In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1-10,

Defendants.

Civil No. 18-0153-CZ

HON. ALEXANDER C. LIPSEY

HARDER LLP
Charles J. Harder (CA# 184593)
Jordan D. Susman (CA# 246116)
132 South Rodeo Drive, Fourth Floor
Beverly Hills, California 90212
(424) 203-1600
charder@harderllp.com
jsusman@harderllp.com
Counsel for Scottsdale Capital Advisors
Pro Hac Vice Pending

PINSKY, SMITH, FAYETTE & KENNEDY, LLP
H. Rhett Pinsky (P18920)
146 Monroe Center St., NW, Suite 805
Grand Rapids, Michigan 49503
(616) 451-8496
hpinsky@psfklaw.com
Counsel for Scottsdale Capital Advisors

BUTZEL LONG, P.C.
Joseph E. Richotte (P70902)
Doaa K. Al-Howaishy (P82089)
Stoneridge West
41000 Woodward Avenue
Bloomfield Hills, Michigan 48304
(248) 258-1616
richotte@butzel.com
al-howaishy@butzel.com
Counsel for MLM and Michael Goode

DEFENDANTS' REPLY IN SUPPORT OF MOTION FOR SUMMARY DISPOSITION OF SECOND AMENDED COMPLAINT

I. SANCTIONS GAMESMANSHIP: Scottsdale is hoping the Court will reflexively apply its earlier rulings without carefully reviewing the new legal arguments raised in support of Defendants' arguments.

Scottsdale notes that Defendants raise arguments similar to those raised in their motion to dismiss the original complaint. Looking to avoid the new dimensions of those arguments, Scottsdale pronounces them to be "the same" and therefore worthy of sanctions.[1] Defendants explain *infra* the nuances that Scottsdale missed, showing Scottsdale's position to be meritless. While Scottsdale accuses Defendants of "clearly" trying to harass it by re-raising these arguments, Defendants are offering the Court an opportunity to correct errors of law and supplying the bases to do so.

Of course, even if Defendants had raised the exact same arguments without adding to them, doing so would have been proper to preserve the arguments for appeal. The new complaint *supersedes* the original complaint. MCR 2.118(A)(4). The original complaint is "abandoned and withdrawn." *Grzesick* v. *Cepela*, 237 Mich. App. 554, 562 (1999). Thus, the Court's earlier rulings are of no practical effect *for appellate purposes*. Any appeal would review the Court's ruling on the new complaint. So, in order to preserve their challenges to the Court's earlier rulings, Defendants must re-raise them here. *Cf. id.* at 562–563.

Regardless, Scottsdale's request is just poor form. It missed the 14-day deadline the Court imposed to file its new complaint. (Exhibit 1, Motion Hr'g Tr. 40:13–15 (Aug. 22, 2018).) Rather than force Scottsdale to file a motion to explain why it missed the deadline, Defendants consented to the filing as a matter of professional courtesy. Asking for sanctions over a matter of issue preservation is an exercise in repaying mercy with malice.

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[1] Scottsdale erroneously contends that Rule 2.612(C) applies to bar Defendants from raising "the same" arguments. The Rule "applies only to *final* judgments and *final* orders," not interlocutory orders like the one the Court previously entered that do not dispose of the entire case. *McDaniel* v. *Jackson*, 78 Mich. App. 218, 223 (1977).

II. SPECIAL STANDARD OF REVIEW: Scottsdale ignores the new points raised in support of Defendants' contention that a special standard applies to defamation cases.

Although the Court previously ruled that the special standard of review in defamation cases is limited to cases involving public officials and public figures, (Order at 4), Defendants offer case law proving that the special standard also applies in private-figure cases. (Motion at 6, citing *Rouch II*, 440 Mich. at 272–27 (1992) (in a private-figure case reviewed on appeal from a (C)(10) ruling, Justice Riley noted that the pleadings in a defamation case are also to be reviewed with heightened scrutiny when challenged under (C)(8)); *Trost* v. *BuckStop Lure Co., Inc.*, 249 Mich. App. 580, 587 n.2 (2002) (observing, in a private-figure case, that Justice Riley out-lined the proper procedure for (C)(8) challenges); *Royal Palace Homes, Inc.* v. *Channel 7 of Detroit, Inc.*, 197 Mich. App. 48, 52–53 (1992) (in another apparently private-figure case: "Justice Riley's position is consistent with previous decisions of this Court.") Scottsdale offers no critique of these cases.

III. STATEMENT NO. 1: Scottsdale has not responded to Defendants' arguments.

Falsity. Defendants argue that Statement No. 1 is opinion in the form of rhetorical hyperbole that cannot be proven false. Scottsdale does not deny that it was connected to two other pump-and-dump schemes in the years preceding publication of the Article. Indeed, the 111-page FINRA report specifically identifies those other schemes, a Panamanian-based pump-and-dump in 2008–2012 and Bahamian-based pump-and-dump in 2008. (Answer Exh. A, FINRA Rpt. at 11–12 and nn. 18 and 20, with links to Securities & Exchange Commission enforcement actions concerning those schemes in *Ruettiger*, *Gibraltar*, and *Tavella*.) The report explains that, in accepting penny stocks for deposit in those schemes, Scottsdale failed to exercise its gatekeeping role to safeguard against being used by its customers as a means to execute a pump-and-dump fraud.[2] So, anyone

[2] Scottsdale's failure to adequately police the Biozoom transaction and halt the pump-and-dump scheme through vigorous due diligence—as it was required to have done by law under SEC Rule 17a-8, the Bank Secrecy Act ("BSA"), and its implementing regulations, *see* BSA, 31 U.S.C. § 5311, *et seq.*; 31 C.F.R. § 1023.320(a)(2) ("SAR Rule"); and 17 C.F.R. 240.17a-8 (SEC regulation requiring brokers to follow the BSA and its rules) (for a convenient summary with links to applic-

following pump-and-dump schemes over the previous years would be familiar with Scottsdale. As noted in Defendants' opening briefs, the challenged statement thus amounts to "everyone knows" about the connection—which is classic rhetorical hyperbole that is not actionable. (Defs.' Br. at 10 (citing *Komarov* v. *Advance Magazine Publ'rs, Inc.*, 691 N.Y.S.2d 298, 301-302 (NY Sup. Ct. 1999)). Scottsdale doesn't deny that it lacks the ability to objectively prove that those who followed such schemes did *not* know of Scottsdale.

Defamatory Meaning. Scottsdale harps on the juxtaposition between the headline and the first sentence. It essentially concedes that anyone reading the linked FINRA report would understand the context of the challenged statement, but that the "damage is done" before the reader gets to the FINRA report. (Opp'n at 9.) That's like saying the reader can't be expected to read the entire text if the article is too long. ***But that isn't the law.*** In making these assessments, a court must read the challenged statement in context, fairly and reasonably construing ***the entire article*** to determine whether the challenged statement is libelous. *Sanders* v. *Evening News Ass'n*, 313 Mich. 334, 340 (1946); *Croton* v. *Gillis*, 104 Mich. App. 104, 108 (1981).

Although Scottsdale wants to emphasize the "could reasonably be understood" standard, it ignores that a person is not responsible for every defamatory implication a reader might draw from his report of true facts, ***absent evidence that he intended the defamatory implication.*** *Royal Palace Homes,*

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able law, visit https://www.sec.gov/about/offices/ocie/amlsourcetool.htm)—signaled to FINRA that Scottsdale had not heeded lessons of its earlier roles in pump-and-dump schemes. It considered this an aggravating factor, which formed a basis for the $1.5 million fine:

> Finally, although [Scottsdale] was not charged in ... *Ruettiger*, *Gibraltar I*, *Gibraltar II*, and *Tavella*, those cases did involve alleged misconduct through accounts at [Scottsdale]. These cases put [Scottsdale] on notice of the risk of sham transactions and the use of nominees to conceal beneficial ownership and facilitate unlawful distributions of securities. They heightened the need for [Scottsdale] to be alert to red flags. ***In light of this history, it is aggravating that Scottsdale performed its gatekeeping function so poorly.***

(Answer Exh. A, FINRA Rpt. 104 at §IV.A(1)(d) (emphasis supplied). Accordingly, it is Scottsdale that mischaracterizes the FINRA report by suggesting the report and the fine have nothing to do with Scottsdale's role in pump-and-dump schemes. (*See* Opp'n at 9 and n.2.)

Inc. v. *Channel 7 of Det., Inc.*, 197 Mich. App 48, 56 (1992). A statement "does not become actionable merely because it could be taken out of context." *Nehls* v. *Hillsdale Coll.*, 178 F. Supp. 2d 771, 779 (ED Mich. 2001), *aff'd* 65 Fed. Appx. 984 (CA6 2003). The new complaint alleges no facts that show Goode intended the defamatory implication Scottsdale has pleaded.

IV. STATEMENT NO. 2: Scottsdale has not responded to Defendants' arguments.

Defendants argue that Scottsdale has failed to sufficiently plead that Statement No. 2 is false because: (1) the statement says Scottsdale is one of the few remaining brokers that both accept *deposits* of penny stocks *and trade* them; but (2) Scottsdale only identifies brokers who *trade* in penny stocks. (Compl. ¶13b.) In its opposition, Scottsdale does not dispute Defendants' argument that *depositing* shares and *selling* shares are distinct activities. Nowhere in the new complaint does SCA identify *any* other brokers who still accept shares for *deposit*. Therefore, it has not sufficiently alleged that the statement as written—"deposit *and* sale"—is false.

In addition, Scottsdale alleges that Statement No. 2 is *per se* defamatory because it implies Scottsdale engages in business activities that are not allowed. (Compl. ¶ 22; Opp'n Br. at 6, § A.3) In their opening brief, Defendants cited *Bufalino*, in which the Supreme Court held that saying someone is in a particular line of business is not defamatory, if it is a "perfectly legitimate business"—*i.e.*, a legal one. (Defs.' Br. at 13 (citing *Bufalino* v. *Maxon Bros., Inc.*, 368 Mich. 140, 151–152 (1962)). Scottsdale does not dispute that it operates a business authorized by law. Thus, *Bufalino* is fatal to its claim for defamation by implication. Rather than acknowledge this, or make any attempt to distinguish *Bufalino*, Scottsdale merely emphasizes the alleged "implication" that it serves a niche market that others have chosen to abandon.

V. FAULT: It is still improper for Scottsdale to rely on its retraction demand to plead fault, and Scottsdale admits no other court has ever applied *res ipsa loquitur*.

The only fact that Scottsdale purportedly pleads in support of its fault allegation is that the Article remains on the website after Scottsdale served a retraction demand. (Opp'n at 9.) Fault is assessed *at the time of the publication*. *Peisner* v. *Detroit Free Press*, 104 Mich. App. 59, 64 (1981), mod.

on other grounds, 421 Mich. 125 (1984). For Scottsdale's pleading to sufficiently allege fault, each new day the Article remains on the website would have to constitute a republication of the Article—that way, Goode could be negligent for republishing the article after receiving the retraction demand. *But that is not the law.* Michigan follows the single-publication rule for Michigan. *Mitan* v. *Campbell*, 474 Mich. 21, 24–25 (2005). Applying the single-publication rule, the Michigan Court of Appeals has held that leaving allegedly defamatory material on a website is *not* a new publication each day it remains online. *Roberts* v. *Detroit Pub. Schs.*, No. 269414, 2007 WL 127791, at *3 (Mich. App. Jan. 18, 2007) (unpublished).

On the issue of *res ipsa loquitur*, Scottsdale has not pointed to any other court that has applied this doctrine in a defamation case. Nor has it disputed Defendants' explanation for why it is improper to do so. It simply asks the Court to unthinkingly apply its earlier, incorrect ruling. The Court should take this opportunity to revisit this legal issue.

CONCLUSION

For these reasons, and those in their opening brief, Defendants respectfully request that the Court dismiss the new complaint with prejudice.

Respectfully submitted,

BUTZEL LONG, P.C.

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JOSEPH E. RICHOTTE (P70902)
DOAA K. AL-HOWAISHY (P82089)
Stoneridge West
41000 Woodward Avenue
Bloomfield Hills, Michigan 48304
(248) 258-1616
richotte@butzel.com
al-howaishy@butzel.com
Counsel for MLM and Michael Goode

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THE COURT: Yes.

MR. KURTZ: --if you'll entertain those.

My interpretation is if we want to amend on those other statements we can. Do we want to send some kind of deadline or--or have that--

THE COURT: Yeah.

MR. KURTZ: --as part of the order as well?

THE COURT: I--I think--yeah, I think that probably makes some sense.

I--I--. Well, yeah, we getting--we getting the end of vacation seasons.

So, we'll do 14-days to amend, and then if you do amend the defendant has, under the rules, a period of time to respond--to file an answer.

MR. KURTZ: And, to be somewhat (inaudible) it sounds like you had to prepare a written something--

THE COURT: Something--something written--

MR. KURTZ: --or--

THE COURT: --I will--. What I can do is--I can whip this up. Technically, as this is a business court case you're entitled to have a document prepared and I will so prepare it and issue that opinion.

MR. KURTZ: I--I really appreciate that, because we didn't have the forethought of having a court recorder