

Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION —S.D.N.Y.: Defamatory online posting did not cause drop in stock price, (Sep. 24, 2014)

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By Rodney F. Tonkovic, J.D.

A complaint alleging that a false statement posted on an online message board led to a decline in a company's stock price was dismissed. The plaintiffs alleged that an unknown defendant made allegedly defamatory statements about their business on InvestorsHub.com that damaged the business and led to a decline in its stock price. The district court found that the complaint failed to state a claim and dismissed the complaint *sua sponte* (*Salvani v. ADVFN PLC*, September 23, 2014, Ramos, E.).

Background. Plaintiff Joseph M. Salvani was a consultant to CodeSmart Holdings, Inc. (CodeSmart). In return for his advice in dealing with institutions and investors, Salvani received cash and CodeSmart securities. InvestorsHub.com is a subscription website intended as a forum for investors to share opinions and information about companies and the market.

In September 2013, a party using the handle "brklynrusso" posted a message on an InvestorsHub.com forum about CodeSmart. The message stated, among other matters, that Salvani had been barred from the financial industry and accused CodeSmart of being a pump-and-dump scheme. This post was picked up by the media and subscriber-based news services and spread rapidly across Wall Street. Salvani, who asserted that nothing in brklynrusso's message was true, demanded that InvestorsHub remove the post. InvestorsHub's webmaster declined, responding that the site did not "make value judgments on the veracity" of member comments.

Salvani claimed that his reputation was damaged by brklynrusso's post. Moreover, the post caused a decline in CodeSmart's stock price. Salvani brought claims under the federal securities laws, as well as state law claims including defamation, libel, and tortious interference with contract.

Case dismissed. InvestorsHub.com's parent company, ADVFN PLC, moved to dismiss under FRCP Rule 12(b) (1) for lack of subject matter jurisdiction. The court found, however, that the complaint brought allegations under specific Exchange Act provisions and articulated a legally cognizable theory. The court accordingly denied the motion to dismiss.

The court, however, proceeded to dismiss the action *sua sponte* for failure to state a claim. The court found that the complaint failed to plead reliance or loss causation, thus failing to state a claim under either Sections 10(b) or 9(a)(4). The court also declined to exercise supplemental jurisdiction over the complaint's state law claims and dismissed them without prejudice.

Reliance. The plaintiffs asserted reliance based on the fraud on the market doctrine. The court found, however, that the plaintiffs could not claim that they relied on the integrity of the market because brklynrusso's statements related to them, and they knew that they were false. Secondly, the complaint failed to plead that the market for CodeSmart stock was open and efficient, which is a prerequisite for relying on the fraud on the market presumption. The court accordingly concluded that the plaintiffs failed to properly plead reliance.

Loss causation. The court also found that the complaint failed to plead loss causation. The plaintiffs argued for the materialization of risk theory, contending that the loss was a foreseeable consequence of the alleged misrepresentations. The court disagreed, concluding that the plaintiffs failed to identify a concealed risk that proximately caused their losses when revealed. The court explained that it was the false statement itself, rather than a concealed risk or "subsequent revealing event," that led to the decline in the stock price.

The case is No. 13 Civ. 7082.

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Companies: JFS Investments Inc.; Investorshub.com, Inc.; ADVFN PLC; IHUB.com, Inc.

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