UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

JOSEPH M. SALVINI and JFS INVESTMENTS INC.,

Plaintiffs,

-against-

ADVFN PLC, a company incorporated under the laws of the United Kingdom, INVESTORSHUB.COM, INC., and JOHN DOE, known herein as "brkylnrusso,"

Defendants.

No. 13 Civ. 7082 (ER)

ECF Case

DEFENDANT INVESTORSHUB.COM'S REPLY IN SUPPORT OF ITS MOTION TO DISMISS THE SECOND AMENDED VERIFIED COMPLAINT FOR LACK OF SUBJECT MATTER JURISDICTION

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Introduction

In their Response and Memorandum of Law in Opposition to Defendant's Motion to Dismiss (the "Response") [D.E. 21], Plaintiffs agree that this Court would lack subject matter jurisdiction over their Exchange Act claims – and also over their pendent state law claims – if their Exchange Act claims are not "colorable." [Id. at 5.] Nothing in the Response shows that the Exchange Act claims are colorable. To the contrary, the Response only further demonstrates that the Exchange Act claims are "so patently without merit as to justify . . . the court's dismissal for want of jurisdiction." Lehman v. Discovery Communications, Inc., 217 F. Supp. 2d 342, 347-49 (E.D. N.Y. 2002) (dismissing libel and slander claims, as well as Section 1983 claim, because court lacked subject matter jurisdiction).

Rather than directly addressing the evident insufficiencies in their Exchange Act claims, however, Plaintiffs spend the majority of the Response trying to show that Defendant InvestorsHub.com ("iHub") is responsible for the statements of the "John Doe" Defendant, or trying to parse out whether iHub would qualify as a primary actor, secondary actor, or aider and abettor under the Exchange Act. Neither of those issues has any bearing on the fact that the Exchange Act claims are frivolous and were included when Plaintiffs amended the Complaint solely for the purpose of manufacturing federal question jurisdiction. The Second Amended Complaint should be dismissed for lack of subject matter jurisdiction.

Argument

I. Plaintiffs' Exchange Act Claims Are Frivolous.

A. Plaintiffs Concede that They Have Not Pled the Reliance Necessary to State a Section 10(b) Claim.

The Supreme Court has declared that "[r]eliance *by the plaintiff* upon the defendant's deceptive acts is an essential element of the § 10(b) private cause of action." Stoneridge Inv.

Partners, LLC v. Scientific-Atlanta, 552 U.S. 148, 159 (2008) (emphasis added). "This is because proof of reliance ensures that there is a proper connection between a defendant's misrepresentation and a *plaintiff's injury*." Erica P. John Fund, Inc. v. Halliburton Co., -- U.S. --, 131 S. Ct. 2179, 2184 (2011) (internal quotation omitted) (emphasis added).

Highlighting the frivolity of their Section 10(b) claim, Plaintiffs simply disregard this controlling Supreme Court precedent and instead declare that their position "is *not* that the Plaintiff relied *himself* on the false information which caused the damages and the ITEN stock price to fall," but rather that the allegedly false statements caused "*other investors* to sell off their share of CodeSmart thereby plunging the price of the stock and causing the loss to the Plaintiffs." [D.E. 21 at 14 (emphasis added).] In other words, Plaintiffs contend that they should be permitted to invoke this Court's subject matter jurisdiction to pursue a claim that they acknowledge does not comport with the controlling U.S. Supreme Court case law. This is the type of "immaterial" claim "made solely for the purpose of obtaining jurisdiction" that the Supreme Court has described as not colorable and not sufficient to invoke subject matter jurisdiction. Arbaugh v. Y&H Corp., 546 U.S. 500, 513 n.10 (2006).

Plaintiffs' unwillingness even to attempt to show reliance is not surprising because, again, controlling Supreme Court precedent precludes such a showing. As iHub demonstrated in its Motion to Dismiss, Plaintiffs could never prove reliance because they knew that the statements about Plaintiff Salvani were false and did not rely upon them. The presumption of reliance arising from the "fraud-on-the-market" theory, which Plaintiffs invoke, is inapplicable here because it is necessarily rebutted by Salvani's knowledge that the statements were false. See Basic Inc. v. Levinson, 485 U.S. 224, 249 (1988) (explaining that a plaintiff who knows that statements about a stock are false "could not be said to have relied on the integrity of the price he

knew had been manipulated"). See also GAMCO Investors, Inc. v. Vivendi, S.A., 917 F. Supp. 2d 246, 253 (S.D. N.Y. 2013) (explaining that "a plaintiff who transacts in a security despite having knowledge of the fraud cannot prove reliance").

Because Plaintiffs cannot address or correct this fundamental failure in their Section 10(b) claim, they instead focus on the issue of whether the OTC Bulletin Board on which CodeSmart shares are traded is a well-developed and efficient market. [D.E. 21 at 11-12.] According to Plaintiffs, a California District Court has found that a plaintiff can invoke the "fraud-on-the-market" reliance theory when the shares in question are traded on the OTC Bulletin Board. But that decision has no bearing here because Plaintiffs are not even attempting to show that *they* relied upon John Doe's allegedly false statements on the iHub Board. Because Plaintiffs admit they did not rely on the allegedly false statements, the question of whether the "fraud-on-the-market" reliance theory can be invoked when shares are traded on the OTCBB is now moot.[1]

Plaintiffs' disregard for controlling U.S. Supreme Court precedent demonstrates that their Section 10(b) claim is not colorable and that they have not properly invoked this Court's subject matter jurisdiction.

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[1] Moreover, the California decision, SEC v. Ficeto, 839 F. Supp. 2d 1101 (C.D. Cal. 2011), fails to defeat iHub's lack-of-reliance argument for a variety of reasons. First, the Ficeto decision never even mentions reliance. Second, the decision arises from an SEC claim, not a private cause of action. Because private rights of action are only implicit in Section 10(b), they are more narrowly construed than SEC claims. See Janus Capital Group, Inc. v. First Derivative Traders, -- U.S. --, 131 S.Ct. 2296, 2302 (2011). And third, whatever conclusion the California Court may have reached, this Court has found that the OTCBB is not the type of well-developed and efficient markets in which fraud-on-the-market reliance can be invoked. Alki Partners, L.P. v. Vatas Holdgin GmbH, 769 F. Supp. 2d 468, 493 (S.D.N.Y. 2011); Burke v. China Aviation Oil (Singapore) Corp., Ltd., 421 F. Supp. 2d 649, 653 (S.D.N.Y. 2005).

B. Plaintiffs Concede that They Have Not Alleged the "Materialization of Risk" Necessary to Plead Loss Causation.

Plaintiffs spend several pages of their Response arguing that they have properly pled loss causation because they allegedly have pled that their loss was "foreseeable" and was within the "zone of risk." According to Plaintiffs, this means they have pled that John Doe's statement was the "proximate cause" of their injury. [D.E. 21 at 15.] But the cases that Plaintiffs cite do not equate the loss causation analysis with a simple proximate cause analysis. Rather, those cases are in agreement with the cases that iHub cited in its Motion to Dismiss, and require something much more specific – materialization of the concealed risk.

As iHub explained in its Motion to Dismiss, Plaintiffs must plead not only that the market reacted in some way to John Doe's statements on the iHub Boards, but also that Plaintiffs' loss was caused by a "corrective disclosure" or "materialization of the concealed risk." See Wilamowsky v. Take-Two Interactive Software, Inc., 818 F. Supp. 2d 744, 751 (S.D.N.Y. 2011). In their Response, Plaintiffs rely on Lentell v. Merill Lynch & Co., 396 F.3d 161 (2d Cir. 2005), which makes precisely the same point: "[t]his Court's cases . . . require both that the loss be foreseeable *and* that the loss be caused by the materialization of the concealed risk." Id. at 173. For example, if a hypothetical plaintiff were to allege that a company concealed the fact that it was under-capitalized, and that concealed risk actually materialized (*i.e.*, the lack of capital ultimately caused the value of the company's shares to plummet), then that hypothetical plaintiff would properly have pled loss causation.

Here, Plaintiffs have not pled loss causation because they have not identified a concealed risk that ultimately materialized. Instead, they have alleged that John Doe falsely stated Plaintiff Salvani was "barred from the financial industry," "gets paid off with cash in a bag," and is engaged in a "pump n dump" scheme. [D.E. 14 ¶ 38.] In their Response, Plaintiffs try to dress

up these allegedly defamatory statements as the concealment of a risk: "the Defendants' misstatements were made in order to mislead investors into selling off their stock while *the truth* that would have prevented the sell-off *remained concealed*." [D.E. 21 at 18 (emphasis added).] It makes little sense to treat the allegedly defamatory statements about Salvani as the concealment of a risk about CodeSmart, but even if the Court were to treat them that way, Plaintiffs would still have to plead that the risk materialized, meaning that the truth about Salvani was revealed, and the price of CodeSmart shares therefore recovered. But Plaintiffs make no such allegation. Instead, they admit that the real facts "remain concealed." [Id.] Thus, they do not plead loss causation.

As iHub explained in its Motion to Dismiss, Plaintiffs' theory of liability more closely resembles those cases in which a plaintiff shows loss causation by pleading that a fraudulent statement was followed by a "corrective disclosure." [D.E. 19 at 8-9.] Indeed, this is the "more common way to plead loss causation." Wilamowsky, 818 F. Supp. 2d at 751. "Under this method, a plaintiff must tie his loss to the dissipation of an inflated (or deflated) price upon a disclosing event that reveals the false information to the market." Id. Here, Plaintiffs do not allege that a corrective disclosure or "disclosing event" ever occurred, nor do they allege that the deflated price of CodeSmart stock dissipated (*i.e.*, they do not allege that CodeSmart prices rebounded) after a corrective disclosure. To the contrary, they allege that the price of CodeSmart shares was $3.97 on September 6, 2013, and continued to drop down to $1.82 per share in November 2013. [D.E. 14 ¶¶ 47, 48.] Thus, Plaintiffs do not merely fail to allege the materialization of risk necessary to plead loss causation, they actually acknowledge that the materialization of risk did not occur. Once again, this admission demonstrates that the Section

10(b) claim is patently without merit and does not provide a basis for invoking federal question jurisdiction.

C. Plaintiffs' Section 9(a)(4) Claim is Not Colorable.

Plaintiffs' Section 9(a)(4) is equally without merit. As iHub showed in its Motion to Dismiss, to prevail on a Section 9(a)(4) claim, Plaintiffs must, at a minimum, plead that John Doe sold or offered to sell, or purchased or offered to purchase, CodeSmart shares. See 15 U.S.C. § § 78i(a)(4); Gulf Corp. v. Mesa Petroleum Co., 582 F. Supp. 1100, 1122 (D. Del. 1984) (explaining that Section 9(a)(4) defendant must be a seller or purchaser of the security). Plaintiffs must also plead that John Doe made a false or misleading statement about CodeSmart "for the purpose of inducing the purchase or sale" of the security. 15 U.S.C. § 78i(a)(4). Plaintiffs do not make these allegations.

Moreover, as Plaintiffs themselves acknowledge, to plead a Section 9(a)(4) claim, they must plead that they relied upon John Doe's allegedly defamatory statements on iHub's Board. [D.E. 21 at 19 (listing plaintiff's reliance as one of the elements of a Section 9(a)(4) claim).] As explained above, because Plaintiff Salvani knew the defamatory statements about him were false, he could not, as a matter of law, reasonably rely upon those statements. Thus, he cannot plausibly plead a Section 9(a)(4) claim. See, e.g., GAMCO Investors, Inc. v. Vivendi, S.A., 917 F. Supp. 2d 246, 253 (S.D. N.Y. 2013) (explaining that "a plaintiff who transacts in a security despite having knowledge of the fraud cannot prove reliance"); Ashland Inc. v. Morgan Stanley & Co., Inc., 700 F. Supp. 2d 453, 469 (S.D. N.Y. 2010) (same).

Plaintiffs added their Exchange Act claims to the Complaint only after they realized that they had no basis for invoking federal subject matter jurisdiction. The claims are frivolous and were added solely for the purpose of obtaining jurisdiction. Therefore, the Second Amended

Complaint should be dismissed for lack of subject matter jurisdiction. Arbaugh, 546 U.S. at 513 n.10.

II. Plaintiffs' State Law Claims Substantially Predominate Over Their Exchange Act Claims.

In the Motion to Dismiss, iHub argued that even if the Court found that it had subject matter jurisdiction over Plaintiffs' Exchange Act claims, it should decline to exercise supplemental jurisdiction over Plaintiffs' state law claims (defamation, libel per se, tortious interference, aiding and abetting defamation, intentional infliction of emotional distress, and injunctive relief) because the state law claims substantially predominate over the Exchange Act claims. Plaintiffs do not deny that the state law claims predominate. Instead, they cite In Re Methyl Tertiary Butyl Ether Products Liability Litigation, 613 F. Supp. 2d 437 (S.D. N.Y. 2009) ("In re MTBE"), and argue that the Court should not dismiss the state law claims unless doing so would promote economy, convenience, fairness, and comity.

The In re MTBE case involved both state and federal claims. Id. at 439. The defendants did not argue that the federal claims were frivolous, as iHub does here, but only that the Court should decline to exercise supplemental jurisdiction over the state law claims because they substantially predominated over the federal claims. Id. at 440. The Court agreed and dismissed the state law claims. Id. at 446. After concluding that the state law claims predominated, the Court considered whether declining to exercise supplemental jurisdiction would "promote the values articulated in Gibbs:[2] economy, convenience, fairness, and comity." Id. at 445. The Court concluded that dismissing the state law claims would promote these values, and the facts it relied upon to reach that result are striking similar to the facts in this case:

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[2] United Mine Workers of Am. v. Gibbs, 383 U.S. 715 (1966).

> these cases were filed a few months ago; no opinions or orders have issued in these cases; there has been no discovery; the Court is not familiar with the facts; and the defendants did not remove these cases to federal court. Further, if there was forum shopping in these cases, it was done by plaintiffs, who originally filed most of these actions without mentioning TSCA [the federal claims], then added TSCA claims only after it was pointed out to them that there was no federal jurisdictional base in their original Complaints.
>
> Because no judicial resources have been invested in these matters, the interests of economy and convenience in retaining supplemental jurisdiction are modest.

Id. at 445. The "economy" and "convenience" calculus is precisely the same in this case. The only judicial resources so far expended have been devoted to analyzing whether federal jurisdiction exists.

With respect to the next issue, "fairness," the In re MTBE Court explained that,

> [a]lthough this Court has gained familiarity with many surrounding legal issues, this Court has no familiarity with the facts alleged in these Complaints or with the unique legal issues that will arise in applying the law to these factual allegations. Further, in this Court's experience with this [multi-district litigation], novel and complex issues of state law never cease to arise. Notwithstanding my experience in this area of litigation, I have every confidence that the state tribunals will be able to handle these state law issues at least as well as they can be handled in the federal courts.

Id. The assessment of this case is the same. This Court does not yet have familiarity with any of the facts in this case, or with the unique legal issues that will arise in connection with the defamation, tortious interference, and emotional distress claims Plaintiffs are pursuing. There is no reason to believe that a state court could not fairly handle those claims.

Finally, comity also counsels in favor of permitting the state court to address these state law claims. Like the TSCA, the Exchange Act is a specialized and relatively narrow statute that does not displace state law. Id. The federal interest in Plaintiffs' defamation, tortious interference, and emotional distress claims is limited in comparison with the State's interest.

"Comity thus counsels in favor of allowing these state claims to proceed in state court." Id. at 446.

Conclusion

WHEREFORE, Defendant InvestorsHub.com, Inc. respectfully requests that the Court grant its Motion to Dismiss and dismiss the Amended Complaint for lack of subject matter jurisdiction.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that a true and correct copy of the foregoing document will be served by electronic service through the Clerk of the Court's CM/ECF filing system on Douglas R. Dollinger, Esq., Douglas R. Dollinger, Esq., P.C. & Associates, 50 Main Street, Suite 1000, White Plains, NY 10606 (info@ddollingerlaw.com). I further certify that the foregoing document will be mailed by first class mail, postage prepaid, to any parties that do not participate in the CM/ECF filing system.

Dated: March 31, 2014.

/s/ James J. McGuire