In the Court of Appeals
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff-Appellee,

v.

MORNINGLIGHTMOUNTAIN, LLC, and MICHAEL GOODE,

Defendants-Appellants,

–and–

DOES 1–10,

Defendants–Not Participating.

Docket No. 348702

Kalamazoo County Circuit Court
Case No.: 18-0153-CZ
HON. ALEXANDER C. LIPSEY

ANSWER TO APPELLEE'S MOTION TO STRIKE

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Under Rule 7.211(B), Defendant-Appellants MorningLightMountain, LLC, and Michael Goode, respectfully submit this Answer in opposition to Plaintiff-Appellee Scottsdale Capital Advisors Corporation's Motion to Strike.

ARGUMENT

I. The "Allegations of Error," "Grounds for Appeal," and "Procedural History" sections of the Application do not violate Rule 7.212(C)(6).

Scottsdale argues that the Allegations of Error section of Defendants' Application does not comply with Rule 7.212(C)(6) because it is biased and does not cite the record. MOTION at 2. Of course, Rule 7.212(C)(6) does not govern this section of the Application.

Applications for leave to appeal are governed by Rule 7.205(B)(1), which tells appellants what they must include in their application. Rule 7.205(B)(1) specifically requires that Applications must:

> [1] state[] the date and nature of the judgment or order appealed from;
>
> [2] concisely recite the appellant's allegations of error and relief sought;
>
> [3] set[] forth a concise argument, conforming to MCR 7.212(C), in support of the appellant's position on each issue; and
>
> [4] if the order appealed from is interlocutory, set[] forth facts showing how the appellant would suffer substantial harm by awaiting final judgment.

MCR 7.205(B)(1). Thus, on the face of the rule, *only the argument section* of an application must conform to Rule 7.212(C).

For the allegations of error, conciseness is the only requirement. The word *concise* means "giving a lot of information clearly and in a few words; brief but comprehensive." OXFORD ENGLISH DICTIONARY ONLINE, https://en.oxforddictionaries.com/definition/concise. The Application fulfills this requirement by concisely reciting six allegations of error in three pages. APPLICATION at viii–x. Excluding citations to supporting authority, each of the allegations of error is brief while remaining comprehensive. The first allegation consists of two sentences, *id.* at viii, the second allegation consists of five sentences, *id.* at viii–ix, the third allegation consists of four

sentences, *id.* at ix, the fourth allegation consists of eleven sentences, *id.* at ix, the fifth allegation consists of four sentences, *id.* at x, and the sixth allegation consists of eight sentences. Thus, this section of the Application complies with the requirement that an appellant concisely recite the allegations of error.

In addition, because Defendants seek an interlocutory appeal, they must explain why they would suffer substantial harm by awaiting final judgment. Rule 7.205(B)(1) imposes no restrictions on this section of the Application. Over two-and-a-half pages, Defendants explained: (1) that Scottsdale's lawsuit is a naked attempt to suppress unfavorable news reports about its regulatory misfeasance and to chill future reporting; and (2) why the cost of litigation erodes free speech. Forcing a person to finance litigation to defend the lawful exercise of their First Amendment rights chills speech—not only for the defendant but for all of society. It leads to self-censoring to avoid the steep financial losses attendant to protracted pretrial litigation.

Scottsdale argues that Defendants must explain how they will suffer substantial harm in an "unbiased" way. MOTION at 4. This is a puzzling proposition. Harm and neutrality are antonyms.

Defendants have articulated why they will suffer substantial harm. If Scottsdale disagrees with Defendants' contention, then the proper place for it to argue the absence of harm is in its brief opposing leave, not through a motion to strike—which is, none too ironically, just another way of trying to silence speech Scottsdale doesn't like. In that regard, the motion proves Defendants' point about why Scottsdale is pursuing this case.

Finally, under Rule 7.205(B)(1), appellants aren't required to include a "procedural history" section in their application. Defendants included it as a courtesy, so that the Court could appreciate the posture of the interlocutory application. Even if Rule 7.212(C)(6) applied to an unrequired section of the Application, it does not require dull prose.

II. The "Grounds for Appeal" and "Statement of the Case" sections of the Application do not violate Rules 2.302(H)(3), 7.210(A)(1), or 7.212(C).

Scottsdale's citation to Rule 2.302(H)(3) is bemusing. This rule says that, "[o]n appeal,

only discovery materials that were filed or made exhibits are part of the record on appeal." MCR 2.302(H)(3). Nowhere in its motion does Scottsdale point to any discovery materials cited in the Application that are not included in the record. Nor can it do so. Defendants seek an appeal from a C8 ruling. By definition, the ruling is based on *the pleadings*, not facts adduced during discovery.

Scottsdale argues next that the Grounds for Appeal and Statement of the Case sections of the Application cite to materials outside of the record. MOTION at 6–9. Not so. Every quoted paragraph and citation is rooted in the record. Rule 7.210(A)(1) defines the record on appeal as the papers filed in the trial court, transcripts of testimony or other proceedings, and exhibits introduced. MCR 7.210(A)(1). Every excerpted paragraph in Scottsdale's motion can be traced back to a pleading or paper filed in the trial court:

- "Scottsdale, a regulated securities broker, has sued MLM and Goode for unfavorable press coverage of a steep fine that the Financial Industry Regulatory Authority ("FINRA") imposed against Scottsdale. Scottsdale has aggressively sued those who deigned to cover the story. *See*, *e.g.*, *Scottsdale Cap. Advisors Corp.* v. *S&P Global, Inc.*, Civ. No. 18-1105 (D. Ariz. 2018) (defamation case dismissed by stipulation); *Scottsdale Cap. Advisors Corp.* v. *The Deal, LLC*, 887 F.3d 17 (Cal. 2018) (defamation case dismissed for lack of jurisdiction). Scottsdale even sued FINRA to stop its disciplinary proceeding. *Scottsdale Cap. Advisors Corp.* v. *FINRA*, 844 F.3d 414 (CA4 2016) (injunctive action dismissed for lack of jurisdiction)."

Source: Appx. 502a, Defendants' Reply at 1, Mot. Summ. Disp., First Am. Compl.

- "This isn't Scottsdale's first lawsuit against a publisher for reporting on Scottsdale public discipline. *See*, *e.g.*, *Scottsdale Cap. Advisors Corp.* v. *S&P Global, Inc.*, Civ. No. 18-1 (D. Ariz. 2018) (defamation case dismissed by stipulation); *Scottsdale Cap. Advisors Corp.* v. *The Deal, LLC*, 887 F.3d 17 (Cal. 2018) (defamation case dismissed for lack of jurisdiction. SCA even sued FINRA to stop its disciplinary proceeding. *Scottsdale Cap. Advisors Corp.* v. *FINRA*, 844 F.3d 414 (CA4 2016) (injunctive action dismissed for lack of jurisdiction)."

Source: Appx. 502a, Defendants' Reply at 1, Mot. Summ. Disp., First Am. Compl.

- "A 'penny stock' is a security issued by a small company that trades at less than $5.00 per share. U.S. Secs. & Exch. Comm'n ("SEC"), Penny Stock Rules (May

9, 2013) ("PENNY STOCK RULES") (available at http://bit.lv/SEC-Penny-Stock-Rules). 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. SEC, Microcap Stock: A Guide for Investors, Introduction (Sept. 13, 2013) (available at http://bit.lv/SEC-Microcap-Guide). 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." Ibid. They are very speculative investments, and Congress has tightly regulated broker-dealers who facilitate penny-stock trading under the Exchange Act. PENNY STOCK RULES, supra at n.3."

Source: Appx. 993a, Defendants' Third Mot. Summ. Disp. at 1.

- One fraud particularly affecting penny stocks is the classic pump-and-dump scheme. The scheme involves touting a company's stock through false and misleading 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 price falls and investors lose their money. SEC, "Pump-and-Dumps" and Market Manipulations (Jun. 25, 2013) (available at http://bit.ly/SEC-Pump-and-Dumps).

Source: Appx. 993a–994a, Defendants' Third Mot. Summ. Disp. at 1–2.

- From March–June 2013, at least eight people opened accounts with broker-dealers and deposited millions of shares of Biozoom stock. They falsely claimed that they had recently purchased the stock from Entertainment Art's original shareholders and that the stock could be freely traded. *SEC* v. *Tavella*, No. 13-4609 (SDNY), Compl. ¶¶ 3–5 (Jul. 3, 2013) (APPX. 832a–833a). After pumping the stock, the fraudsters dumped (*i.e.*, sold) 14 million shares in three months. They netted almost $34 million, of which about $17 million was wired to overseas bank accounts. *Id.* at 2–3, ¶¶ 6–7. Eventually, the stock collapsed.

Source: Appx. 994a, Defendant's Third Mot. Summ. Disp. at 2. Note that Scottsdale includes the citation Defendants gave to the record, while claiming that this excerpt is not supported by the record.

- In July 2013, 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. Many of the trading accounts frozen through the SEC's enforcement action were held at Scottsdale. *Tavella*, Stip. 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).

Source: Appx. 994a, Defendants' Third Motion Summ. Disp. at 2.

- Indeed, since the filing of this lawsuit, the SEC has entered an order sanctioning Scottsdale's representative 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. *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). The representative's 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." *Id.* at 2, Part III, Summary.

Source: Appx. 994a–995a, Defendants' Third Mot. Summ. Disp. at 2–3.

- Among other things, it was this same kind of failure to conduct searching inquiries that resulted in FINRA taking disciplinary action against Scottsdale. FINRA imposed a $1.5 million fine against Scottsdale for "institutionaliz[ing] misconduct as its standard way of doing business," among other aggravating factors. Amended Extended Hr'g Panel Decision 105 at Part IV.A(1)(d), *FINRA Dep't of Enforcement* v. *Scottsdale Cap. Advisors Corp.*, No. 2014041724601 (Jun. 20, 2017) (the "**FINRA Decision**") (APPX. 973a). 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.

Source: Appx. 995a, Defendants' Third Mot. Summ. Disp. at 3; Appx. 973a, FINRA Decision at 105. Note, here again, Scottsdale includes the citation Defendants gave to the record, while claiming that this excerpt is not supported by the record.

- The statement that Scottsdale claims is libelous is contained within the Article, which was published after the Biozoom fraud. The Article includes extensive quotations from FINRA's enforcement decision. It also includes a link to the decision.

Source: Appx. 801a, Scottsdale's Third Am. Compl. ¶¶ 12–13; Appx. 63a, Scottsdale's First Am. Compl., Exh. 1 at 1; Appx. 823a–824a, Defendants' Answer to Third Am. Compl., Exh. A.

- The statement at issue in this case does nothing more than correctly note that penny stocks were illegally traded through Scottsdale brokerage accounts. Despite the accuracy of the statement, Scottsdale has sued MLM and Goode because it objects to the "juxtaposition" of the Article's headline in conjunction with the challenged statement.

Source: Appx. 801a, Scottsdale's Third Am. Compl. ¶ 14. Note that the last two excerpts are drawn from Scottsdale's own pleadings, yet Scottsdale claims they are not supported by the record.

Scottsdale's grievance appears to be that these sources are not cited in each paragraph. It again cites, and this time quotes, Rule 7.212(C)(6) for this supposed requirement. As explained in Part I, *supra*, however, at the application stage, a brief need only conform to the requirements of Rule 7.212(C) *in the argument section* of the application. Here, every fact upon which Defendants rely *in the argument section* contains a citation to the Appendix, which includes a copy of every pleading and paper filed in the trial court—which Defendants provided because lower court records are not transferred up from the lower court at the application stage. IOP 7.205(B)(1) ("The Court strongly recommends that the appellant attach to its application for leave to appeal copies of relevant transcripts and pleadings as the Court does not receive the lower court record for purposes of considering whether to grant or deny applications for leave to appeal.")

Notably, under Rule 7.205(B)(1), appellants aren't required to include a "statement of the case" section in their application. Here, Defendants included it as a courtesy to the Court, so that it had some context for the arguments it was about to review.

CONCLUSION

Scottsdale once again wishes to silence speech. It cannot do so through court rules that do not apply. Defendants' Application conforms to the requirements of Rule 7.205(B)(1). The Court should therefore deny Scottsdale's motion.

Respectfully submitted,

BUTZEL LONG, P.C.

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