14-3994-cv

United States Court of Appeals

for the

Second Circuit

JOSEPH M. SALVANI, JFS INVESTMENTS INC.,

Plaintiff-Appellant,

– 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 APPELLEE INVESTORSHUB.COM, INC.

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, Appellee InvestorsHub.com, Inc. hereby discloses that it is a wholly owned subsidiary of ADVFN PLC. ADVFN PLC is not a party to this appeal because service of process of the summons and complaint was never effectuated on ADVFN PLC.

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INTRODUCTION

Plaintiffs/Appellants contend that this case raises an important question about the "scope of federal securities laws and primary liability under § 10(b) of the Securities Exchange Act of 1934 ('Exchange Act')." (Initial Brief at 1.) In reality, it asks a much simpler question – can a complaint that fails to allege the most basic elements of a Section 10(b) claim (such as reliance) survive a motion to dismiss? The answer, of course, is no.

Plaintiffs failed to allege the most basic elements of a Section 10(b) claim because their case is not really about securities transactions, but instead is about *defamation*. Plaintiffs allege that an unknown individual posted a false statement about them on Defendant/Appellee's website. As a result, in their original Complaint, Plaintiffs asserted only state law claims, including defamation.

Because those state law claims were inadequate to invoke federal subject matter jurisdiction, Plaintiffs attempted to recast them as federal claims in their Second Amended Complaint. In particular, they tried to re-frame their defamation claim as one under Section 10(b) of the Exchange Act by alleging, in essence, that an unknown person posted a defamatory statement *about Plaintiff Joseph Salvani* on Defendant's website, and that that statement, which Plaintiffs knew to be false, caused them to make a poor investment decision that lost money. These allegations are nonsensical and do not come close to stating a Section 10(b) claim.

Plaintiffs' camouflaged defamation claim does not support Section 10(b) liability, and therefore the District Court properly dismissed the Second Amended Complaint. That decision should be affirmed.

COUNTER STATEMENT OF THE CASE

The Statement of the Case presented by Plaintiffs is generally accurate in terms of describing the allegations contained in the Second Amended Complaint, but omits certain facts that are relevant to this appeal.

Background Facts

Plaintiff/Appellant Joseph M. Salvani is an investment advisor who resides in Florida. (A-11, ¶ 11; A-13, ¶ 20.)[1] Salvani owns Plaintiff/Appellant JFS Investments Inc., a Florida corporation. (A-11, ¶ 12; A-13, ¶ 20.) Plaintiffs allege that they had a contract to provide investment consulting services to a company known as CodeSmart Holdings, Inc. (stock symbol ITEN). (A-8, ¶ 5; A-13, ¶ 21.)

Defendant/Appellee InvestorsHub.com, Inc. ("iHub") owns and hosts an Internet website that provides a forum for investors to gather and share market insights using an advanced discussion platform (the "Site"). (A-15, ¶ 29.) The Site contains electronic bulletin boards ("Boards") on which its members can review and post opinions related to a variety of investment-related topics.

[1] References are to the page numbers of the Appendix (A-_) and, where appropriate, to numbered paragraphs within the Appendix.

Defendant/Appellee John Doe is an unknown individual who has posted messages on iHub's Board under the screen name "brklynrusso." (A-12, ¶¶ 16, 17.)

In the Second Amended Complaint, Plaintiffs object to certain statements posted by "brklynrusso" on iHub's Boards. (A-17, ¶ 38.) In particular, Plaintiffs' Second Amended Complaint alleges the following statements made by "brklynrusso" are actionable:

> salvani was a former broker barred from the financial industry. He now gets "consulting" jobs with OTC bulliten 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:
>
> 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

(A-17, ¶ 38 (emphasis omitted).) (The "brklynrusso Statements.")

Plaintiffs claim the brklynrusso Statements were false and defamatory (A-7, ¶ 2; A-8, ¶ 5; A-10. ¶ 9; A-11, ¶ 10; A-14, ¶¶ 26, 27; A-15, ¶ 32; A-16, ¶¶ 34, 35; A-17, ¶ 38; A-18, ¶ 40), and caused Salvani emotional distress (A-8, ¶ 5; A-10, ¶ 9; A-36, ¶ 117). Plaintiffs further allege that the brklynrusso Statements, which

Plaintiffs attribute to both John Doe, the author, and iHub, tortiously interfered with Plaintiffs' contract with CodeSmart Holdings. (A-35, ¶¶110-14.)

The Second Amended Complaint also purports to state two claims under federal law. First, Plaintiffs assert, in effect, that as a result of the brklynrusso Statements, the price of CodeSmart stock dropped and Salvani was injured. Plaintiffs contend that these allegations state a claim for a violation of Section 10(b) of the Exchange Act. (A-27, ¶¶ 77-80.) Based largely upon the same purported facts, Plaintiffs also assert a claim, solely against John Doe, under Section 9(a)(4) of the Exchange Act. (A-28, ¶¶ 81-84.) The Second Amended Complaint averred that the District Court had federal subject matter jurisdiction over the Exchange Act claims and, therefore, could take supplemental jurisdiction over the state-law claims pursuant to 28 U.S.C. § 1367. (A-10, ¶ 9.)

Procedural Background

Plaintiffs filed their original Complaint on October 4, 2013, asserting only state law claims (for defamation, libel per se, and intentional infliction of emotional distress). (SA-15-21.)[2] Those claims were asserted against only iHub and John Doe. Because none of these claims raised a federal question, and the parties were not diverse, the Complaint failed to allege any basis for federal subject

[2] References are to the page numbers of the Supplemental Appendix (SA-_) and, where appropriate, to numbered paragraphs within the Supplemental Appendix.

matter jurisdiction. Accordingly, counsel for iHub sent Plaintiffs' counsel a Rule 11 letter asking Plaintiffs to withdraw the Complaint.

In response, Plaintiffs amended their Complaint to name iHub's parent company, ADVFN PLC, a United Kingdom entity, as a Defendant, and to assert federal securities law claims against John Doe (although not against iHub or ADVFN). (SA-42-44.) At a January 10, 2014, pre-motion conference with the District Court, iHub sought leave to move, again, for dismissal of the Amended Complaint. (SA-58-60.) At the conference, the District Court granted Plaintiffs leave to amend their complaint again. (SA-61)

On January 31, 2014, Plaintiffs served their Second Amended Complaint, in which they asserted their Exchange Act claims against both John Doe and iHub and ADVFN.[3] (A-27-29.) The Second Amended Complaint asserts defamation and related state law claims as well. (A-29-38.)

iHub moved to dismiss the Second Amended Complaint. (A-43.) iHub argued that Plaintiffs were asserting Exchange Act claims merely as a pretext to invoke subject matter jurisdiction, and that the claims were so lacking in substance

[3] Appellants never served any of the complaints on the John Doe Defendant or ADVFN. Thus, iHub was the only Defendant to appear in this matter and is the only Appellee in this appeal. In their Initial Brief, Plaintiff included in the caption an alleged entity identified as "IHUB.com.com." This entity was not name as a party below, was not listed on the Notice of Appeal, and is, to iHub's knowledge, not a real entity.

that they were not colorable. Relying upon Arbaugh v. Y&H Corp., 546 U.S. 500, 513 n.10 (2006), iHub argued that the entire case should be dismissed for lack of subject matter jurisdiction. In particular, iHub argued that the Section 10(b) claims necessarily failed because Plaintiffs did not – and could not – plead reliance or loss causation. iHub likewise argued that Plaintiffs' Section 9(a)(4) claim against John Doe was not colorable for primarily the same reasons. Because iHub believed the federal claims were not colorable, and because the state-law claims substantially predominated over the federal claims, iHub asked the District Court to dismiss the Second Amended Complaint for lack of subject matter jurisdiction. (A-45-65.)

The Ruling on Review

In September 2014, after the Motion to Dismiss had been fully briefed, the District Court entered an order dismissing the Second Amended Complaint (the "Order"). (A-112.) The District Court found that, while Plaintiffs' claims were "drawn so as to seek recovery under federal law" (A-122 (quoting Nowak v. Ironworkers Local 6 Pension Fund, 81 F.3d 1182, 1189 (2d Cir. 1996)), on the merits Plaintiffs' claims failed as a matter of law. In particular, the District Court held, as iHub had argued, that Plaintiffs did not and could not plausibly plead reliance (A-127-28) or loss causation (A-130-35) sufficient to sustain a claim under Section 10(b). For the same reasons, the Court rejected Plaintiffs' Section

9(a)(4) claim. (A-135-36.) Because Plaintiffs could not plead viable Exchange Act claims, the Court dismissed those claims. (A-123-36.)

Having dismissed the federal claims, the Court concluded that "traditional values of judicial economy, convenience, fairness, and comity" weighed in favor of declining to exercise supplemental jurisdiction over the remaining state law claims. (A-136 (quoting Kolari v. N.Y.-Presbyterian Hosp., 455 F.3d 118, 122 (2d Cir. 2006).) Accordingly, the Court dismissed the remaining state law claims without prejudice. (A-136) This appeal followed.[4]

SUMMARY OF THE ARGUMENT

The Order on review should be affirmed. To state a viable claim under Section 10(b), Plaintiffs were required to plead reliance and loss causation as those terms are used in connection with the Exchange Act. But the Second Amended Complaint does not plead reliance, nor could it: because Plaintiffs did not believe John Doe's statements, they could not have relied upon or been misled by them.

To plead loss causation, Plaintiffs would have had to plead that John Doe made a false statement that concealed something material from the market and that,

[4] Before the District Court dismissed the Second Amended Complaint, the parties did not serve or answer any written discovery and did not take any depositions. Likewise, other than issuing certain ministerial orders (e.g., orders granting *pro hac vice* admission to out-of-state attorneys) and ruling on the Motion to Dismiss, the District Court did not devote judicial resources to this matter.

when the truth was disclosed or the concealed risk materialized, it negatively affected the value of CodeSmart Holdings' shares. The Second Amended Complaint made no such allegations. As a result, Plaintiffs' Section 10(b) claim failed.

A claim under Section 9(a)(4) would require Plaintiffs to plead essentially the same elements as the Section 10(b) claim. Because Plaintiffs failed to plead those elements, their Section 9(a)(4) claim failed as well.

Having dismissed the federal claims, the District Court properly recognized that judicial economy, convenience, and comity counseled in favor of dismissing the remaining state-law claims. That decision also was correct.

ARGUMENT

I. This Court Reviews Plaintiffs' Failure to State a Claim for Relief *De Novo*.

The District Court's decision to dismiss Plaintiffs' Exchange Act claims is reviewed *de novo*. Aegis Ins. Servs., Inc. v. 7 World Trade Co., L.P., 737 F.3d 166, 176 (2d Cir. 2013). When considering a motion to dismiss under Rule 12(b)(6), the District Court was required to accept all factual allegations in the complaint as true and draw all reasonable inferences in the plaintiff's favor. Koch v. Christie's Int'l PLC, 699 F.3d 141, 145 (2d Cir. 2014). But the District Court was not required to credit "mere conclusory statements" or "[t]hreadbare recitals of

the elements of a cause of action." Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009) (citing Bell Atl. Corp. v. Twombly, 550 U.S. 544, 555 (2007)).

"To survive a motion to dismiss, a complaint must contain sufficient factual matter . . . to 'state a claim to relief that is plausible on its face.'" Id. at 678 (quoting Twombly, 550 U.S. at 570). A claim for relief is facially plausible "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. (citing Twombly, 550 U.S. at 556). The plaintiff must allege facts sufficient to show "more than a sheer possibility that a defendant has acted unlawfully." Id. Where the plaintiff has not "nudged [his] claims across the line from conceivable to plausible, [the] complaint must be dismissed." Twombly, 550 U.S. at 570.

The District Court properly dismissed Plaintiff's federal claims because the facts alleged in the Second Amended Complaint simply did not state a plausible claim for relief under the Exchange Act. Having dismissed the federal claims at the pleading stage, the District Court properly declined to retain jurisdiction over the remaining state-law claims. The Order should be affirmed.

II. Plaintiffs Failed To Plead A Plausible Claim For Relief.

In Count I of the Second Amended Complaint, Plaintiffs claim that John Doe and iHub violated Section 10(b) of the Exchange Act, 15 U.S.C. ¶ 78j(b), and Rule 10b-5 as promulgated by the SEC. Because a private right of action under

Section 10(b) and Rule 10b-5 is implied, not express, courts must narrowly construe the right and recognize it only when the facts pleaded clearly establish the claim. Janus Capital Grp., Inc. v. First Derivative Traders, -- U.S. --, 131 S. Ct. 2296, 2301-02 (2011).

To prevail on a Section 10(b) claim, a plaintiff must show: "(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 Inv. Partners, LLC v. Scientific-Atlanta, 552 U.S. 148, 157 (2008) (citing Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 341-42 (2005)).

Plaintiffs assert that the brklynrusso Statements caused them injury, including by violating the federal securities laws. This transparent effort to create federal subject matter jurisdiction fails at the outset because, on the facts, Plaintiffs did not and cannot plead elements essential to a Section 10(b) or Section 9(a)(4) claim. Specifically, as the District Court held, in the Second Amended Complaint, Plaintiffs did not plead – and based upon the facts alleged in the Second Amended Complaint, could not plead – the necessary elements of reliance or loss causation.

A. Plaintiffs Did Not Plead Reliance.

"Reliance by the plaintiff upon the defendant's deceptive acts is an essential element of the § 10(b) private cause of action." Stoneridge Inv. Partners, 552 U.S.

at 159. "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).

There are two ways for Section 10(b) plaintiffs to plead and prove reliance. First, the "traditional (and most direct) way a plaintiff can demonstrate reliance is by showing that he was aware of a company's statement and engaged in a relevant transaction – *e.g.*, purchasing common stock – based on that specific misrepresentation." Id. at 2185. Second, a plaintiff can prove reliance by invoking a *rebuttable* presumption of reliance based upon the "fraud on the market" theory. Id. Here, Plaintiffs did not plead either theory.

With respect to the first form of reliance (direct reliance), the District Court noted that Plaintiffs did not even attempt to plead that they learned about John Doe's statements on iHub's Board and then relied upon those false statements when considering a specific transaction. (See A-128 ("Plaintiffs acknowledge that they themselves did not rely on the false statements.").) Indeed, such an allegation would be inherently illogical: a plaintiff could not reasonably rely upon a misrepresentation when the misrepresentation is *about* the plaintiff and the plaintiff *knows* that statement to be *false*. Tellingly, the words "rely" and "reliance" never

even appeared in the Second Amended Complaint. Under the traditional theory of reliance, Plaintiffs' Section 10(b) claim failed.

Desperate to avoid dismissal from federal court, Plaintiffs contend that they properly alleged the second type of reliance, the "fraud on the market" theory. They are mistaken. The "fraud on the market" theory holds that "the market price of shares traded on a well-developed market reflects all publicly available information, and, hence, any material misrepresentations." Id. (internal quotation omitted). "Because the market transmits information to the investor … we can assume . . . that an investor relies upon public misstatements whenever he buys or sells stock based upon the price set by the market." Id. (internal quotation omitted).

The "fraud on the market" theory creates a presumption that the market prices of shares traded on a well-developed market reflect all publicly available information, but the presumption is *rebuttable*. Basic Inc. v. Levinson, 485 U.S. 224, 250 (1988). The case law is clear that a plaintiff who knows that statements made to the market are false cannot be said to have "relied" upon them under a "fraud on the market" theory. Put another way, such a plaintiff has, by his own allegations, rebutted the "fraud on the market" theory. That is precisely the situation here.

Plaintiffs allege that they knew that the statement made by John Doe on the iHub Board was false. (A-18 ¶¶ 40-44; A-20, ¶¶ 51-55.) In fact, Plaintiffs allege that the same day the brklynrusso Statement was posted, Plaintiffs demanded that iHub remove the Statement from its Boards because it was false. (A-22, ¶ 57.) As the Supreme Court has explained, a plaintiff's knowledge that statements were false necessarily means that he did not rely upon the statements and therefore rebuts the presumption of "fraud on the market" reliance:

> [A] plaintiff who believed that [the company's] statements were false . . . and who consequently believed that [the company's] stock was artificially underpriced, but sold his shares nevertheless because of other unrelated concerns . . . could not be said to have relied on the integrity of a price he knew had been manipulated.

Basic, 485 U.S. at 249.

Numerous cases apply the principle established in Basic that a plaintiff who knows a statement to be false cannot not use the "fraud on the market" theory to establish reliance. See 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"); Tiberius Capital, LLC v. PetroSearch Energy Corp., No. 09 Civ. 10270(GBD), 2011 WL 1334839, at *6 (S.D.N.Y. Mar. 31, 2011) ("Plaintiff cannot establish reliance by utilizing the fraud-on-the-market presumption because, at the time Plaintiff 'sold' its Petrosearch shares, Plaintiff affirmatively disbelieved the Defendants'

misrepresentations."), aff'd, 485 F. App'x 490 (2d Cir. 2012); Ashland Inc. v. Morgan Stanley & Co., Inc., 700 F. Supp. 2d 453, 469 (S.D.N.Y. 2010) ("An investor may not justifiably rely on a misrepresentation if, through minimal diligence, the investor should have discovered the truth.") (internal quotation omitted).

Plaintiffs make no effort to explain how or why the "fraud on the market" theory is applicable here to satisfy their burden of pleading that they relied upon the brklynrusso Statements. Instead, Plaintiffs suggest that *other investors* relied upon John Doe's statements and, therefore, Plaintiffs' sale of the securities was based on a fraud. (Initial Brief at 24.) But this argument is insufficient to satisfy the requirement enunciated by the Supreme Court 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, 552 U.S. at 159 (emphasis added). As the District Court noted, Plaintiffs fail to point to even one case from any jurisdiction accepting their argument that third-party reliance satisfies Section 10(b). They failed to identify any cases supporting their position because the law is to the contrary. See, e.g., ATSI Commc'ns, Inc. v. Shaar Fund, Ltd., 493 F.3d 87, 105 (2d Cir. 2007) (to plead Section 10(b) claim, plaintiff must plead a false statement "upon which the plaintiff relied").

Plaintiffs also gamely suggest that reliance is not a necessary element of their Section 10(b) claim because Plaintiffs' damages were the result of a non-volitional or "forced" sale. (Initial Brief at 21.) This argument makes no sense. A forced sale occurs when the holders of securities are forced "by other investors *in the same firm* to trade their investments for cash." Rand v. Anaconda-Ericsson, Inc., 794 F.2d 843, 847-48 (2d Cir. 1986) (emphasis added). Thus, the forced-sale doctrine has been limited to securities transactions "resulting in an intra-firm freeze-out of one group of investors by another." Id. This case does not involve an intra-firm freeze-out of Plaintiffs by another group of investors, and the Second Amended Complaint never alleges that Plaintiffs were "forced" to sell their CodeSmart Holdings shares by anyone. Thus, the forced-sale doctrine has no application here.

As the District Court ruled, Plaintiffs did not plead and could not plead reliance. As a result, Plaintiffs' Section 10(b) claim failed and was properly dismissed.

B. Plaintiffs Failed to Plead Loss Causation.

The Second Amended Complaint also failed to state an Exchange Act claim because it did not allege – and could not allege – the final element of a Section 10(b) claim: loss causation. Loss causation is "a causal connection between the material misrepresentation and the loss." Dura Pharm., Inc. v. Broudo, 544 U.S.

336, 342 (2005). "Loss causation . . . requires a plaintiff to show that a misrepresentation that affected the integrity of the market price *also* caused a subsequent economic loss." Erica P. John Fund, 131 S. Ct. at 2186 (emphasis in original). More particularly, loss causation requires a showing "that the misstatements were the reason the transaction turned out to be a losing one." First Nationwide Bank v. Gelt Funding Corp., 27 F.3d 763, 769 (2d Cir. 1994).

To establish loss causation, there must be an allegation that the defendant's "misstatement or omission *concealed* something from the market that, *when disclosed*, negatively affected the value of the security." Lentel v. Merrill Lynch & Co., 396 F.3d 161, 173 (2d Cir. 2005) (emphasis added). Thus, Plaintiffs had to plausibly allege that the brklynrusso Statements caused Plaintiffs to sell their shares of CodeSmart at a lower price than the price available after the misrepresentation came to light.

"The Second Circuit has outlined two possible methods of pleading loss causation, the 'corrective disclosure' theory, and the 'materialization of concealed risk' theory." Lighthouse Fin. Grp. v. Royal Bank of Scotland Grp., PLC, No. 11 Civ. 398(GBD), 2013 WL 4405538, *9 (S.D.N.Y. Aug. 5, 2013) (citing In re Omnicom Grp., Inc. Sec. Litig., 597 F.3d 501, 511 (2d Cir. 2010)). See also Wilamowsky v. Take-Two Interactive Software, Inc., 818 F. Supp. 2d 744, 751 (S.D.N.Y. 2011) (identifying same two theories as accepted methods of proving

loss causation in the Second Circuit). See also Solow v. Citigroup, Inc., 827 F. Supp. 2d 280, 292 (S.D.N.Y. 2011) ("Loss causation is typically shown by the reaction of the market to a corrective disclosure which reveals a prior misleading statement, but may also be shown by the materialization of risk method, whereby a concealed risk . . . comes to light in a series of revealing events that negatively affect stock price over time.") (quoting In re Vivendi Universal, S.A., Sec. Litig., 765 F. Supp. 2d 512, 555 (S.D.N.Y. 2011) (internal quotation marks omitted)). Plaintiffs did not plead either of these theories.

1. Plaintiffs Did Not Allege A Corrective Disclosure.

The corrective disclosure theory assumes that the defendant made a false statement or failed to disclose material information about a security, and requires an allegation that "the market reacted negatively to a 'corrective disclosure,' which revealed an alleged misstatement's falsity or disclosed that allegedly material information had been omitted." Wilamowsky, 818 F. Supp. 2d at 751 (quoting In re AOL Time Warner, Inc. Sec. Litig., 503 F. Supp. 2d 666, 677 (S.D.N.Y. 2007)). When the corrective disclosure is made, and the market realizes that it has been trading based upon false information or omitted material information, the market reacts by "correcting" the price of the security to where it would have been in the absence of the false statement or omission.

Here, to plead loss causation through corrective disclosure, Plaintiffs would have had to allege that the brklynrusso Statements caused the price of CodeSmart Holdings shares to drop, Plaintiffs sold their shares while the price was depressed, a corrective disclosure was made, and the market reacted by correcting (*i.e.*, increasing) the price to where it would have been in the absence of the false statements.[5]

The Second Amended Complaint did not allege a corrective disclosure. It appears to assert that John Doe made his allegedly false statement on September 5, 2013, that the price of CodeSmart Holdings stock fell after September 6, that Plaintiffs sold shares of CodeSmart Holdings after September 6, and therefore that Plaintiffs suffered an economic loss. (A-19, ¶¶ 46-49.) Because the Second Amended Complaint never alleged that a corrective disclosure was made after September 5, let alone that the market reacted to such a corrective disclosure by correcting upwards the price of CodeSmart Holdings shares, there is no allegation of loss causation. To the contrary, the Second Amended Complaint alleged that, on September 6, the price of CodeSmart Holdings shares was $3.97 and the share price continued to drop down to $1.82 per share in November 2013. (A-20, ¶¶ 47, 48.) No corrective disclosure was alleged to have been made, and therefore there

[5] Even if they had made such allegations, Appellants still would not have alleged the necessary element of reliance.

also exists no allegation that the market "corrected" upward the price of CodeSmart Holdings shares. The allegations of the Second Amended Complaint, in fact, foreclose such an allegation.

Because the Second Amended Complaint did not allege a corrective disclosure and the concomitant market correction after the disclosure, it did not properly plead a theory of corrective disclosure loss causation.

2. Plaintiffs Did Not Allege Materialization of Risk.

Loss causation also may be alleged "by showing that the loss was foreseeable and caused by the materialization of the risk concealed by the fraudulent statement." Wiliamowsky, 818 F. Supp. 2d at 751 (quoting In re Omnicon Grp., Inc. Sec. Litig., 597 F.3d 501, 513 (2d Cir. 2010)). In other words, "where the alleged misstatement *conceals* a condition or event which then occurs and causes the plaintiff's loss, a plaintiff may plead that it is the materialization of the undisclosed condition or event that causes the loss." Id. (internal quotations omitted) (emphasis added).

The Second Amended Complaint did not allege that brklynrusso concealed any condition or event relating to Plaintiffs or CodeSmart Holdings. Rather, it alleged that he falsely described CodeSmart Holdings as being a "pump and dump"

scheme.[6] (A-17, ¶ 38; A-19, ¶¶ 43, 45, 46.) Because the Second Amended Complaint did not allege the concealment of any material condition or event, it also did not allege that any undisclosed condition or event materialized and caused Plaintiffs' loss. Thus, the Amended Condition did not allege loss causation under a materialization of risk theory.

Plaintiffs' failure to plead two of the essential elements of a Section 10(b) claim (*i.e.*, reliance or loss causation) was fatal to that claim. The District Court properly dismissed the Section 10(b) claim.

C. Plaintiffs' Arguments Concerning "Loss Foreseeability," The "Zone Of Risk," And The "Subject" Test Are Misdirected.

Unable to properly plead a corrective disclosure or a materialization of risk, Plaintiffs argue that there are other means of pleading loss causation. In particular, they argue that they can satisfy the loss causation element of Section 10(b) so long as they allege "loss foreseeability" or that their injuries were within the "zone of risk" or meet the "subject" test. (Initial Brief at 21-30.) Plaintiffs are mistaken on each point, however, because "loss foreseeability," "zone of risk," and the "subject" test are simply shorthand terms for the loss causation analysis discussed above.

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[6] A "pump and dump" scheme arises when false information about a stock is used to artificially inflate the stock's price. See U.S. v. Gushlack, 728 F.3d 184, 196 (2d Cir. 2013).

In In re Omnicom Group, Inc. Securities Litigation, 597 F.3d 501 (2d Cir. 2010), this Court discussed its own complicated development of the loss causation analysis, and noted that the loss causation is "occasionally confusing because it is often used to refer to three overlapping but somewhat different concepts." Id. at 509. First, it is sometimes used to mean a plaintiff's *reliance* on a misrepresentation about a security. Id. at 509-10. Second, it sometimes refers to the *but-for cause* of the loss suffered by the plaintiff. Id. at 510. Third, and most critically,

> 'loss causation' relates to the question whether events that are a cause-in-fact of investor losses fall within the class of events from which Section 10(b) was intended to protect the particular plaintiffs and which the securities laws were intended to prevent. This issue, one of proximate cause, was the subject of extended (to say the least) discussion in three opinions in AUSA Life Ins. Co. v. Ernst & Young, 206 F.3d 202 (2d Cir. 2000). Subsequently *we adopted the 'zone of risk' test* outlined in the dissenting opinion in AUSA. See Lentell v. Merrill Lynch & Co., 396 F.3d 161, 172-75 (citing AUSA, 206 F.3d at 235, 238 (Winter, J., dissenting)).

In re Omnicom Grp., 597 F.3d at 510 (emphasis added).

Plaintiffs read this Court's adoption of the "zone of risk" test as establishing a test for loss causation that is different from the "corrective disclosure" and "materialization of risk" tests; it is not. After acknowledging the adoption of the "zone of risk" test, the Omnicom Group Court set forth the two methods of showing loss causation through the "zone of risk" test – namely, a corrective disclosure or a materialization of the risk. 597 F.3d at 511. As the Court noted,

"[e]stablishing either theory as applicable would suffice to show loss causation." Id. Thus, a loss is within the "zone of risk" if it is caused by a corrective disclosure or a materialization of risk, neither of which were alleged by Plaintiffs.

Plaintiffs' reliance on a so-called "loss foreseeability" analysis is similarly misplaced. The concept of "loss foreseeability" is simply another characterization of the same loss causation analysis outlined in Omnicom Group. As explained in Lentell v. Merrill Lynch & Co., "[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." 396 F.3d at 173. Thus, in order to show loss causation, a plaintiff must plead that "the misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security. Otherwise, the loss in question *was not foreseeable*." Id. (emphasis added). Far from being a separate test for loss causation, "loss foreseeability" is simply a description of the loss causation test.

Plaintiffs' third argument, that this Court has adopted a "subject" test, is, once again, nothing more than Plaintiffs' attempt to put a different label on the loss causation requirement. Again, as explained in Lentell v. Merrill Lynch & Co.,

> to 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), *i.e.*, that the misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security.

396 F.3d at 173. In other words, as iHub argued and the District Court agreed, the subject of the misrepresentation is the cause of plaintiff's loss when plaintiff's injury arises as a result of a corrective disclosure or a materialization of risk. Here, Plaintiffs never alleged such loss causation and, therefore, they failed to state a Section 10(b) claim.

D. Plaintiffs Failed To Plead A Viable Section 9(a)(4) Claim.

Plaintiffs' attempt to plead a claim under Section 9(a)(4), 15 U.S.C. § 78i(a)(4) – Count II of the Second Amended Complaint – also failed. Section 9(a)(4) "closely parallels Rule 10b-5." Panfil v. ACC Corp., 768 F. Supp. 54, 59 (W.D.N.Y. 1991). But a Section 9(a)(4) claim is more difficult to plead and prove than a Section 10(b) claim. See id. (Explaining that a Section 10(b) claim "requires no *additional* proof of facts creating a *higher* burden of proof when compared to subsection 9(a)(4). In fact, Rule 10b-5 creates a lower burden of proof than does subsection 9(a)(4) and contains no elements that compensate for this change.") (quoting Chemetron Corp. v. Bus. Funds, Inc., 682 F.2d 1149, 1162 (5th Cir. 1982), rev'd on other grounds, 460 U.S. 1007 (1983)). In other words, where a plaintiff's Section 10(b) claim fails, his Section 9(a)(4) claim necessarily also fails. Here, Plaintiffs' Section 9(a)(4) claim fails for the same reasons their Section 10(b) claim does. See supra Sections II.A and B (discussing reliance and loss causation).

In addition, to be liable under Section 9(a)(4), the defendant must, among other things, sell or offer to sell, or purchase or offer to purchase, a security, 15 U.S.C. § 78i(a)(4); Gulf Corp. v. Mesa Petroleum Co., 582 F. Supp. 1110 n.8 (D. Del. 1984) (explaining that Section 9(a)(4) defendant must be a seller or purchaser of the security), and must make a false or misleading statement about the security "for the purpose of inducing the purchase or sale" of the security. 15 U.S.C. § 78i(a)(4). Here, Plaintiffs did not allege such an attempted sale, by iHub or Defendant John Doe, nor would one make sense on the facts alleged in the Second Amended Complaint.

The Second Amended Complaint acknowledges that the identity of John Doe "is unknown to plaintiffs at this time" (A-12, ¶ 17) and that shares in CodeSmart Holdings are traded on the OTC Bulletin Board (A-21, ¶ 54), meaning they are traded through dealers or brokers and that the end customers usually are anonymous. As a result, Plaintiffs could not possibly know if John Doe sold or offered to sell CodeSmart Holdings shares, and they could not know whether he made the allegedly false statements about Plaintiffs and CodeSmart Holdings "for the purpose of inducing the purchase or sale of such security." 15 U.S.C. § 78i(a)(4). Because Plaintiffs had no knowledge about these issues, the Second Amended Complaint contains no factual allegations concerning John Doe's possible sale or purchase of CodeSmart Holdings shares. Although the District

Court did not rely upon the lack of allegations about John Doe's sales or purchases as a basis for dismissing the Section 9(a)(4) claim, it provides a further justification for dismissal of the Second Amended Complaint.[7]

III. Judicial Economy, Convenience, And Comity Compelled Dismissal Of The Pendent State-Law Claims.

After dismissing the Exchange Act claims, the District Court properly declined to exercise supplemental jurisdiction over the state-law claims. This Court reviews a district court's decision not to exercise supplemental jurisdiction under an "abuse of discretion" standard. Kolari v. N.Y.-Presbyterian Hosp., 455 F.3d 118, 122 (2d Cir. 2006).

A district court may decline to exercise supplemental jurisdiction when "the [state-law] claim substantially predominates over the claim or claims over which the district court has original jurisdiction," as they did here. 28 U.S.C. § 1367(c)(2). Moreover, as the District Court explained, when all federal question claims are dismissed before trial, the "traditional 'values of judicial economy,

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[7] To be clear, in paragraph 82 of the Second Amended Complaint, Plaintiffs recited the black-letter elements of a Section 9(a)(4) claim, but this recitation of legal conclusions did not constitute the pleading of plausible facts required by the Federal Rules. See Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009) ("a complaint must contain sufficient factual matter, accepted as true, to state a claim for relief that is plausible on its face") (internal quotation omitted). "[A] plaintiff's obligation to provide the grounds for his entitlement to relief requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." Starr v. Sony BMG Music Entm't, 592 F.3d 314, 321 (2d Cir. 2010).

convenience, fairness, and comity'" weigh in favor of declining to exercise supplemental jurisdiction over any remaining state-law claims. (A-136 (quoting Kolari, 455 F.3d at 122 (quoting Carnegie-Mellon Univ. v. Cohill, 484 U.S. 343, 350 (1988))).)

No progress was made in this case with respect to litigating the state-law claims. No discovery was served or answered, and no motions were filed addressing the merits of the state-law claims. The only substantive issue ever presented to the District Court was the question of whether Plaintiffs had stated a claim for relief under federal law and whether the District Court had subject matter jurisdiction over the dispute. Thus, no judicial resources were expended on resolving the state-law claims.[8]

[8] Moreover, both the state law claims (sounding in defamation, and tortious interference) and the federal claims against iHub would be barred by the Communications Decency Act ("CDA"), 47 U.S.C. § 230. The CDA declares that "[n]o provider or user of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider." 47 U.S.C. § 230(c)(1). It further states: "[*n*]*o cause of action may be brought* and no liability may be imposed under any State or local law that is inconsistent with this section." 47 U.S.C. § 230(e)(3) (emphasis added). iHub is a provider of an interactive computer service and, therefore, is covered by the CDA. See, e.g., Medytox Solutions, Inc. v. Investorshub.com, Inc., 152 So. 3d 727 (Fla. 4th DCA 2014) (holding that iHub is protected from liability by the CDA), rev. den. ---So. 3d ---, 2015 WL 1638667 (Fla. Apr. 10, 2015). Therefore, the CDA immunizes iHub from claims based on its alleged failure to remove objectionable content from its Site.

In light of these facts, the District Court's decision declining to exercise jurisdiction over Plaintiffs' state-law claims was proper, was not an abuse of discretion, and should be affirmed.

CONCLUSION

WHEREFORE, Appellee InvestorsHub.com, Inc., respectfully requests that the Court affirm the District Court's Order.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE WITH FED. R. APP. P. 32(A)(7)(B)

Pursuant to Fed. R. App. P. 32(a)(7)(C), the undersigned hereby certifies that this brief complies with the type-volume requirements of Fed. R. App. P. 32(a)(7)(B) because the brief, contains 5,963 words according to the word-processing system used to prepare the brief, excluding those sections exempted from the word count by Fed. R. App. P. 32(a)(7)(B)(iii).

This brief also complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and Fed. R. App. P. 32(a)(6) because it has been prepared in Microsoft Word 2010 using the Times New Roman proportionally spaced typeface in 14-point font.

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