In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

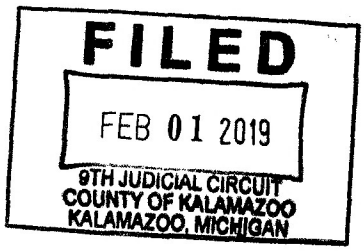
v.

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

Defendants.

Civil No. 18-0153-CZ

HON. ALEXANDER C. LIPSEY



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MEMORANDUM SUPPORTING MOTION FOR SUMMARY DISPOSITION OF THIRD AMENDED COMPLAINT

Under Rule 2.116(C)(8), MLM and Goode offer this Memorandum in support of their Motion to dismiss the Third Amended Complaint ("Complaint") with prejudice on summary disposition for failure to state a claim upon which relief can be granted.

INTRODUCTION

This is a defamation action. Scottsdale has sued MLM and Goode for allegedly libelous statements posted in an online article at goodetrades.com, a blog reporting on news about penny-stock trading.

A "penny stock" refers to a security issued by a very small company that trades at less than $5.00 per share.[1] Also known as "microcap stocks," penny stocks are issued by companies, many of which do not file financial reports with the U. S. Securities & Exchange Commission.[2] The SEC describes these securities as "among the most risky," suffering from a scarcity of publicly-available information that allows "fraudsters [to] easily spread false information about microcap companies, making profits while creating losses for unsuspecting investors."[3] They are very speculative investments, and Congress has tightly regulated broker-dealers who facilitate penny-stock trading under the Exchange Act.[4]

One fraud particularly affecting penny stocks is the classic pump-and-dump scheme. The scheme involves touting a company's stock through false and mislead-ing statements to the marketplace to ignite a buying frenzy that "pumps" the price of a stock (usually a penny stock). The hucksters then sell (or "dump") their stocks at the "pumped" up price, realizing a handsome profit. Once they dump their shares and stop hyping the stock, the

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1 United States Secs. & Exch. Comm'n ("SEC"), Penny Stock Rules (May 9, 2013) ("PENNY STOCK RULES") (available at http://bit.ly/SEC-Penny-Stock-Rules).

2 SEC, Microcap Stock: A Guide for Investors, Introduction (Sept. 13, 2013) (available at http://bit.ly/ SEC-Microcap-Guide).

3 *Ibid.*

4 PENNY STOCK RULES, *supra* at n.1

price falls and investors lose their money.[5]

MLM and Mr. Goode reported on pump-and-dump schemes, including one involving stock in Biozoom, which was touted as a biomedical technology company. Before April 2013, Biozoom was known as Entertainment Art, Inc., and it produced leather bags. In April 2013, it announced that it was changing its name to Biozoom and exiting the leather-bag business to develop biomedical technology. From March 2013 (the month before the announcement) to June 2013, at least eight people opened accounts with broker-dealers and deposited millions of shares of Biozoom that they (falsely) claimed were purchased from Entertainment Art's original shareholders in the previous few months and could be freely traded.[6] From May 16–July 17, 2013, these people sold 14 million shares yielding almost $34 million, of which nearly $17 million was wired to overseas bank accounts.[7] Eventually, the stock collapsed. The SEC brought an enforcement action, *U. S. Securities & Exchange Comm'n* v. *Tavella*, to recover the ill-gotten gains and make swindled investors whole.

Scottsdale, a broker-dealer that facilitated penny-stock trading and claims to be one of the dominant companies in the microcap securities market for handling more than $125 million worth of trades in 2015 alone,[8] accepted Biozoom stocks for deposit and facilitated trading in the microcap market. Many of the trading accounts frozen through the SEC's enforcement action were held at Scottsdale.[9] And, notably, since Scottsdale filed this lawsuit against MLM and Mr. Goode, the SEC entered an order sanctioning Scottsdale's

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5 SEC, "Pump-and-Dumps" and Market Manipulations (Jun. 25, 2013) (available at http://bit.ly/SEC-Pump-and-Dumps).

6 *SEC* v. *Tavella*, Civ. No. 13-4609 (SDNY), Complaint at 2, ¶¶ 3–5 (Jul. 3, 2013).

7 *Id.* at 2–3, ¶¶ 6–7.

8 Compl. at 3, ¶ 11.

9 *Tavella*, Civ. No. 13-4609 (SDNY), Stipulated Order Granting Prelim. Inj., Asset Freeze, and Other Relief (R. 16, Jul. 16, 2013); Final J. Defs. Graciarena & Loureyro (R. 67, Dec. 8, 2014); Final Default J. Against Tavella [and Others] (R. 69, Jan. 9, 2015).

representative Timothy Scarpino for facilitating the sale of 8.2 million Biozoom shares that generated $18.5 million in gains—just over half the shares and half the gains—for the fraudsters.[10] His offense was "fail[ing] to conduct a searching inquiry into facts surrounding the proposed sales" of unregistered Biozoom stock, despite the presence of "significant red flags."[11]

Among other things, it was this same kind of failure to conduct searching inquiries that resulted in the Financial Industry Regulatory Authority ("FINRA") taking disciplinary action against Scottsdale.[12] FINRA imposed a $1.5 million fine against Scottsdale for "institutionaliz[ing] misconduct as its standard way of doing business," among other aggravating factors.[13] Part of the institutionalized misconduct included Scottsdale's failure to revise its procedures to focus on potential sham transactions after botching its gatekeeping role in the Biozoom pump-and-dump scheme that led to the SEC's enforcement action.[14]

FINRA had equally harsh words for Scottsdale's owner, John Hurry. FINRA found that he "violat[ed] his duty to observe high standards of commercial honor and just and equitable principles of trade," and it was "purposeful and egregious," which led FINRA to conclude that "[he] is a threat to investors and the integrity of the markets."[15] Worse yet, FINRA found that Hurry "repeatedly testified falsely, and that there was a

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[10] *In re Timothy C. Scarpino*, SEC No. 3-18483, Order Instituting Admin. and Cease-and-Desist Proceedings, Making Findings, Imposing Remedial Sanctions, and a Cease-and-Desist Order (May 15, 2018).

[11] *Id.* at 2, Part III, Summary.

[12] Answer Exh. A, *FINRA* v. *Scottsdale Capital Advisors Corp.*, No. 2014041724601, Am. Extended Hr'g Panel Dec. (Jun. 20, 2017) (available at http:// bit.ly/FINRA-Panel-Decision) ("FINRA PANEL DEC.")

[13] *Id.* at 107, Part IV(A)(3).

[14] *Id.* at 11-12, 101-102, 104.

[15] *Id.* at 107, Part IV(B).

pattern of doing so when he thought no contradictory evidence would come to light."[16] FINRA barred Hurry from associating with any other FINRA member for any reason.[17]

Which brings us to this lawsuit. The statement that Scottsdale claims is libelous is contained within an article written by Goode and published by MLM about three years after the Biozoom fraud. The article includes extensive quotations from FINRA's enforcement decision. It also include a link to the decision.

Scottsdale doesn't argue that the reporting about the FINRA action is inaccurate. Rather, it plucks a few sentences from the articles and claims that they wrongfully accuse it of actively engaging in a pump-and-dump scheme. In context, however, the articles do nothing more than note that penny stocks were illegally traded through Scottsdale brokerage accounts. And the notion that these articles damaged Scottsdale in any way—much less in some way unique and independent of (*a*) FINRA castigating and fining Scottsdale, or (*b*) FINRA excommunicating Mr. Hurry from the securities industry—is risible.

After four attempts at pleading a sufficient claim, Scottsdale has now conceded it is one of a few remaining brokers that still allow the deposit and sale of penny stocks,[18] and

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[16] *Ibid.*

[17] *Id.* at 108. The FINRA National Adjudicatory Council affirmed this ruling. *FINRA* v. *Scottsdale Capital Advisors Corp.*, No. 2014041724601 (FINRA Dec. Jul. 20, 2018) at 104, Part V (available at http://bit.ly/FINRA-National-Decision). Scottsdale has appealed to the SEC, which has stayed the fine until pending its decision. The appeal is irrelevant to this action, however, since the Court must assess the Statement at the time of publication, not based on later developments. *Peisner* v. *Detroit Free Press*, 104 Mich. App. 59, 64 (1981), *mod. on other grounds*, 421 Mich. 125 (1984).

[18] On December 17, 2018, Scottsdale sued FINRA in the U.S. District Court for the District of Columbia. It alleged: "At this point, only a handful of firms are still willing and able to process and clear sales of microcap securities, and those firms are under intense pressure to cease their participation in the market." R. 1, Compl. ¶ 6, *Scottsdale Capital Advisors Corp.* v. *FINRA.*, Civil No. 18-02973 (DDC Dec. 17, 2018). What Scottsdale claimed was false and defamatory is now so true that it supports a lawsuit against FINRA.

that most of the accounts frozen in the Biozoom pump-and-dump were at Scottsdale. So, what started as a defamation claim over four statements across two articles is now down to just one statement—a statement the court has already ruled is not defamatory:

> *If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors.*

(the "Statement," which appeared in an article on goodetrades.com (the "Website") in April 2017 (the "Article")).

One must question Scottsdale's motives for continuing to press this claim. Although irrelevant for (C)(8) purposes, Scottsdale has admitted in discovery that: (1) none of its clients has mentioned the Statement; (2) it has lost no customers; and (3) it has suffered no lost revenue.[19] Even assuming Scottsdale could prevail on a theory of defamation *per se*,[20] a plaintiff is only entitled to nominal damages, unless he can prove that the defendant acted maliciously. *Burden* v. *Elias Bros. Big Boy Restaurants*, 240 Mich. App. 723, 727-728 (2000). Having accused Goode and MLM of acting only negligently, carelessly, or recklessly,[21] and having suffered no actual losses,[22] the only apparent reason for continuing this lawsuit is to gain editorial control over unfavorable news coverage.[23] In other words, this lawsuit is about one thing: shutting down free speech. It is commonly known as a "strategic lawsuit against public participation." It is brought with the intent to

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[19] Exhibit 1, Scottsdale Interrog. Answers 27-30.

[20] Goode and MLM argue, *infra*, that this is not a case of defamation *per se* because: (1) the challenged statement does not accuse Scottsdale of a crime; and (2) no reasonable reader—a sophisticated person familiar with the penny stock market and Scottsdale's role in that market as a broker (not as a depositor-seller of the stock)—reading the article in its entirety (including the linked FINRA article) could reasonably conclude otherwise.

[21] Compl. ¶¶ 22-25.

[22] *Id.* at ¶ 17. Allegations about economic losses, like all others, must be pleaded in good faith and not for an improper purpose. MCR 1.109(E)(5)).

[23] *See* Compl., Prayer for Relief ¶ C.

censor the speaker's message because it is unwanted, not because it is false or defamatory. Fortunately, the First Amendment no more allows a "litigation veto" than it does a "heckler's veto."

For the reasons that follow, the Court should dismiss the Complaint with prejudice for failing to state a claim upon which relief can be granted.

SPECIAL STANDARD OF REVIEW FOR FIRST AMENDMENT CASES

Motions for summary disposition brought under MCR 2.116(C)(8) in defamation actions test the legal sufficiency of the complaint. *Singerman* v. *Municipal Serv. Bureau*, 455 Mich. 135, 139 (1997). The Court must limit its review to the pleadings—which by court rule includes both the complaint *and* the answer. MCR 2.116(G)(5) (review of a (C)(8) motion is limited to the pleadings); MCR 2.110(A) (defining a pleading to include complaints and answers). The Court must take the well-pleaded factual allegations as true and construe them in the light most favorable to the nonmoving party. *Dalley* v. *Dykema Gossett*, 287 Mich. App. 296, 304–305 (2010).

Importantly, however, courts have a special, heightened duty under the First Amendment to review the sufficiency of defamation complaints to make sure that pleading requirements are met. *Bose Corp.* v. *Consumers Union*, 466 U. S. 485 (1984). Although *Bose Corp.* involved a public figure and this case (allegedly) involves a private figure, the distinction between public and private figures is irrelevant to the scrutiny that must be brought to bear when assessing whether a defamation claim is properly pleaded—the distinction goes only to *the level of fault* that applies in a given case. The heightened scrutiny of the pleadings applies to *all* defamation cases, regardless of whether the plaintiff is a public or private figure. *Rouch* v. *Enquirer & News (After Remand)* ("*Rouch II*"), 440 Mich. 238, 272–27 (1992) (Riley, J. concurring) (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)). Although stated in a concurrence, "Justice Riley's position [in his concurring opinion in *Rouch II* is consistent with previous decisions of this Court." *Royal Palace Homes, Inc.* v. *Channel 7 of Detroit, Inc.*, 197 Mich. App. 48, 52–53 (1992) (also apparently a private-figure case). *See also Trost* v. *BuckStop Lure Co., Inc.*, 249 Mich. App. 580, 587 n.2 (2002) (observing, in a private-figure case, that Justice Riley outlined the proper procedure for (C)(8) challenges).

Michigan courts take this duty seriously. Recognizing that summary disposition is "an essential tool" to protect against "forbidden intrusions into the field of free expression," *Kevorkian* v. *American Med. Ass'n*, 237 Mich. App. 1, 5 (1999) (citing *Ireland* v. *Edwards*, 230 Mich. App. 607, 613 and n.4 (1998)), our courts long ago adopted an *Iqbal*-like pleading standard that requires plaintiffs to specifically plead: (1) the defamatory words and the facts that would establish that the words are false; (2) the facts identifying the publication of those words to a third party; (3) the level of fault that must be proved and the facts that would establish the speaker acted with that level of fault; and (4) the harm suffered by the publication. *Gonyea* v. *Motor Parts Fed. Credit Union*, 192 Mich. App 74, 76–77 (1991). *Accord Ashcroft* v. *Iqbal*, 556 U. S. 662 (2009) (federal plaintiffs must "plausibly" plead claims through specific factual allegations). Pleading specific facts is a "relatively simple requirement"; defendants are entitled to summary disposition under MCR 2.116(C)(8) "on this ground alone" when plaintiffs fail to follow it. *Rouch II*, 440 Mich. at 279.

Also important, the heightened pleading requirement allows courts to resolve several questions of law on the pleadings, including: (1) whether a statement is capable of being defamatory; (2) the nature of the speaker and the level of constitutional protections afforded to the statement; and (3) whether actual malice exists, if the plaintiff is required to show that level of fault. *Thomas M. Cooley Law School* v. *Doe 1*, 300 Mich. App. 245, 342 (2013). 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). 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) (citing Michigan law).

ARGUMENT

Scottsdale has again failed to sufficiently plead a claim for defamation. In Michigan, a libel plaintiff must prove that the defendant: (1) made a false statement of fact, (2) that was defamatory, (3) which was "of and concerning the plaintiff, (4) in the form of an unprivileged publication to a third party, (5) with a level of fault amounting to at least negligence on the part of the publisher, and (6) thereby damaged the plaintiff. *Northland Wheels Roller Skating Ctr.* v. *Detroit Free Press*, 213 Mich. App. 317, 323 (1995) (citing *Rouch II*). As an initial matter, the Statement is nonactionable hyperbole. Even if it were a statement of fact, it is not neither false nor defamatory. The Statement is also subject to the fair-comment privilege. The Complaint does not plead a claim in avoidance of the privilege. Finally, Scottsdale's most recent amendments have not cured its failure to adequately plead the level of fault with the required factual support.

I. HYPERBOLE: The Statement is not a false material statement *of fact* because it is nonactionable hyperbole.

To be actionable, the challenged statement must be provably false. *Ireland*, 230 Mich. App. 607 (citing *Milkovich* v. *Lorain Journal Co.*, 497 U.S. 1, 17–22 (1990)). In other words, the statement must state "actual, objectively verifiable facts." *Milkovich*, 497 U.S. at 17–21. Nonfactual hyperbole is not provably false. As noted in Part III, *infra*, Scottsdale has been connected to at least two pump-and-dump schemes in the years preceding publication of the Article. The Statement thus amounts to "everyone knows" about the connection—which is classic rhetorical hyperbole that is not actionable. *See, e.g.*, *Komarov* v. *Advance Magazine Publ'rs, Inc.*, 691 N.Y.S.2d 298, 301–302 (NY Sup. Ct. 1999) (plaintiff was as

"well known" in the community as notorious mobster John Gotti was rhetorical hyperbole that cannot be proven false and not actionable).[24] Scottsdale cannot objectively prove that those who followed penny stock pump-and-dump schemes did *not* know of Scottsdale. It says that it could do so through a poll, (Compl. ¶ 15), but we do not try cases by polling the community. Trials are not gameshows where people "text their vote" to the jury. The absence of any legal mechanism to conduct and admit such a poll into evidence only underscores that this is *Komarov*-style hyperbole, not a provable statement of fact.

II. TRUTH: The Statement is not actionable because it is not materially false.

If the Court holds that the Statement is not an opinion, it should still find that Scottsdale has failed to plead facts sufficient to show that the Statement is false. Scottsdale says the Statement is false because it has "never been involved in any 'pump and dump' schemes, has never been a defendant in any 'pump and dump' lawsuits, and has never been convicted of engaging in 'pump and dump' activity." (Compl. ¶ 15.) But, on its face, the Statement doesn't accuse Scottsdale of these things, as the Court previously held in dismissing this statement from the First Amended Complaint. (Op. 7 (Oct. 4, 2018).)

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[24] *See also Hogan* v. *Winder*, 762 F.3d 1096, 1107-1108 (CA10 2014) (accusing someone of blackmail for threatening to sue a former employer was not actionable because, in context, it was nonactionable hyperbole); *Fasi* v. *Gannett Co.*, 930 F. Supp. 1403 (D Haw. 1995) ("Frank 'the Extortionist' Fasi is at it again" was hyperbole, not a true accusation of criminal activity); *Haberstroh* v. *Crain Publ'ns, Inc.*, 189 Ill. App. 3d 267 (1989) (saying a professor was on an "acid trip" was not an accusation of illegal drug use); *McGilvray* v. *Springett*, 68 Ill. App. 275 (1896) (statement that the plaintiff had stolen money from the town treasury "and everybody knows it" was not slanderous; bystanders understood this was not an accusation of larceny, but allegedly overbilling the town for services).

III. NOT LIBELOUS: The Statement is not actionable because it is not reasonably capable of a defamatory meaning.

Undeterred, Scottsdale alleges that the juxtaposition of the headline "FINRA fines Scottsdale Capital Advisors $1.5 million" implies that FINRA fined Scottsdale for its involvement in the pump and dump of penny stocks—and that this the *only* conclusion that a "reader" could make. (Compl. ¶ 14.)

In a lengthy and strongly worded opinion in *Locricchio* v. *Evening News Association*, 438 Mich. 84 (1991), the Michigan Supreme Court placed severe restrictions on "libel by implication." Relying on *Sanders* v. *Evening News Association*, 313 Mich. 334 (1946), the Court held that, under Michigan law, "imposing liability on a media defendant for facts it publishes accurately and without material factual omissions about public affairs" is prohibited. *Locricchio*, 434 Mich. at 117. Noting that defamation by implication was not so "analytically distinct" as to "require a departure from the guiding principles of general libel and First Amendment libel law," *id.* at 132, the Court emphasized the "severe constitutional" burden of proving falsity that a plaintiff must carry. *Id.* at 122. *Locricchio* renders it extremely difficult, if not practically impossible, to advance a defamation by implication claim under Michigan law. This is as it should be. The falsity requirement should be construed and applied in a manner that assures true speech will not be punished.

The courts look with extreme skepticism upon any theory that threatens to soften the requirement that a libel plaintiff plead and prove a specific false statement of fact. Emphasizing the principles articulated *Locricchio*, the Michigan Court of Appeals has held that a libel defendant "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, 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). There are no facts pleaded that, if proven, would establish that

MLM and Goode intended to imply that Scottsdale was *committing* pump-and-dump schemes, as opposed to serving as the means by which such schemes were accomplished.

As noted earlier, the Court must read the Statement in context, fairly and reasonably construing the entire article to determine whether the challenged statement is libelous. *Sanders*, 313 Mich. at 340; *Croton*, 104 Mich. App. at 108. The linked FINRA decision provides the context. It details how Scottsdale's business is susceptible to sham transactions.

FINRA noted, among Scottsdale's many shortcomings, that the SEC had previously sued two of Scottsdale's registered representatives in a case involving a pump-and-dump scheme: a Panamanian-based pump-and-dump in 2008–2012 and Bahamian-based pump-and-dump in 2008. FINRA PANEL DEC. at 11–12 and nn. 18 and 20. FINRA fined Scottsdale in part because FINRA directly tied the success of the $34 million Biozoom pump-and-dump scheme to Scottsdale's lax anti-fraud safeguards, which it never improved despite being on notice that its existing safeguards were inadequate to detect and prevent fraud. *Id.* at 107, Part IV.A(3). FINRA explained that, in accepting penny stocks for deposit in the earlier 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. Scottsdale's subsequent failure to adequately police transactions—as it was required to do 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); and 17 C.F.R. 240.17a-8 (SEC regulation requiring brokers to follow the BSA and its rules)—signaled to FINRA that Scottsdale had not heeded the 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.*

FINRA PANEL DEC. 104 at Part IV.A(1)(d) (emphasis supplied). Accordingly, Scottsdale grossly 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* Compl. ¶ 14.)

Under Section 5 of the Securities Act, the sale of securities without registration is unlawful unless an exemption exists. 15 U.S.C. § 77e(a)(1). In selling penny stocks without registration, Scottsdale "usually relie[d] on a 'safe harbor' exemption created by the [SEC], Rule 144." FINRA PANEL DEC. 5 at Part I.A. When a securities transaction involves "large blocks of thinly traded, little-known securities acquired in a chain of private transactions," like the Biozoom stock, it is "a red flag that the SEC and FINRA have both said requires a 'searching inquiry.'" *Id.* at 6, Part I.A(3). "These red flags ought to have been investigated and properly resolved *before* the securities could be sold. [Scottsdale], however, *blinded itself* to the multiple red flags signaling that the transactions were unlawful public distributions of securities. It did not conduct the required searching inquiry. It [therefore] sold the securities without a reasonable basis for a Rule 144 exemption." *Id.* at 7, Part I.A(3) (emphasis added).

Explaining Scottsdale's willful blindness, FINRA noted that "[Scottsdale] was on notice that its business was susceptible to sham transactions and the use of nominees to conceal the true beneficial owners of securities. *In four disciplinary actions* involving Scottsdale's own employees and customers, the SEC alleged that sham transactions and nominees were used in unlawful sales in violation of Section 5 of the Securities Act. Those unlawful sales in turn were used to facilitate fraud and manipulation." FINRA PANEL DEC. 11, Part III.B(1)(a)(iv)(a) (emphasis added). FINRA identified the nature of the fraud and manipulation, two of which involved pump-and-dump schemes. *Id.* at 11–12, Part III.B(1)(a)(iv)(a). After detailing Scottsdale's shortcomings in each of the earlier regulatory actions—

including the Biozoom fraud—FINRA held that those actions "should have caused [Scottsdale] to take special care . . . to revise its procedures to focus on potential sham transactions and the use of nominees. [Scottsdale] did not." *Id.* at 13, Part III.B(1)(a)(iv)(a).

Scottsdale attempted to minimize the significance of its gatekeeping function, arguing that it was unfair to look back to the pump-and-dump schemes because no formal accusation had been made in the current disciplinary case that the challenged transactions were part of a pump-and-dump fraud. *Id.* at 13, Part III.B(1)(a)(iv)(b). FINRA was unmoved: "It is not necessary, however, to prove that fraud occurred in order to conclude that [Scottsdale and other respondents] failed to perform their gatekeeping duty adequately." *Ibid.* In trying to make the same argument here, (Compl. ¶ 14), Scottsdale ignores the central thrust of the Article: a company with a history of being used by third parties as a tool to execute pump-and-dump schemes because of its repeated failure to take its gatekeeping function seriously was fined $1.5 million for yet again not doing its job to adequately safeguard the investing public.

In its last brief on this subject, Scottsdale essentially conceded that anyone reading the linked FINRA report would understand this context, but argued that the "damage is done" before the reader gets to the FINRA report. (Opp'n at 9, Mot. Summ. Dispo., Second Am. Compl.) This is just another way of 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*, 313 Mich. at 340; *Croton* v. *Gillis*, 104 Mich. App. 104, 108 (1981). In context, the Statement is not libelous.

Even if the Court were to conclude that the Statement is capable of a defamatory implication, the alleged implication is substantially true. Substantial truth is an absolute defense to a defamation claim. *Collins* v. *Detroit Free Press*, 245 Mich. App. 27, 33 (2001).

The doctrine precludes liability if the gist or sting of the statement is true; a statement is not considered false unless the literal truth would have produced a different effect in the mind of the reader. *Ibid.*

Scottsdale's claim rests on the distinction between actively committing fraud and being used as a tool for fraudsters. A person who followed pump-and-dump schemes—*i.e.*, the reasonable audience—would know the difference between these two things *and* understand from the linked FINRA report that Scottsdale was involved in pump and dumps *as a tool.* Moreover, the linked FINRA report shows that regulators found Scottsdale to be a *willing* tool because it "institutionalized misconduct as its standard way of doing business." FINRA PANEL DEC. 105 at Part IV.A(1)(d). Anyone who followed pump-and-dump schemes would know of Scottsdale. Anyone who read the entire article (including the linked FINRA report)—as the Court must under *Sanders*—would also understand *how* Scottsdale was involved. Thus, the Statement is substantially true.

IV. PRIVILEGED: The Article addresses a matter of public concern—enforcement of securities regulations to guard against frauds on the market— making the Statement privileged under Michigan's common law fair-comment privilege.

A news story about any matter of public interest or concern is protected under Michigan's common law fair-comment privilege. *Lawrence* v. *Fox*, 357 Mich. 134 (1954). There is no requirement that the publication deal with a "public controversy," a term of art that applies in other contexts in First Amendment cases. *Bichler* v. *Union Bank & Trust*, 745 F.2d 1006, 1011 (CA 9184) (applying Michigan common law). The fair-comment privilege is a qualified privilege that exists based upon the circumstances surrounding the publication, not the publication's content. *Lawrence*, 357 Mich. at 140. The privilege also applies regardless of whether the plaintiff is a public or private figure. *Peisner* v. *Detroit Free Press, Inc.*, 82 Mich. App. 153, 161 (1978). "Everyone, citizen and reporter, has the right to comment on matters of public importance, and expressions of opinion and even

misstatements of fact are not actionable in a libel suit unless made maliciously for the purpose of damaging another's reputation." *Orr* v. *Argus-Press Co.*, 586 F.2d 1108, 1113 (CA6 1978) (applying Michigan law). "Negligence on the part of the newspaper *is not sufficient to establish liability*. Scienter is required. If the statement is honestly believed to be true and published in good faith, there is no scienter and no liability." *Ibid.* (internal quotations omitted) (emphasis added). "The burden is on *the plaintiff* to prove the untruth of the statements *and actual malice*." *Dadd* v. *Mount Hope Church*, 486 Mich. 857 n.1 (2010) (quoting *Van Vliet* v. *Vander Naald*, 290 Mich. 365, 371 (1939)) (emphases added).

The source of the content bears on the privilege's application: "If the source of the publisher's information is a person or organization of probity and good repute, the jury would have warrant to find that he honestly believed that what he published was the truth ... On the other hand, if his sources were notably mendacious, there might well be warrant to find otherwise." *Lawrence*, 357 Mich. at 143. Although the reliability of the source is often a question for the jury, that is not the case here. The source that Goode and MLM relied upon here is a detailed legal decision from a licensing authority empowered to act as the frontline regulator of securities brokers like Scottsdale. (FINRA is a self-regulatory organization that is responsible under the Exchange Act of 1934 for policing enforcement of federal securities laws by its members. *See* 15 U.S.C. § 78f.) As a matter of law, no reasonable juror could conclude that the functional equivalent of a court decision is "mendacious" or otherwise of bad repute; a reasonable juror could only conclude that reliance on a *de facto* judicial decision is a trustworthy source. *Cf. Sherwood* v. *Evening News Ass'n*, 256 Mich. 318, 321 (1931) ("fair and impartial reports of judicial, executive, legislative, or other official public proceedings are considered qualifiedly privileged."); M.C.L. § 600.2911(3) (more or less codifying the *Sherwood* privilege).

A plaintiff can overcome the fair-comment privilege only by pleading and proving that the defendant abused the privilege by recklessly disregarding the truth—*i.e.*, by

entertaining serious doubts about the truth of the publication. *Schultz* v. *Newsweek, Inc.*, 668 F.2d 911, 918 (CA6 1982) (applying Michigan law and recognizing that Michigan has replaced the old definition of "actual malice," meaning spite or ill will, with the new "actual malice" standard articulated in *New York Times Co.* v. *Sullivan*, 376 U.S. 254 (1964)). Michigan requires plaintiffs to allege facts in the complaint that would establish actual malice. *Gonyea*, 192 Mich. App. at 76–77; *Rouch II*, 440 Mich. at 279. It is not enough to offer conclusory allegations that the defendant entertained serious doubt—the plaintiff must plead facts that, if proved, would allow a jury to make that finding.

Scottsdale alleges that Goode and MLM "purposefully omitted" that FINRA fined Scottsdale for rule violations instead of its involvement in pump-and-dump activity. (Compl. ¶ 23.) Not only is this a conclusory allegation entitled to no weight, but it is contradicted by the Article, which includes a reference to FINRA Rule 2010 and Section 5 of the Securities Act, and the FINRA report, which *is part of the article.* Moreover, the report explained that FINRA fined Scottsdale in part for failing to remedy lax procedures that had proven to be inadequate to prevent pump-and-dump schemes, including the Biozoom fraud. FINRA PANEL DEC. 107 at Part IV.A(3). On a pleadings-based motion to dismiss, a court needn't accept as true allegations that are plainly contradicted by an exhibit to a pleading. *Sprewell* v. *Golden State Warriors*, 266 F.3d 979, 988 (CA9 2001) (applying Fed. Rule Civ. Proc. 12(b)(6), the equivalent of M.C.R. 2.116(C)(8)).

In short, Scottsdale is displeased that Goode and MLM published an Article stating that FINRA tied its $1.5 million fine to rule violations that had previously allowed pump-and-dump schemes to succeed. But since that is exactly what the FINRA report says, Scottsdale has failed to plead facts from which the jury could find that they entertained serious doubt correctness of the conclusion they drew from the report. At most, Scottsdale has alleged that Goode and MLM failed to adequately investigate and understand the legal issues in the FINRA report before reporting on it. But allegations of inadequate

investigation are insufficient to constitute malice. *Beckley Newspapers Corp.* v. *Hanks*, 389 U.S. 81 (1967). And nonlawyers are not held liable for technical errors in reporting on legal matters, as long as the gist or sting of the legal report is substantially true. *Rouch II*, 440 Mich. at 249–265 (collecting authorities and offering in detail as an example the case of a Wisconsin judge who could not sue a newspaper for libel over a story mischaracterizing his remarks—in which he wondered aloud if a 15-year-old convicted of sexual assault should receive a more lenient sentence having grown up in a sexually permissive society—as a "ruling," which story led to his recall from office).

V. FAULT: The Complaint does not adequately plead negligence.

To adequately plead fault, a plaintiff must identify the level of fault that applies to the claim *and* allege facts that would establish that level of fault if proved. *Gonyea*, 192 Mich. App. at 76–77; *Rouch II*, 440 Mich. at 279. There are two levels of fault: negligence and actual malice. *Ibid.* The negligence standard applies in cases involving private figures; the actual-malice standard applies in cases involving public officials, public figures, and limited-purpose public figures. *Ibid.* Scottsdale alleges that it is a private figure and that MLM and Goode are the direct and proximate cause of its damages, Compl. ¶ 29, so it impliedly pleads the level of fault to be negligence.

Negligence is defined as the failure to use the care that an ordinary person would use under the circumstances. MICH. CIV. J. INSTR. 10.02. Thus, in order to meet the *Iqbal*-like pleading standard, Scottsdale must allege what a reasonably careful reporter and reasonably careful publisher would have done under the circumstances, and then plead facts alleging that MLM and Goode failed to do those things. *Michigan Microtech, Inc.* v. *Federated Publ'ns, Inc.*, 187 Mich. App. 178, 186 (1991). These standards are intertwined with the "reasonable audience" standard. *Air Wis. Airlines Corp.* v. *Hoeper*, 71 U.S. 237, 246–251 (2014). The Complaint does not satisfy these pleading requirements.

Scottsdale alleges that a reasonably careful reporter "reads the documents he cites and would not report, or imply that a fine for procedural noncompliance is the equivalent of a fine for intentional pump and dump activity." (Compl. ¶ 24.) Scottsdale would presumably have the Court draw an inference that Goode did not read the FINRA report. Yet the Article in which the Statement appears quotes from the report at length. Thus, the Article itself precludes this from being a *reasonable* inference. *Lakeside Oakland Dev.* v. *H&J Beef Co.*, 249 Mich. App. 517, 530 n4 (2002) ("[w]hen considering a motion under MCR 2.116(C)(8), ... any *reasonable* inferences or conclusions that can be drawn from the facts, are accepted as true." (cleaned up) (emphasis added)).

Alleging that Goode did not read the FINRA report is also a rather odd allegation to make. Essentially, Scottsdale's position is that a reasonable journalist would take the time to read source material, but: (1) a reasonable reader would not do so, even though the material forms part of the article; and (2) the Court should not do so when assessing the sufficiency of the Complaint. Not only does the law presume that the reasonable reader reads the entire story, but in this case the law also presumes they're sophisticated readers. Under *Air Wisconsin*, Goode and MLM can reasonably expect that the reasonable audience of visitors to the Website are people familiar with the microcap market, including the players in the market and their roles (*e.g.*, depositor-sellers, broker-dealers, and buyers, etc.). Those readers, being versed in the industry, would conclude that Scottsdale was the *means* by which a pump-and-dump was accomplished, not that Scottsdale had itself engaged in illegal activity—particularly with the benefit of links to source documents.[25]

Under *Rouch II*, a failure to plead *both* the level of fault that must be proved *and the facts* that would establish the speaker acted with that level of fault entitles MLM and Goode

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[25] Indeed, this probably explains why Scottsdale hasn't suffered any loss of business. (Goode and MLM do not rely on the absence of damages for this Motion; it is merely an observation.)

to summary disposition under MCR 2.116(C)(8). *Rouch II*, 440 Mich. at 279 (Riley, J., concurring). Scottsdale's failure to plead facts adequately supporting a claim of negligence is fatal to the Complaint.

VI. DISMISSAL WITH PREJUDICE: Scottsdale cannot cure the flaws in the Complaint by further amendment.

Leave to amend should be withheld when amendment would be futile. *Allegheny-Ludlam Corp.* v. *Michigan Dept. of Treas.*, 207 Mich. App. 604, 605 (1994). Amendment would be futile in this case. The Statement is nonactionable hyperbole, and no amount of re-pleading will change that. Even if could be construed as a statement of fact, it is substantially true when considered in light of FINRA's disciplinary decision, it is not capable of defamatory meaning, and it is privileged. After four failed attempts at a proper pleading, it is time to bring this case to a close.

PRAYER FOR RELIEF

MLM and Goode respectfully request that the Court grant summary disposition in their favor under Rule 2.116(C)(8) and dismiss the Complaint with prejudice.

Respectfully submitted,

BUTZEL LONG, P.C.

Dated: JANUARY 29, 2019

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STATE OF MICHIGAN
KALAMAZOO COUNTY CIRCUIT COURT

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

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

Defendants.

File No.: 2018—0153-CZ

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PLAINTIFF'S ANSWER TO DEFENDANTS' FIRST SET OF INTERROGATORIES

Under Rule 2.309(B), Plaintiff Scottsdale Capital Advisors, Corporation ("Plaintiff"), answers Defendants MorningLightMountain, LLC, and Michael Goode (collectively "Defendants") First Set of Interrogatories as follows:

RESERVATION OF RIGHT TO SUPPLEMENT

Interrogatory to the extent that it is ambiguous, overbroad as to time, burdensome, and harassing. In light of the foregoing objections, Plaintiff will not respond to this Interrogatory.

25. Identify every act, fact, and event that supports SCA's answer to Interrogatory No.24.

OBJECTION: Plaintiff objects to this Request to the extent that it is not reasonably calculated to lead to the discovery of relevant evidence in light of the fact that Plaintiff is not seeking special damages for specific lost business relationships. Plaintiff further objects to this Interrogatory to the extent that it is ambiguous, overbroad as to time, burdensome, and harassing. In light of the foregoing objections, Plaintiff will not respond to this Interrogatory.

26. Identify each person and business that SCA knows, believes, or suspects has factual information supporting SCA's answers to Interrogatory Nos. 24 and 25, providing the full name of the person or business. For each person, provide their business address, business telephone number, business email, personal address, personal telephone number, and personal email. For each business, provide their state of incorporation; resident agent's name, business address, business telephone, and business email; and chief executive's name, business address, business telephone, and business email.

OBJECTION: Plaintiff objects to this Request to the extent that it is not reasonably calculated to lead to the discovery of relevant evidence in light of the fact that Plaintiff is not seeking special damages for specific lost business relationships. Plaintiff further objects to this Interrogatory to the extent that it is ambiguous, overbroad as to time, burdensome, and harassing. In light of the foregoing objection, Plaintiff will not respond to this Interrogatory.

27. Identify each person and business that declined to enter into, or declined to renew, a business relationship with SCA because of the Statement in the April Article, providing the full legal name of the person or business. For each person, provide their business address, business telephone number, business email, personal address, personal telephone number, and personal email. For each business, provide their state of incorporation; resident agent's name, business

address, business telephone, and business email; and chief executive's name, business address, business telephone, and business email.

OBJECTION: Plaintiff objects to this Interrogatory to the extent that it is not reasonably calculated to lead to the discovery of relevant evidence in light of the fact that Plaintiff is not seeking special damages for specific lost business relationships. Plaintiff further objects to this Interrogatory to the extent that it is ambiguous, overbroad as to time, burdensome, and harassing. In light of the foregoing objection, Plaintiff will not respond to this Interrogatory.

28. Identify every act, fact, and event that supports SCA's answer to Interrogatory No. 27.

OBJECTION: Plaintiff objects to this Interrogatory to the extent that it is not reasonably calculated to lead to the discovery of relevant evidence in light of the fact that Plaintiff is not seeking special damages for specific lost business relationships. In light of the foregoing objection, Plaintiff will not respond to this Interrogatory.

29. Identify each person and business that SCA knows, believes, or suspects has factual information supporting SCA's answers to Interrogatory No. 27 and 28, providing the full name of the person or business. For each person, provide their business address, business telephone number, business email, personal address, personal telephone number, and personal email. For each business, provide their state of incorporation; resident agent's name, business address, business telephone, and business email; and chief executive's name, business address, business telephone, and business email.

OBJECTION: Plaintiff objects to this Interrogatory to the extent that it is not reasonably calculated to lead to the discovery of relevant evidence in light of the fact that Plaintiff is not seeking special damages for specific lost business relationships. In light of the foregoing objection, Plaintiff will not respond to this Interrogatory.

30. Identify all damages that SCA claims as a result of the Statement in the April Article, itemized by the type of damages, monetary value, and the date(s) the damages were incurred.

OBJECTION: Plaintiff objects to this Interrogatory to the extent that it is not reasonably calculated to lead to the discovery of relevant evidence in light of the fact that Plaintiff is not seeking special damages.

ANSWER: Without waiving the foregoing objection, Plaintiff states that it is seeking general damages for the harm the Statement in the April Article has caused to its business reputation. This harm is ongoing.

31. Identify every act, fact, and event that supports SCA's answer to Interrogatory No.30.

OBJECTION: Plaintiff objects to this Interrogatory to the extent that it requests information not fully available to Plaintiff because those who have formed negative opinions of Plaintiff are unlikely to voice those opinions of Plaintiff.

ANSWER: Without waiving the foregoing objection, Plaintiff states that the Statement in the April Article directly calls Plaintiff's business reputation into question by insinuating that it engages in practices that typical brokers do not do. This has damaged Plaintiff's business reputation by making it appear to be a sub-par brokerage that is engaging in questionable, non-standard, potentially illegal business practices.

32. Identify each person and business that SCA or any of its Agents knows, believes, or suspects has factual information supporting SCA's answer to Interrogatory Nos. 30 and 31, providing the full name of the person or business. For each person, provide their business address, business telephone number, business email, personal address, personal telephone number, and personal email. For each business, provide their state of incorporation; resident agent's name, business address, business telephone, and business email; and chief executive's name, business address, business telephone, and business email.

OBJECTION: Plaintiff objects to this Interrogatory to the extent that it is not reasonably calculated to lead to the discovery of relevant evidence in light of the fact that Plaintiff is not seeking special damages.