Lift.

5. That Respondents admit that there was negligence on their part in guiding their members but they did not tolerate the alleged investment activities[9];
6. **That Respondents' scheme is that the bonus awarded to a member is based on sales output of a member in a 2:1 sales matrix system.** This only means that Respondents should not release a bonus unless and until the member has recorded sales. Although a bit confusing to the new members on how their packages worth Php 1,500.00 is equivalent to rebates worth Php 2,000.00, the scheme is a plain membership store that helps members earn rebates in selling products. Thus, for two packages sold, the member is entitled to receive sales package rebates or a cash bonus worth Php 2,000.00. No definite promises, no particular dates, no percentages and interest promised. This marketing strategy is often misunderstood by some members especially those who lack proper training and experience[10];
7. That Respondents are not engaged in investment contract since the elements of such is not present in the instant case. One, the money invested by the members does not subject them to financial loss since there is a product involved. **Two, the investment was returned already in the form of products. Three, the profits expected by the members are given to the in a form of rewards or bonuses because of the outcome of their sales and not solely from the efforts of others.** In fact, the return on investment was given because of the outcome in the sales of products/packages[11];
8. That Respondents' present motion is supported by one hundred thirty two (132) of their members.

At the hearing of Respondents' *Motion to Lift*, which was set on 13 November 2015, Respondents reiterated the grounds alleged in their *Motion to Lift*. After the parties' oral arguments, the Commission's Enforcement and Investor Protection Department **(EIPD)** was given fifteen (15) days to file its *Comment*. Then, Respondents were also given the same period to file their *Reply/Rejoinder*.

On 27 November 2015, EIPD filed its *Comment/Opposition*[12] to Respondents' *Motion to Lift*, arguing, among others:

1. That Respondents have been operating since November 2014 and they have been receiving benefits from all the investments pouring in through the sales strategies of their member-employees. <u>In fact, Mr. Athos Garganera, one of Respondents' incorporators, was the one who conducted the seminar attended by the EIPD investigating team</u>[13];
2. That Respondents admitted that they were not distributing products from March to September of 2015. <u>Respondents' non-distribution of</u>

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[9] Paragraph 7 of the Motion to Lift.
[10] Paragraph 8 of the Motion to Lift.
[11] Paragraph 9 of the Motion to Lift.
[12] Dated 25 November 2015.
[13] Page 3 of EIPD's Comment.

products only proves that the promised interest for the money invested does not depend on the outcome of the sales of the products since, as already admitted in Respondents' motion, there was no product ever distributed to the investors[14];

3. That the promised return on investment was derived from the investments of the new investors rather than from the income earned through the sale of the products[15];
4. That the elements of an investment contract is present in the instant case. There is a placement of money consisting of a minimum of P1,500.00 where the investor is promised to earn 33% of the total money invested or a payout exit of P2,000.00. The money invested is placed in a common enterprise and the investor expects to derive profits as they are primarily attracted to join Respondents by the prospects of return on their investment. The investor expects to earn profits from the entrepreneurial and managerial efforts of others[16].

On 10 December 2015, Respondents filed their *Reply*[17], to EIPD *Comment/Opposition*, alleging, among others:

1. That Respondents are not engaged in selling/offering investment contracts. Respondents give each of their member one (1) package of different products. Members should also purchase products from Respondents' stores for a minimum amount of Php 500.00 per month to be entitled to rebates or bonuses[18];
2. That Respondents have fourteen (14) stores nationwide in which products are displayed in every store and are ready for purchase by anyone. Members may purchase products anytime and they earn redeemable points. Products for new members are available in Respondents' warehouse as early as May 2015. The return on investment did not come from efforts of others but from the members themselves by buying packages and accumulating points through purchases[19];
3. That the training attended by EIPD was conducted by an unauthorized personnel, Mr. Athos Garganera, who is not Respondents' authorized trainer and did not use the Board-approved presentation[20];
4. That the internet advertisement, which was examined as part of the investigation, did not come from Respondents. They maintain one Facebook page (KLIKMART REWARDS) and an official website (www.klikmartrewards.com) but these web advertisement were shut down because of the Assailed CDO[21].

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[14] Page 4 of EIPD's Comment.
[15] Page 5 of EIPD's Comment.
[16] Page 8 of EIPD's Comment.
[17] Dated 05 August 2015.
[18] Paragraphs 3-4 of Respondent's Reply.
[19] Paragraphs 5-7 of Respondent's Reply.
[20] Paragraph 8 of Respondent's Reply.
[21] Paragraph 9 of Respondent's Reply.

In response to Respondents' *Reply*, EIPD on 22 December 2015 filed a *Rejoinder*[22], alleging among others, the following:

1. That Respondents did not in any way controvert the findings in the Commission's CDO;
2. That Respondents admitted that they were not distributing their products to their members prior to the issuance of BFAD license but still solicited and accepted investments from the public. Their non-distribution of products only proves that the promised interest for the money invested does not depend on the outcome of the sales of the products[23];
3. That Respondents' denial of Mr. Athos Garganera's authority to conduct seminar is illogical since the latter is one of the owners and actively spreading Respondents' business scheme[24].

EIPD also attached in said *Rejoinder* a copy of the statement of Mark Dominique Nadela, a poseur-investor in a National Bureau of Investigation (NBI) under-cover surveillance operation in Respondents' Tagbilaran, Bohol Branch on 03 September 2015[25].

With the submission of EIPD's *Rejoinder* and with no remaining issues to be clarified, the hearing on the *Motion to Lift* is terminated and submitted for resolution.

The issue to be resolved can be summarized as follows: "Whether or not Respondents presented sufficient grounds to overcome the findings in the Commission's *Cease and Desist Order*".

We find the instant *Motion to Lift* bereft of merit.

The Assailed CDO was based on the Commission's findings that Respondents are offering/selling investment contracts. Respondents require their investors to invest the amount of Php 1,500.00 to Php 15,000.00 with a promised return of 33% of investment within a period of 21 days to 1 month (*Membership Bonus*). Also, they provide a reward system for recruiting other investors.

EIPD presented the following evidence in support of its motion: 1.) Certifications from the Commission's Market Securities Regulation Department (MSRD) and Corporate Governance and Finance Department (CGFD) certifying that Respondents are not licensed to offer/sell securities; 2.) Documents and statements gathered in three (3) surveillance and ocular inspections showing that Respondents

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[22] Dated 17 December 2015.
[23] Page 2 of EIPD's Rejoinder.
[24] Page 4 of EIPD's Rejoinder.
[25] Annex "A" of EIPD's Rejoinder.

enticed investors to place money in a common enterprise and led to expect profits from the business scheme which Respondents primarily develop and operate.

Respondents' argument in their *Motion to Lift* that they are legitimate Multi-Level Marketing (MLM) companies is unmeritorious. In a multilevel or network marketing, individuals sell products to the public — often by word of mouth and direct sales. Typically, distributors earn commissions, not only for their own sales, but also for sales made by the people they recruit[26]. Assuming that Respondents are MLM companies, this does not rebut EIPD's findings that investment-taking is still present in their business scheme, particularly the promise of 33% return on investment after 21 days to 1 month. This is because members earn profits without the need for selling products or recruiting members. Additionally, EIPD presented a sworn statement[27] of Mr. Mark Dominique Nadela, a poseur-investor in a NBI under-cover surveillance operation in Tagbilaran, Bohol. Mr. Nadela personally invested Php 1,500.00 in Respondents' business enticed by the promised return of 33% on his investment within a short period of one month or less.

It should be emphasized that on numerous occasions the concept of MLM is exploited to disguise pyramiding schemes[28]. Thus, in the US Case of *FTC vs. Koscot Interplanetary Inc.*[29], a four (4) part test was formulated to determine whether an MLM business is a pyramid scheme. This is known as the "*Koscot test*" which comprises of the following: 1.) payment of money to the company; 2.) the participant receives the right to sell a product [or service]; 3.) the participant receives compensation for recruiting others into the program; 4.) the compensation is unrelated to the sale of products [or services] to the ultimate user.

In the instant case, Respondents' business model satisfies the *Koscot test*. They require their new members to place the amount of Php 1,500.00 to Php 15,000.00 to gain entry in their business scheme. After placement, a new member receives the right to sell their products. In fact, Respondents admit this scheme when they claim to be a MLM company, which awarded rebates or bonuses based on sales of their members[30]. Further, members receive additional compensation when they recruit new investors, through the rewards system [*Infinite Direct Referrals* or *Customer Finder Fee* [31], *Unilevel Bonus (Power of Piso)*[32] and *Royalty Raffle Bonus*

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[26] https://www.ftc.gov/tips-advice/business-center/guidance/multilevel-marketing, last accessed on 26 January 2016.

[27] Annex "A" of EIPD's Rejoinder.

[28] *People v. Balasa*, G.R. Nos. 108601-2 (1998), in citing the Consumer Act of the Philippines (RA 7394), defines a pyramid scheme as a sales devices whereby a person, upon condition that he makes an investment, is granted by the manufacturer or his representative a right to recruit for profit one or more additional persons who will also be granted such right to recruit upon condition of making similar investments: *Provided*, That, the profits of the person employing such a plan are derived primarily from the recruitment of other persons into the plan rather than from the sale of consumer products, services and credit; *Provided, further*, That the limitation on the number of participants does not change the nature of the plan.

[29] 86 F.T.C. 11106 (1975).

[30] Paragraph 4 of Respondents' Motion to Lift.

[31] The investor will get P50.00 for every direct referral who will invest a minimum of P1,500.00. The corporation imposed no limit as to the number of referrals, page 5 of the Assailed CDO.

[32] An investor will earn P1.00 for every product (i.e. coffee-P195.00/box, soap-P160.00/piece, rice-P45.00/kilo) that will be purchased by his referrals, When referrals or down line of an investor reach the 20th level, then, he will earn more than

(Balato)[33]][34]. Finally, rewards system for recruitment is completely unrelated to the sales of Respondents' products.

Thus, Respondents offer more rewards/benefits from recruitment rather than from selling of their products. Stated otherwise, the rewards emphasize on recruitment over retail sales.

In their *Motion to Lift*, Respondents also argue that EIPD's findings are based on individual members' strategies who lack of proper training. However, it should be emphasized that it was Mr. Garganera, an incorporator and director, who presented Respondents' business scheme to EIPD investigators. In short, it is apparent that Respondent's argument impliedly admitted the fact that investment-taking is present in Mr. Garganera's presentation that Respondents promise 33% return of investment after 21 days. It is also evident that they are not selling products from March to September 2015 but are soliciting/collecting investments with a promise of high return. Respondents themselves admitted that they did not distribute their products since the start of their business. Assuming further that there are products to be distributed, they still promoted their investment scheme and accepted monies from their members despite knowing that they could not distribute their products. In other words, Respondents' products are merely inconsequential to very design and intent of their business model which is solicitation of investments. Obviously, the promised returns comes from the investment of new members since there is no sale of products.

Finally, as to the Respondents' claim that their position is supported by one hundred thirty two (132) members, such is untenable. The photocopy of a list of names and signatures of Respondent's members[35] to support their claim does not indicate that the persons stated therein are Respondents' members, nor show that they are supporting Respondents' position in the instant case. Thus, it has no relation to alleged expression of support.

Comparing the evidence presented, EIPD was able to adequately establish, through its investigation, that Respondents offer/sell securities in the form of investment contracts. EIPD proved the elements of an investment contract and the non-registration of the same. In fact, Respondents' arguments show that they have adopted a pyramiding scheme when they offer/sell these investment contracts.

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2 million Pesos. However, in order for an investor to claim his money, he must first purchase one product from the Respondents, page 6 of the Assailed CDO.

[33] Respondents has the option to choose how much percentage will be given as a bonus or "*balato*". If the primary investor loses in the raffle bonus and the 15th person in his down line wins, then, the 14th person in the down line all the way up to the primary investor will be given a "Balato". If the prize won is P1 million and Respondents decides to give 10% royalty bonus, then, all persons above the winner will be given P100,000.00 each, page 6 of the Assailed Order.

[34] EIPD investigators witnessed rewards schemes employed by Respondents during Mr. Garganera's seminar. Likewise, Respondents presented their Board-approve Power Point presentation illustrating their earning schemes. Comparing EIPD's version and Respondent's Board-approved presentation, we find similarities to wit: 1.) Respondents' "*Customer Finder Fee*" is similar to EIPD's findings on "*Infinite Direct Referrals*"; Respondents' "*Cashback Bonus (Php1.00)*" is similar to EIPD's findings on "*Unilevel Bonus (Power of Piso)*"; 3.) Respondents' "*Raffle Winner's Royalty Bonus*" is similar to EIPD's findings on "*Royalty Raffle Bonus (Balato)*".

[35] Annex "E" of Respondents' *Reply*.

Moreover, Respondents' evidence failed to overcome EIPD's findings that indeed Respondents are selling/offering securities in the form of investment contracts to the public without the necessary license from the Commission. Thus, Respondents' arguments and evidence lack merit.

To reiterate, securities are shares, participation or interests in a corporation or in a commercial enterprise or profit-making venture and evidenced by a certificate, contract, instruments, whether written or electronic in character. One of the types of securities are investment contracts[36]. As a rule, all securities shall not be sold or offered for sale or distribution within the Philippines, without a registration statement duly filed with and approved by the Commission[37].

Additionally, in *Primanila Plans, Inc. vs. Securities and Exchange Commission*[38], the Supreme Court ruled that:

> "The law is clear on the point that a cease and desist order may be issued by the SEC *motu proprio*, it being unnecessary that it results from a verified complaint from an aggrieved party. A prior hearing is also not required whenever the Commission finds it appropriate to issue a cease and desist order that aims to curtail fraud or grave or irreparable injury to investors. There is good reason for this provision, **as any delay in the restraint of acts that yield such results can only generate further injury to the public that the SEC is obliged to protect**."

Finally, it is declared in Section 2 of the SRC, that:

> "Section 2. Declaration of State Policy. – The State shall establish a socially conscious, free market that regulates itself, encourage the widest participation of ownership in enterprises, enhance the democratization of wealth, promote the development of the capital market, protect investors, **ensure full and fair disclosure about securities,** minimize if not totally eliminate insider trading and other fraudulent or manipulative devices and practices which create distortions in the free market. To achieve these ends, this Securities Regulation Code is hereby enacted."

WHEREFORE, premises considered, the *Motion to Lift Cease and Desist Order dated 16 October 2015* filed by KLIKMART SHOPPING CLUB CORP. and KLIKMART DRAGON, INC. is hereby **DENIED** for lack of merit. The CEASE AND DESIST ORDER issued against the subject corporations, their officers, directors, agents, representatives, conduits, assigns, and any and all persons/entities claiming and acting for and in behalf and under their authority, is hereby **MADE PERMANENT**.

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[36] Section 3, (b) of the Securities Regulation Code (SRC).

[37] Section 8.1 of the SRC.

[38] G.R. No. 193791, August 6, 2014.

The Enforcement and Investor Protection Department is hereby **DIRECTED** to: (a) serve this *Resolution* to the President, General Manager, Corporate Secretary, Treasurer or In-House Counsel of KLIKMART SHOPPING CLUB CORP. and KLIKMART DRAGON INC. and (b) post copies of the *Resolution* at the entrance of the main offices and/or branches, if any, of KLIKMART SHOPPING CLUB CORP. and KLIKMART DRAGON INC.

Let a copy of this *Resolution* be also posted in the Commission's website; and published in a national newspaper of general circulation and furnished to all operating departments and offices of the Commission for their information and appropriate action.

EIPD, in coordination with other concerned departments, is **FURTHER DIRECTED** to submit a formal compliance report, by way of a pleading, to the Commission *En Banc* WITHIN TEN (10) DAYS from receipt of this *Resolution.*

SO ORDERED.

Mandaluyong City; 05 April 2016.

TERESITA J. HERBOSA
Chairperson

MANUEL HUBERTO B. GAITE*
Commissioner

ANTONIETA F. IBE
Commissioner

EPHYRO LUIS B. AMATONG*
Commissioner

BLAS JAMES G. VITERBO
Commissioner

*On Official Business.