# 14-3994-cv

# United States Court of Appeals

*for the*

# Second Circuit

JOSEPH M. SALVANI, JFS INVESTMENTS INC.,

*Plaintiffs-Appellants,*

– v. –

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

*Defendants-Appellees.*

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

## BRIEF FOR PLAINTIFFS-APPELLANTS

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## CORPORATE DISCLOSURE STATEMENT

In accordance with Federal Rule of Appellate Procedure 26.1, Plaintiff Joseph M. Salvani appears in his individual capacity and on behalf of Plaintiff JFS Investments Inc., ("JFS") stating that JFS is a corporation organized under the laws of the State of Florida with its principal place of business in the State of Florida. There is neither a parent company to JFS, nor a publicly held corporation that owns 10% or more of its stock.

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## JURISDICTIONAL STATEMENT

The district court had federal question jurisdiction in this case under 28 U.S.C. § 1331, as Plaintiffs have asserted claims arising under the laws of the United States; specifically, causes of action involving federal questions related to Section 10b-of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 a), (b) or Rule 10b-5(c) thereunder [17 C.F.R. § 240.10b-5]; [15 U.S.C. § 78 i(a)(4)]. This Court has jurisdiction over this appeal from a final judgment of a district court under 28 U.S.C. § 1291.

## STATEMENT OF THE ISSUES

I. Did the district court err in dismissing Plaintiffs' claims for failure to state a claim where Plaintiffs have pleaded sufficient facts to establish that all of their claims were plausible?

This question should be answered in the affirmative.

## STATEMENT OF THE CASE

The matter before this Court presents principally a single question about the scope of federal securities laws and primary liability under § 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b), and Securities and Exchange Commission Rule 10b-5 ("Rule l0b-5"), and 17 C.F.R. § 240.10b-5. Resolution of the issue turns on the Court's determination of whether Plaintiffs' claims alleging that Defendants, as the webhost provider and secondary actors, can

be held jointly liable with Defendant brklynrusso as primary violators under § l0(b) of the Exchange Act and Exchange Rule 10b-5 for the portion of false statements made or created and attributed to iHub at the time of publication and which have caused financial injury to Plaintiffs. The district court already correctly concluded that it had subject matter jurisdiction, but incorrectly determined that Plaintiffs had failed to state a claim.

Plaintiffs-Appellants Joseph M. Salvani ("Salvani") and JFS Investments, Inc. ("JFS") Salvani and JFS commenced this action against Defendants ADVFN PLC and iHub.com (collectively, "iHub"), and John Doe ("brklynrusso"), and eventually filed a Second Amended Complaint ("SAC") asserting claims under the Securities Exchange Act, claims for common law defamation and libel, claims of tortious interference with contract, claims of aiding and abetting, claims of intentional infliction of emotional distress, and claims for injunctive relief. (A2-4, 6-41). iHub moved to dismiss under Rule 12(b)(1) and 12(b)(6). (A4, 43-65). Plaintiffs opposed the motion. (A4, 66-100). Defendants replied, reiterating their prior contentions. (A4, 101-111). The district court denied the motion to dismiss under Rule 12(b)(1), but granted it under Rule 12(b)(6). (A5, 112-137). The court then declined to exercise jurisdiction over Plaintiffs' remaining state-law claims. (A5, 136-137). Plaintiffs timely appealed. (A5, 138-139).

## STATEMENT OF THE FACTS

The following summary of the relevant facts is deemed true for purposes of this Motion to Dismiss:

Salvani is an individual residing in Florida. (A11). JFS is a Florida corporation through which Salvani does business. (A11). ADVFN is a United Kingdom corporation that is the parent company of its wholly owned subsidiary, iHub. (A11-12). ADVFN controls iHub's day-to-day operations and is vicariously liable for iHub's acts or omissions. (A11-12). iHub is a Missouri corporation that owns and operates the website iHub.com (the "Website"). (A12). Defendant brklynrusso is an unidentified individual that, upon information and belief, resides in New York. (A12). Throughout his career, Salvani has enjoyed a good reputation, both generally and in the financial community at large. (A13).

Salvani has worked as an investment advisor through JFS and other companies for over twenty-five years. (A13). At all times prior to September 5, 2013, Salvani was engaged by CodeSmart, a New York company, under a written consulting agreement. (A13). Under this agreement, Salvani advised and guided CodeSmart in its dealings with institutional and retail investors for purposes of raising more than $3 million in capital. (A13). Salvani and JFS were paid in cash and CodeSmart securities. (A13). Prior to September 5, 2013, Salvani was the lawful holder of CodeSmart (ticker symbol ITEN) securities. (A13). Upon

information and belief, brklynrusso is an individual investor of CodeSmart who knew of and was aware of the agreement between CodeSmart and Salvani/JFS. (A13-14).

iHub, under ADVFN's control and direction, has operated its Website as a service and content provider since at least 2006. (A14). It provided brklynrusso a membership/service agreement in New York. (A14). iHub generates revenue by soliciting paid-for memberships throughout the United States, including New York. (A14-15). iHub currently has approximately 250,000 members, including traders and other securities professionals. (A15). Most of these members pay for the privilege of making online posts on the Websites banner-specific headings related financial topics. (A15).

iHub generates these banner topics to seek public review and comment, claiming that the Website is "built to provide a forum for serious investors to gather and share market insights in a dynamic environment using an advanced discussion platform." (A15). iHub provides and develops or creates its own banners encouraging comments/authorship of posts, ratifying or otherwise adopting Member posts. (A16). This includes defamatory banners designed to invite defamatory comments or posts, or banners adopting Member posts containing defamatory content. (A16). Examples of content-specific defamatory banner headings employed by iHub include, but are not limited to, the following:

"Most Shady OTC/PK CEO's (CROOK)"; "Fighting the Crooked CEO's and/or the MM's that HELP THEM"; "Crooks, Frauds, Liars, and Banksters"; and "Crooked's Den of Self Actualization." (A16).

iHub limits the comments on the Website's message boards to subscription "Members," who must register and accept iHub's terms of service. (A15). These terms of service specify that a "Member" **must** "agree that you will not upload, share, post, or otherwise distribute or facilitate distribution of any comment … that: [i]s unlawful, threatening, abusive, harassing, defamatory, libelous, vulgar, hateful, deceptive, fraudulent, invasive of another's privacy, tortious, …" and so on. (A15-16). They do not require iHub to remove any content that violates the terms of service. (A16-17). iHub denies responsibility for any defamatory posts despite its awareness of Member policy violations in posting per se defamatory messages under its banner-specific defamatory headings, and refuses to disclaim the accuracy of the posts or otherwise advise the readers that the posts are not adopted by them. (A16-17). To respond to any Member post, iHub requires that the person become at least a non-paying Member and register and agree to its Membership Agreement. (A17).

In addition to membership revenues, iHub generates revenue by selling advertising on the Website. (A15). Through iHub's content-specific banners, under which it provides publications to its membership of "serious investors," the

Website has attracted easily recognized financial institutions involved in investment services, including, but not limited to, Chase Bank, eTrade, Fidelity, Charles Schwab, and TD Ameritrade. (A15).

On or about September 5, 2013, at 10:33 AM, brklynrusso posted the following to iHub's message board titled "CodeSmart Holdings, Inc. (ITEN)", and stating:

> **salvani was a former broker barred from the financial industry.** He now gets "consulting" jobs with OTC bulletin board co's that have no other means to raise money so he goes out w/ his cronies(brokers he knows)that promote the stock. How he gets paid? The brokers are given restricted stock which they subsequently sell **he gets paid off with cash in a bag.** The stock usually collapses w/
>
> little value once they have exited. Just google Joe Salvani:
>
> **[Emphasis added.]**
>
> http://www.forbes.com/forbes/1998/0504/6109174s1.html he works with this group out on LI and a broker Daniel welsh or walsh from garden state securities who also get stock in all of salvanis deals. they get stock as an advisor for pretty much doing nothing....its a total joke and im shocked the sec hasn't knocked on their door yet. as for ITEM, 35k rev losing 2mil ayr w/ a 50mil mkt cap....you tell me if this is a real px at 4**? pump n dump at its best [Emphasis added.]**

(A17-18). Upon information and belief, brklynrusso is a paying member of IHub and an investor in CodeSmart, who can and did post the per se defamatory statement about Salvani in order to injure Salvani and manipulate ITEN's stock price in the market, knowing that the defamatory post would be read by serious investors, traders, and other securities professionals. (A18). Member brklynrusso

disseminated this false rumor through the Website's message board fully knowing, by reason of the defamatory content-specific boards and invited per se defamatory banner headings that his post would be published and read by traders and other securities professionals as evincing criminal wrongdoing by Salvani/JFS. (A18). iHub disseminated this false rumor through the Website's message board without disclaimer, and with full knowledge by reason of the defamatory content-specific boards and invited per se defamatory banner headings that this post would be published and read by traders and other securities professionals as evincing criminal wrongdoing by Salvani/JFS. (A18).

Shortly after the defamatory post, the false rumors spread rapidly across Wall Street. (A19). The media and various subscriber-based news services quickly picked up the post and further disseminated it throughout the marketplace. (A19). The brklynrusso post was material and was intended to harm Salvani/JFS. (A19). It was entirely false, and brklynrusso knew it to be false when made. (A19). He intended the post to injure Salvani in his profession and his ownership interest in ITEN. (A19). In the alternative, brklynrusso knew, or was reckless in not knowing, that the rumor he fabricated and disseminated was false and misleading and would injure Salvani in his profession and his ownership interest in ITEN. (A19). iHub's creation and publication of defamatory banners and headings and in its business practices of disregarding its own policy prohibiting

offensive conduct were material to causing Salvani's injuries. (A19). iHub knew or should have known that, without a full and proper disclaimer, the post would harm Salvani by evincing a knowledge of a "pump and dump" scheme that would cause him injury in his profession and in his ownership interest in ITEN. (A19).

On or about August 30, 2013, shortly before brklynrusso began disseminating the false pump and dump rumor, ITEN stock began to trade in unanticipated and unexplained volumes, experiencing trading at losses, and evincing signs of stock manipulation. (A19-20). On August 30, 2013, ITEN stock was valued at $4.60 per share. (A20). It then experienced a steep decline from September 6, 2013 through September 10, 2013, falling from $3.97 per share to $3.05 per share. (A20). This was an almost twenty-five percent decline in just two trading days. (A20). Over the next several days, ITEN shares further declined, from $2.13 per share and down to $1.82 per share by November 12, 2013. (A20).

Salvani's ITEN shares were traded during this period. (A20). But for the false brklynrusso post and its dissemination, Salvani would not have experienced actual losses in his trades. (A20). The post referred to Salvani by name throughout, was made about him and concerning him, and was understood by those who read it to reflect and convey the appearance that Salvani was a criminal, thus impugning his reputation and character in his occupation as a financial advisor. (A20). The entire statement was false, defamatory, and libelous on its face and it

pertains to Salvani in his occupation. (A20). The post exposed and continues to expose Salvani to hatred, contempt, ridicule, and obloquy because it taints him in his profession as having been a "broker" prosecuted and "barred" from the financial industry. (A21).

It is commonly known by most "serious investors" that the only lawful powers that can ban or bar an individual from the financial industry would come from a finding of fact by a lawful tribunal that could issue an order enjoining or prohibiting Salvani from engaging in financial transactions, including, but not limited to, the SEC, FINRA, or a court of competent jurisdiction. (A21). There are no such orders, decrees, or judgments against Salvani or JFS, nor have any ever existed. (A21). Defendants knew and were aware of this fact. (A21).

Moreover, the post falsely accuses Salvani of engaging in stock manipulations involving CodeSmart. (A21). CodeSmart is a public company, listed on the OTCBB under ticker symbol ITEN. (A21). It identified Salvani and "brokers he knows" and accused him of engaging in a pump and dump scheme with these "brokers." (A21). Salvani is not, and has never claimed to be, a broker. (A21). Nor has he ever engaged in any of the activity claimed in the post. (A21).

Salvani discovered the post on September 5, 2013 and made a formal written demand on iHub that it be removed. (A22). He explained that it was unlawful and defamatory. (A22). On September 9, 2013, iHub refused to remove the post,

despite its per se defamatory nature, directing Salvani to obtain a court order and claiming a right "not to make value judgments on the veracity" of its Member's posts. (A22). The post has appeared continuously on the Website since September 5, 2013, and continues to be read and seen by the public. (A21-22).

iHub is a "content provider" under ADVFN's actual or constructive control, providing and publishing its own comments/authorship and in ratifying or otherwise adopting per se defamatory postings by creating message boards with defamatory banner headings. (A22-23). iHub, under ADVFN's actual or constructive control, engaged in and materially contributed to the unlawfulness of the post. (A23). They have expressly participated in the development of the per se defamatory statements by enhancing the Post by providing defamatory content-specific banners that intentionally invited comment and assisted in providing specific and targeted matters related to the financial industry in support of its stated purpose "… to provide a forum for serious investors to gather and share market insights in a dynamic environment using an advanced discussion platform …" (A23). The headings lack a proper disclaimer or disclosure that the Posts are not adopted by iHub and are intended to expose the targeted individuals to hatred, contempt, ridicule, and obloquy in most instances in their profession. (A23). By reason of the content-specific defamatory published banner headings, absent any disclaimer or disclosure, iHub invited Members to post intended per se defamatory

subject matter on the Website. (A23). As a result, iHub's message boards have been filled with invited membership comments expressly encouraging defamatory Posts publically defaming individuals with comments as described above, and in particular, those statements made about Salvani. (A23-24). At all times, iHub uses moderators to screen Membership Posts and remove anything that it deems, in its exclusive opinion and discretion, is offensive content. (A24). It claims that these screeners are used to "promote the civil exchange of on-topic dialog that complies with the iHub's Terms of Service," as stated in iHub's User and Moderator Handbook." (A24). The Handbook states that "In short, the role of the Moderator is to help foster an environment that promotes and encourages posting of ALL opinions and information about companies, regardless of the bullish or bearish sentiment of the posts, and to be the site's first line of defense in ensuring [they] remain free of spam, vulgarity, and personal attacks." (A24) (emphasis added). iHub's moderators have the ability to delete posts. (A24). iHub has more than 17,000 active boards, each of which may have one or more moderators. (A24). Currently, 6,802 of the boards have at least one moderator. (A24). At least 4,317 iHub Members volunteer as moderators on one or more boards. (A24).

Thus, iHUb's created and published content-specific banner headings inviting comment directed at "Most Shady OTC/PK CEO's (CROOK)"; "Fighting the Crooked CEO's and/or the MM's that HELP THEM"; "Crooks, Frauds, Liars,

and Banksters"; and "Crooked's Den of Self Actualization," without a disclaimer or disclosure. (A25). This is juxtaposed against its policy of not removing posts based on "value judgments as to the veracity of user-posted content," together with its refusal to remove the defamatory Post after receiving notice that it is untrue. (A25). Thus, iHub has created, developed, and otherwise encouraged an environment that the Website is a "lawless no-man's land" by way of its developed and adopted message content-specific banners on the Website and its omission of critical information concerning the sale of securities. (A25).

Thus, the iHub Membership consists entirely of Members who have been invited to post, and who understand and agree that no matter what content they post, iHub is under no obligation to remove a post and will be immune from liability. (A25). By doing so, iHub has encouraged and otherwise engaged in development of a business practice of comment-publication involving defamatory allegations as the core of its content in attracting membership and readers engaged in the sale/purchase of securities. (A25). iHub has made it clear to all its Members and users and to the public that defamatory comments are not only invited, but are adopted and ratified. (A25-26). As such, iHub has engaged in a materially misleading business practice, deceptive conduct, a manipulative act, and a device/scheme or artifice in favor of its members and against the public, where the content-specific banners inviting comment operates as a fraud and deceit on the

public. (A26). This unlawful practice has increased user activity, which draws sponsors and paid advertisers and results in additional income to iHub. (A26-27).

iHub's mandate forcing Salvani to respond to the defamatory Post with a rehabilitating comment of his own, only after accepting the oppressive clause in the Website's Terms of Service that iHub will have no obligation to remove the source of the defamation contradicts its claim that posting on the Website "merely requires that such person fill out the on-line registration form and create a login name, alias (or screen name), and password" and is further proof of its control of the content. (A27). The defamatory Post has, at all times, via the manner it was presented and with the intent to present "market insights" has directly affected Salvani's and JFS's ability to participate in and perform the agreement with CodeSmart and others. (A27).

Salvani and JFS commenced this action against Defendants, asserting claims under the Securities Exchange Act, claims for common law defamation and libel, claims of tortious interference with contract, claims of aiding and abetting, claims of intentional infliction of emotional distress, and claims for injunctive relief. (A6-41). iHub moved to dismiss, claiming that Plaintiffs' federal claims were not colorable and that his state-law claims predominated. (A43-65). Plaintiffs opposed, explaining that iHub is a primary violator under Section 10b and SEC Rule 10b-5, that they had pleaded facts establishing liability under those sections,

and that their Section 10b reliance and fraud-on-the-market claims were colorable. (A66-100). They continued that they were not required to plead direct reliance because Defendants intentionally created per se defamatory banner headings. (A66-100). Plaintiffs further demonstrated that their Section 9(a)(4) claim was colorable, and that their state law claims did not predominate because the claims were related to the same case or controversy. (A66-100). They also confirmed that the Communications Decency Act, 47 U.S.C. § 230, did not apply. (A66-100). Defendants replied, reiterating their prior contentions. (A101-111).

The district court granted the motion to dismiss. (A112-137). The court agreed that the claims were colorable, and therefore denied the motion to dismiss for lack of subject matter jurisdiction. (A118-123). It concluded, however, that Plaintiffs had failed to state a claim because they had failed to plead reliance under a fraud-on-the-market claim and loss causation. (A123-136). The court then declined to exercise jurisdiction over Plaintiffs' remaining state-law claims. (A136-137). Plaintiffs timely appealed. (A138-139).

## SUMMARY OF THE ARGUMENT

The order appealed from should be reversed and Plaintiffs' claims reinstated because they have stated plausible claims in their SAC. iHub is a primary violator under Section 10b and Rule 10b-5. As such, it and ADVFN can be held liable here. Plaintiffs have pleaded sufficient facts in their SAC to establish all of the

elements of a Section 10b and Rule 10b-5 claim. Because Defendants intentionally created per se defamatory banner headings, Plaintiffs were not required to plead direct reliance on the misstatements in an open and developed market. The OTCBB is an open and well-developed market covered by the Exchange Act, and Plaintiffs may rely upon the presumption of reliance. Plaintiffs have also properly pleaded loss causation, loss foreseeability, and causation under the "zone of risk" or "same subject" test. Plaintiffs have also properly pleaded a Rule 9(a)(4) claim, and their claims are plausible. Lastly, Plaintiffs' state law claims do not predominate.

## ARGUMENT

### I. STANDARD OF REVIEW.

When reviewing a Fed R. Civ. P. 12(b)(6), the court must "tak[e] all factual allegations in the [verified] complaint as true and constru[e] all reasonable inferences in favor of plaintiffs." *Conboy v. AT&T Corp.*, 241 F.3d 242, 246 (2d Cir. 2001) (citing *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957); *Absolute Activist Value Master Fund LTD v. Ficeto*, 677 F.3d 60, 65 (2d Cir. 2012). In order to survive a motion to dismiss, "a complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quotations and citations omitted). A claim is plausible on its face "when the plaintiff pleads factual content that allows the court

to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.*

A Rule 12(b)(6) dismissal "is inappropriate unless it appears beyond doubt, even when the complaint is liberally construed, that the plaintiff can prove no set of facts which would entitle [them] to relief." *Sec. Investor Prot. Corp. v. BDO Seidman, LLP*, 222 F.3d 63, 68 (2d Cir. 2000). Dismissal is not warranted unless "no relief could be granted under any set of facts that could be proved consistent with die allegations." *Hishon v. King & Spalding*, 467 U.S. 69, 73 (1984).

A complaint alleging securities fraud must also satisfy the heightened pleading requirements of Federal Rule of Civil Procedure 9(b) and the Private Securities Litigation Reform Act of 1995 ("PSLRA") by stating the circumstances constituting fraud with particularity. *See, e.g., ECA & Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co.*, 553 F.3d 187, 196 (2d Cir. 2009) (citing *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 (2007)). These requirements apply whenever a plaintiff alleges fraudulent conduct, regardless of whether fraudulent intent is an element of a claim. *Rombach v. Chang*, 355 F.3d 164, 170 (2d Cir. 2004) ("By its terms, Rule 9(b) applies to 'all averments of fraud.'" (quoting Fed. R. Civ. P. 9(b))).

Specifically, Rule 9(b) requires that a securities fraud claim based on misstatements must identify: (1) the allegedly fraudulent statements, (2) the

speaker, (3) where and when the statements were made, and (4) why the statements were fraudulent. *See, e.g.*, *Anschutz Corp. v. Merrill Lynch & Co., Inc.*, 690 F.3d 98, 108 (2d Cir. 2012) (citing *Rombach*, 355 F.3d at 170). Conditions of a person's mind—such as malice, intent or knowledge—may be alleged generally, however. *Kalnit v. Eichler*, 264 F.3d 131, 138 (2d Cir. 2001) (citing Fed. R. Civ. P. 9(b)). Like Rule 9(b), the PSLRA requires that securities fraud complaints "'specify' each misleading statement," set forth the reasons or factual basis for the plaintiff's belief that the statement is misleading, and "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 345 (2005). These heightened pleading standards, when viewed together with the more general standards applicable to Rule 12(b)(6) motions to dismiss, make clear that "plaintiffs must provide sufficient particularity in their allegations to support a plausible inference that it is more likely than not that a securities law violation has been committed." *In re Lululemon Sec. Litig.*, No. 13 Civ. 4596 (KBF), 2014 WL 1569500, at *9 (S.D.N.Y. Apr. 18, 2014) (citing *ECA & Local 134 IBEW*, 553 F.3d at 196).

(quoting 15 U.S.C. §§ 78u–4(b)(1), (2)); *see also, e.g.*, *Slayton v. Am. Express, Co.*, 604 F.3d 758, 766 (2d Cir. 2010).

## II. THE ORDER APPEALED FROM SHOULD BE REVERSED BECAUSE PLAINTIFFS HAVE STATED PLAUSIBLE CLAIMS IN THEIR SECOND AMENDED COMPLAINT.

### A. iHub is a Primary Violator Under the Exchange Act l0b and SEC Rule 10b-5.

Based on the overall content of the statements Plaintiffs have presented colorable claims sounding in facts which show that defendant iHub's own banner headings and participation in the creation of brklynrusso statements was attributable to iHub as a primary violator for securities fraud at the time of publication and not simply an aider and abettor.

The distinction between primary liability under Rule 10b-5 and aiding and abetting is fundamental in this case for the reason that the Supreme Court has concluded that "the 1934 [Exchange Act] does not itself reach those who aid and abet a § 10(b) violation. *Central Bank v. First Interstate Bank,* 511 U.S. 164, 114 S.Ct. 1439, 128 L.Ed.2d 119 (1994). Notwithstanding the Supreme Court's holding that Rule 10b-5 liability does not extend to aiders and abettors, the Court acknowledged that "secondary actors" could, in some circumstances, still be liable for fraudulent conduct. *Id.* at 191.

The Court explained that "[a]ny person or entity … who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5 assuming all of the requirements for primary liability under Rule 10b-5 are

met. *Id.* This Circuit holds that a secondary actor can be held liable in a private damages action brought pursuant to Rule 10b-5(b) for false statements attributed to the secondary-actor at the time of dissemination. A claim under § 10(b) must allege a defendant has made a material misstatement or omission indicating an intent to deceive or defraud attributable to the defendant. *Central Bank, supra*.

Putting a working definition behind the *Central Bank* holding means a defendant must actually make a false or misleading statement in order to be held liable under Section 10(b). "Anything short of such conduct is merely aiding and abetting, and no matter how substantial that aid may be, it is not enough to trigger liability under Section 10(b)." (quoting *In re MTC Elec. Techs. Shareholders Litig.*, 898 F. Supp. 974, 987 (E.D.N.Y. 1995).

The test used to determine a right to private securities litigation liability against secondary actors is set forth in *Shapiro v. Cantor*, 123 F.3d 717 (2d Cir. 1997). In applying a test the Second Circuit has adopted the bright line" analysis to distinguish between primary violations of Rule 10b-5 and aiding and abetting. The Court outlined the "bright line" approach, holding that "a secondary actor cannot incur primary liability under [Rule 10b-5] for a statement not attributed to that actor at the time of its dissemination." *Id.*

While the "[t]he mere identification of a secondary actor as being involved in a transaction, or the public's understanding that a secondary actor "is at work

behind the scenes" are alone insufficient … [to] be cognizable, a plaintiffs claim against a secondary actor … based on that actor's own 'articulated statement,' or on statements … explicitly adopted by the secondary actor are actionable". *Lattanzio,* 476 F.3d at 155.

In this case the claims meet the bright line standard for the reason as alleged in the SAC the banner headings presented 011 the iHub Website are specific and attributable to iHub at the time of the postings dissemination with iHub being liable as a primary violator to Plaintiffs for their damages.

### B. Plaintiffs have Pleaded Facts Establishing Liability Under the Exchange Act l0b and SEC Rule 10b-5.

To maintain a private damages action under § 10(b) and Rule 10b-5, a plaintiff must prove: (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation. *Stoneridge mv. Partners, 552* U.S. at 157 (citing *Dura Pharm., Inc. v. Broudo,* 544 U.S. 336, 341-42 (2005). Plaintiffs' SAC meets and exceeds the pleading requirement necessary to establish each of the foregoing elements.

### C. Plaintiffs' 10(b) Reliance and their Fraud-on-the-Market Claims Are Colorable.

By way of their Motion Defendant iHub argues that the Court lacks subject matter jurisdiction for the reason that even if the factual statements are taken as

true the complaint lacks the facial sufficiency necessary to create the relationship between the proof needed to maintain a cause of action involving material misrepresentations, scienter and reliance on the misrepresentation claimed, loss causation, economic loss, corrective disclosure and material risk so as to produce a violation of Rules § 10(b) and 10b-5 and damages attributable to them.

### D. Where Defendants Intentionally Created Banner Headings of a Per Se Defamatory Nature Plaintiffs Need Not Plead Direct Reliance on the Misstatements in an Open and Developed Market.

Plaintiffs invoke the presumption of reliance doctrine based on their fraud-on-the-market theory adopted in *Basic*, 485 U.S. at 241-42, 108 S. Ct. 978 (reliance of investors on misrepresentations is presumed where market for securities is open and developed). And, "where the success of a fraud does not require an exercise of violation by the plaintiff, but instead requires an exercise of volition by other persons, there need be no showing that the plaintiff himself relied upon the deception.') (citing *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 797 (2d Cir. 1969), *cert. denied, 400 U.S.* 822 (1970»; *Vine v. Beneficial Fin. Co.*, 374 F.2d 627, 635 (2d Cir.) ("Whatever need there may be to show reliance in other situations [citing *List* and other cases], we regard it as unnecessary in the limited instance when no volitional act is required and the result of a forced sale is exactly that intended by the wrongdoer."), *cert. denied*, 389 U.S. 970 (1967).

Defendant in support of their arguments point to the lack of any direct reliance claims on any material misrepresentations asserted by Plaintiffs and generally dismiss the Plaintiffs' fraud-on-the-market theory, arguing that ITEN is an OTC stock which does qualify as a securities regulated under the Securities laws and Regulations invoking the defenses that Rules § 10(b) and 10b-5 are inapplicable to their conduct.

Defendants present two cases in support of the argument where "this Court has already distinguished the OTCBB from well-developed markets" *Alki Partners, L.P. v. Vatas Holding GmbH,* 769 F. Supp. 2d 468, 493 (S.D.N.Y. 2011), further citing that "the Court is unaware of any court holding that the OTCBB ... meet[s] this ... standard.") and *Burke v. China Aviation Oil (Singapore) Corp., Ltd.,* 421 F. Supp. 2d 649, 653 (S.D.N.Y. 2005) (same).

Defendant ignores however, that the SEC has successfully argued that reliance is satisfied where the case involves securities traded on the over-the-counter securities market. *SEC v. Ficeto,* No. 11 Civ. 1637 (GFIK), 2011 U.S. Dist. LEXIS 150141, at *31 (C.D. Cal. Dec. 20, 2011) (holding *Morrison v. National Australia Bank Ltd.,* 130 S. Ct. 2869 (2010), "did not purport to overturn the universally accepted principle that § 10(b) applies with equal force to market manipulation on national exchanges and the domestic over-the-counter market").

*Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010). In the cases cited by Defendants, those courts were likely unaware of the *Ficeto* holding:

> 'The Exchange Act's stated purpose is '[t]o provide for the regulation of securities exchanges *and of over-the-counter markets* operating in interstate and foreign commerce[.]" Securities Exchange Act of 1934,48 Stat. 881 (1934) (emphasis added) cited in (*Ficeto*). The Act's Senate Report likewise noted the "unorganized 'over-the-counter' markets" that the hill addressed and that it was "vitally necessary" to provide the Commission with authority "to subject [over-the-counter markets] to regulation similar to that prescribed for transactions on organized exchanges." S.Rep. No. 73-792, at 6 (1934). Thus, the textually grounded purpose of the Act is to treat securities traded on the domestic over-the-counter market (for example, via the OTCBB and Pink Sheets) similar to securities traded on national exchanges, having drawn no distinction in articulating the need to regulate both." (*Ficeto*).

Based on the holding in *Ficeto* and the Congressional intent referenced therein, the Court should find that the OTCBB is an open and well developed market covered by the Exchange Act and that Plaintiffs' may rely on the presumption of reliance doctrine.

*1. Plaintiffs Have Properly Pleaded Loss Causation.*

Notwithstanding, Defendants claimed lack of specific allegations related to the loss causation facts at play in this case, the Second Circuit refrains from specifying a pleading stringency for loss causation, and instead states that "loss causation is a fact based inquiry and the degree of difficulty in pleading will be affected by circumstances[.]" *Lentell v. Merill Lynch & Co.*, 396 F.3d 161, 173 (2d Cir. 2005)). Moreover, "[ ... ] if the loss was caused by an intervening event, like a

general fall in the price of Internet stocks, the chain of causation is a matter of proof at trial and not to be decided on a Rule 12(b)(6) motion to dismiss." *Einergent Capital v. Stonepath Group Inc.*, 343 F.3d at 197." *Id*.

The SAC expressly addresses the change in price, Plaintiffs' allegations are consistent and provide claims in support of all of the elements required to satisfy the 10(b)-10b-5 and the intervening events. Defendants mistakenly argue that the reliance plausibly causing the damages and sale by Plaintiffs alleged in the SAC is claimed to be the result of what brklynrusso posted on the iHub Board and that it was impossible to rely on the posting as Plaintiff knew better.

Clearly, the claim is not that the Plaintiff relied himself on the false information which caused the damages and the ITEN stock price to fall, this is Defendants' theory not Plaintiffs'. By maintaining their own theory of the ease, Defendants are left to speciously and freely argue that the lack of "Corrective Disclosure" and "Materialization of the Risk" were absent in support of the claims for market adjustment to show a loss.

This, however, is not the theory of Plaintiffs' case. Plaintiffs allege that Defendants intentionally developed and published pro se defamatory statements on the iHub Boards causing other investors to sell off their shares of CodeSmart, thereby plunging the price of the stock and causing the loss to the Plaintiffs.

Plaintiffs' theory, a theory universally accepted by the courts, allows Plaintiffs to prove loss causation differently than the manner Defendants assert is required.

Moreover, any claim requiring Plaintiffs to meet the corrective disclosure or materialization of risk standards is marred in the control of die postings attributable to iHub. Plaintiffs requested that corrective action be taken and Defendant iHub refused to provide any type of retraction or even a disclaimer.

The Court's attention is directed to *In re Omnicom Group, Inc. Securities Litigation,* where that court held:

> Use of the term … 'Loss causation' may … refer to the requirement that the wrong for which the action was brought **is a but-for cause or cause-in-fact** of the losses suffered, also a requirement for an actionable Section 10(b) claim. *Dura Pharms.*, 544 U.S. at 342, 125 S.Ct. 1627; see also 15 U.S.C. § 78u-4(b)(4) … In short, **plaintiffs must show 'a sufficient connection between the fraudulent conduct and the losses suffered.'** *Lattarizio v. Deloitte & Touche LLP*, 476 F.3d 147, 157 (2d Cir. 2007). This requirement exists … to protect them against those economic losses that misrepresentations actually cause.' *Dura Pharms.*, 544 U.S. at 345, 125 S.Ct. 1627." *In re Omnicom Group, Inc. Securities Litigation*, 597 F.3d *501* (2d Cir. 2010)." **[Emphasis added.]**

The Second Circuit applies a two-part loss causation test, requiring that the **loss be foreseeable** and that the intended misrepresentation be **within** a **Zone of risk** concealed.

"We have described loss causation in terms of true tort-law concept of proximate cause, i.e., 'that the damages suffered by plaintiff must be a foreseeable consequence of any misrepresentation or material omission,' *Einergent Capital,*

343 F.3d at 197 (quoting *Castellano v. Young & Rubicam,* 257 F.3d 171, 186 (2d Cir. 2001)); [ ... ]

Put another way, a misstatement or omission is the 'proximate cause' of an investment loss if the risk that caused the loss was within the zone of risk concealed by the misrepresentations and omissions alleged[.] See *A USA Lift Ins. Co. v. Ernst & Young* 206 F.3d 202, 238 (2d Cir. 2000) (Winter, J., dissenting)." *Lentell v. Merill Lynch & Co.,* 396 F.3d 161, 173 (2d Cir. 2005).

There can be little doubt iHub, a claimed leader in market investment information (A15) intended to create the banner headings and content specific boards without disclaiming the postings and ratified or adopted posting; the banner heading and content specific boards are within the zone of risk created where the statements were material and were the proximate cause of the Plaintiffs' loss. At the very least the matter is a question of fact and not a question of law.

*2. Loss Foreseeability Has Been Properly Alleged.*

To prove that the loss was foreseeable, the Plaintiffs have alleged that Defendants could reasonably foresee that inviting and developing content headings expressing a criminal nature that was defamatory per-se to the targeted victim and subsequently published on a board dedicated to a particular stock caused a sell-off of that stock and thereby caused a financial loss to Plaintiffs who own that stock.

Here, as pleaded the Plaintiffs' SAC alleges that the Defendants failed to disclaim, and intentionally developed-created its own per se defamatory banners encouraging the comment-authorship, ratifying and otherwise expressly adopting per se defamatory posts by its members allowing postings to be made using message boards created by them and containing content-specific banner headings such as "Most Shady OTC/IPK, CEO's CROOK" "Fighting the Crooked CEO"s and/or the MM's that HELP THEM", "Crooks, Frauds, Liars, and Banksters", and "Crooked's Den of Self Actualization".

Under the circumstances, iHub's conduct was intentional-foreseeable and an adoption of the posting without a disclaimer and/or connection action taken to the statements that "**salvani was a former broker barred from the financial industry … he gets paid off with cash in a bag …** [and that] **this is a real … pump n dump at its best**. (A17-18) (emphasis added).

The SAC clearly provides that brklynrusso's comments were invited, developed, adopted, and ratified by the Defendant iHub where the trading volume for shares of CodeSmart Holdings, Inc. increased dramatically and the stock price fell by almost twenty-five percent in two days of trading. The loss to the Plaintiffs included the decreased value of the shares held by the Plaintiffs as well as the loss in value of the contracts that were not performed between ColdSmart and the

Plaintiffs as a result of the posting. Based on these facts, this Court should find that Plaintiffs can satisfy the "foreseeability of the loss" element of the test.

*3. "Zone of Risk" or Same "Subject" Test.*

The second part of this Court's loss causation test is the "zone of risk" or same "subject" test. *Lentell v. Merill Lynch & Co.*, 396 F.3d 161, 173 (2d Cir. 2005). In *Lentell,* the court defamed the "zone of risk" test as: "[A] misstatement or omission is the 'proximate cause' of an investment loss if die risk that caused the loss was within the zone of risk concealed by the misrepresentations and omissions alleged by a disappointed investor." *AUSA Life Ins. Co. v. Ernst & Young,* 206 F. 3d 202, 238 (2d Cir. 2000) (Winter, J, dissenting) cited *Lentell*.)

The court also defined the "subject" approach: "[T]o establish loss causation, 'a plaintiff must allege that the subject of the fraudulent statement or omission was the cause of the actual loss suffered,'" *Suez Equity Investors, L.P. v. Toronto Dominion Bank,* 250 F.3d 87, 95 (2d Cir. 2001) (emphasis added) cited in *Lentell.*

Defendants argue that that the conduct complained of did not have the effect of causing shareholders to refrain from market sales. However, the argument offered is misplaced. The facts in the instant case are distinct from the facts in *Dura* and its progeny in that this is not a case where the Defendants' misstatements were made in order to mislead investors into buying or holding onto their stock while the risk remained concealed. To the contrary, 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.

Under the latter, the zone of risk is not concealed, and thus the Defendants' argument that Plaintiffs cannot prove loss causation under the Second Circuit's test. However, to accept this argument would be to suggest that there is a difference in causation between telling an audience in a crowded movie house that there isn't a fire when there actually is and telling the audience there is a fire when there actually is not.

In the instant matter, the court must therefore look to the "subject" test and consider whether the subject of the fraudulent statement, that the Salvani was a disbarred broker involved in a "pump and dump" scheme, was the cause of the actual loss suffered by the Plaintiffs.

Plaintiffs have sufficiently pleaded reliance and loss causation and have shown the court that these claims are neither frivolous nor insubstantial. Plaintiffs have not asserted 10(b) and 10(b)(5) claims merely for the purpose of manufacturing subject matter jurisdiction as the Defendants claim. These claims are colorable and this Court has jurisdiction over them.

Therefore the SAC should not be dismissed for lack of subject matter jurisdiction or for failure to state a cause of action under Fed. R. Civ. P. 12(b)(6).

**E. Plaintiffs' Section 9(a)(4) Claim is Colorable.**

Defendants contend that "where a plaintiffs' Section 10(b) claim fails, their Section 9(a)(4) claim also "necessarily fails." In support of their claim they argue that a 10(b) cause of action "requires no additional proof of acts" but they assert that there exist a higher burden of proof beyond 10(b) when compared to subsection 9(a)(4). Indeed, Rule 10b-5 allows for a lower standard of proof than does subsection 9(a)(4). *Chemetron Corp. v. Business Funds, Inc.*, 682 F.2d 1149, 1162 (5th Cir. 1982), rev'd on other grounds, 460 U.S. 1007 (1983)).

"Subsection 9(a)(4), as privately enforced through subsection 9(e), requires: (1) a misstatement or omission (2) of material fact (3) made with scienter (4) for the purpose of inducing a sale or purchase of a security (5) on which the plaintiff relied (6) that affected plaintiffs purchase or selling price. [The court] thus perceive that the implied cause of action under Rule 10b-5(b) and the express remedy of subsection 9(a)(4) differ in at least three respects, scienter, intent to induce a purchase or sale, and causation." See *Chemetron* at 1161-1162.

*1. Scienter.*

"While Rule 10b-5 permits recklessness to fulfill its scienter requirement […] section 9(a)(4) and (e) and its legislative history do not permit [a court] to loosen its scienter requirement by permitting recklessness to suffice." *See* S.Rep.No.792, 73d Cong., 2d Sess. 17 (1934), *reprinted in 5 Ellenberger &*

*Mahar, Item 17; H.R.Rep.No.* 1383, 73d Cong., 2d Sess. 20 (1934), *reprinted in 5 Ellenberger & Mahar,* Item 18 cited *in Chemetron,* at 1162.

The Court's attention is directed 10 the SAC's specific language concerning iHub's intent. Plaintiffs never exclusively allege that Defendants' conduct was solely reckless, in fact, the opposite is true, the allegations are and the facts support the Defendants conduct was intentional.

Plaintiffs allege that brklynrusso intentionally posted the defamatory statements causing the sell-off of CodeSmart stock and that iHub intentionally and knowingly ratified and adopted the Post after refusing to remove it once Salvani notified iHub of its per se defamatory nature. And, for the reason that the allegations involve intentional awareness, the conduct complained of satisfies the scienter requirement.

*2. Intent to Induce.*

"While one may intend to do a fraudulent act thereby fulfilling Rule 10b-5(b)'s scienter requirement, die intent that that act *induce a purchase or sale* is a distinct and more specific requirement." *Chemetron* at 1162. Plaintiffs claim that Defendants' intent was to induce a sell-off of CodeSmart stock and have provided the timeline of events coinciding with the declining price of the shares in factual support of this claim. This Court should find this sufficient to satisfy the

requirement of the act to "induce a purchase or sale", acts which are be attributed to iHub by reason of its conduct and awareness of the activities of brklynrusso.

*3. Causation.*

Subsection 9(a)(4)'s causation standard is also a higher standard, hut again Plaintiffs have met their burden. Plaintiffs' purchase or sale price must be "affected" by the conduct complained of, while "the causation requirement is satisfied in a Rule 10b-5 case if the misrepresentation *touches upon* the reasons for the investment's decline in value.' *Huddleston v. Hennan*, 640 F.2d at 549 (emphasis added)." *Chemetron* at 1162.

The distinction here, is that the Plaintiffs allege that, by reason of the material misstatements, iHub invited, made, developed, ratified, and adopted the Post which "affected" the price of CodeSmart stock. Indeed, Plaintiffs provided the facts which directly support the 9(a)(4) causation standard.

Plaintiffs have met the burden for their 10(b) claims and the 9(a)(4) claim. Therefore, the Court should find the 10(b) and 9(a)(4) claims are colorable.

*4. Plaintiffs' Claims are Plausible.*

Defendant argues that Plaintiffs lack a legitimate basis for asserting claims under the Exchange Act because Plaintiffs have no knowledge about these issues and the SAC contains no factual allegations concerning John Doe's possible sale or purchase of CodeSmart shares. The facts are to die contrary, Plaintiffs SAC alleges

that "Plaintiffs are informed and believe that brklynrusso was and/or is a paying member of the Website and an investor with CodeSmart who can and did post the per se defamatory statement concerning Salvani intending to injure him and manipulate ITEN's stock price in the market by reason and use of the defamatory per se banners attributable to iHub at a time where they failed to disclaim the comments and fully knowing and intending that the post would be read by serious investors, traders and other securities professionals."

This Court, in *Arista Records LLC v. Doe 3*, held that the plausibility standard set forth in *Twombly* applies to all civil actions, see *Igbal*, 129 S.Ct. at 1953, and does not prevent a plaintiff from "pleading facts alleged 'upon information and belief where the facts are peculiarly within the possession and control of the defendant, see, e.g., *Boykin v. KeyCorp*, 521 F.3d 202, 215 (2d Cir. 2008), or where the belief is based on factual information that makes the inference of culpability plausible, see *Igbal*, 129 S.Ct. at 1949 ('A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.')." *Arista Records*, 604 F.3d 110. Here, the identity of brklynrusso is peculiarly within the possession and control of iHub, and brklynrusso's information regarding his investment in CodeSmart is peculiarly within the possession and control of brklynrusso.

In satisfaction of its pleading requirements, Plaintiffs have provided specific facts in the SAC alleging that brklynrusso was an iHub member - evidenced by his ability to post on their boards; that iHub invited, developed, ratified, and adopted brklynrusso's posting stated above by, among other things, the creation of their banner headings and failure to disclaim the postings or refusing to remove the posting after being notified by the Plaintiff of its defamatory nature where iHub had the choice to do so in applying its own membership rules; and that the price of CodeSmart shares dramatically declined immediately following the posting.

Based on these facts alone, the Court can draw the reasonable inference that Plaintiffs' claims express Defendants' plausible liability for their Exchange Act and SEC Rule claims. And, under the circumstances, in line with this Court's holdings in *Arista Records, supra*. Plaintiffs are not prevented from pleading facts alleged "upon information and belief' and have asserted a legitimate basis for asserting their claims.

### F. Plaintiffs' State Law Claims Do Not Substantially Predominate Over Their Exchange Act Claims Because The Claims are Related to the Same Case or Controversy.

Defendants contend that the Court should decline to exercise supplemental jurisdiction in this case claiming the state law claims substantially predominate over the federal claims under 28 U.S.C. § 1367(c)(2), arguing the claims are only

appendages to the state claims and that the state claims constitute the "real body of the case".

In fact, this Court has original jurisdiction for the reason that a federal question exists in this matter and "[e]xcept as provided in subsections (b) and (c) or as expressly provided otherwise by Federal statute, in any civil action of which the district courts have original jurisdiction, the district courts shall have supplemental jurisdiction over all other claims that are so related to claims in the action within such original jurisdiction that they form part of the same case or controversy under Article III of the United States Constitution." 18 U.S.C. § 1367(a).

Here, the defamatory statement invited, made, ratified, and adopted by the Defendants were also the operative material misrepresentations in the 10(b), 10(b)(5), and 9(a)(4) federal claims. Consequently, the material misrepresentation-defamatory statement-posting is essential to satisfying elements of both the federal and state claims thereby making those claims related and part of the same case in controversy.

And, this Court holds that "where at least one of the subsection 1367(c) factors is applicable, a district court should not decline to exercise supplemental jurisdiction unless it also determines that doing so would not promote the values articulated in *United Mine Workers of America v. Gibbs*, 383 U.S. 715: economy, convenience, fairness, and comity." *In Re Methyl Tertiary Butvl Ether*

*Products Liability Litigation*, 613 F. Supp. 2d 437 (S.D.N.Y. 2009).

It cannot be rationally contended that separating Plaintiffs' case into federal and state courts would promote any of the values in *Gibbs*. Therefore, even if this Court finds that Plaintiffs' state claims predominate the federal claims, it should still order the district court to exercise supplemental jurisdiction.

## CONCLUSION

Without discovery, the real facts of this case are exclusively in the hands of Defendants. The law does not allow Defendants to hide behind technicalities and subterfuge to avoid the truth. Plaintiffs' facts, if accepted as true, state plausible claims against Defendants. If Defendants wish to refute those facts, then discovery is required. Accordingly, for the reasons stated above, the judgment appealed from should be reversed, and Plaintiffs' claims reinstated, together with such other and further relief to Plaintiffs as this Court deems just and proper.

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## CERTIFICATE OF COMPLIANCE

Pursuant to Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedure, the foregoing brief is in 14-Point Times Roman proportional font and contains 8,408 words and thus is in compliance with the type-volume limitation set forth in Rule 32(a)(7)(B) of the Federal Rules of Appellate Procedure.

Dated: February 17, 2015

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