Feinberg v Marathon Patent Group, Inc.
2020 NY Slip Op 30813(U)
March 13, 2020
Supreme Court, New York County
Docket Number: 651463/2018
Judge: O. Peter Sherwood

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 49

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JEFFREY FEINBERG, JEFFREY FEINBERG, AS TRUSTEE OF THE JEFFREY L. FEINBERG PERSONAL TRUST, and TERRENCE K. ANKNER, AS TRUSTEE OF THE JEFFREY L. FEINBERG FAMILY TRUST,

Plaintiffs,

DECISION AND ORDER
Index No. 651463/2018

-against-

Mot. Seq. Nos.: 006 & 007

MARATHON PATENT GROUP, INC., DOUG CROXALL, and FRANCIS KNUETTEL II,

Defendants.

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O. PETER SHERWOOD, J.:

In motion sequence 006, defendants Marathon Patent Group, Inc. (Marathon) and Doug Croxall (Croxall) move pursuant to CPLR 3211(a)(1), (5), and (7) to dismiss the first cause of action for violations of section 11 of the Federal Securities Act of 1933 (the Securities Act), second cause of action for violations of section 12(a)(2) of the Securities Act, third cause of action for violations of section 15 of the Securities Act, fourth cause of action for fraud and fraudulent concealment, fifth cause of action for constructive fraud, and sixth cause of action for negligent misrepresentation in the amended complaint (the Complaint) of the plaintiffs Jeremy Feinberg (Feinberg), individually and in his capacity as trustee of the Jeremy L. Feinberg Personal Trust (the Personal Trust) and Terrence K. Ankner, in his capacity as trustee of the Jeremy Feinberg Family Trust (the Family Trust).

In motion sequence 007, defendant Francis Knuettel II (Knuettel, together with Croxall and Marathon, Defendants) moves pursuant to CPLR 3016(b), and 3211(a)(1), (5), and (7) to dismiss the Complaint in its entirety and to join Marathon's motion to dismiss.

Background

This action arises out of alleged misrepresentations and omissions of material facts made by Defendants to plaintiffs with respect to the financial condition and the future prospects of Marathon. Plaintiffs were investors of Marathon and acquired stock of Marathon through the open

market and by participating in the 2016 securities offering of common stock in Marathon (the 2016 Offering). The 2016 Offering was effectuated through a prospectus, dated January 6, 2015 (the Prospectus), Marathon's previously filed registration statement (the Registration Statement), and the prospectus supplement, dated December 9, 2016 (the Prospectus, Registration Statement, and Prospectus Supplement, collectively, the Offering Documents). Plaintiffs assert that they were wrongfully induced by Defendants to retain millions of dollars' worth of Marathon stock (Complaint, ¶ 1).

As alleged in the Complaint, Marathon is a publicly traded company in the business of acquiring patents and patent rights seeking to monetize their value through litigation and licensing (Complaint, ¶ 14). As of December 31, 2016, Marathon allegedly owned 515 patents and had economic rights in over 10,000 additional patents (*id.*). Croxall was Marathon's chief executive officer and Chairman of the Board of Directors from November 2012 to January 2018 (Complaint, ¶ 15). Knuettel was Marathon's chief financial officer from May 2014 to April 2018 (Complaint, ¶ 16).

Feinberg is a California resident who acquired at least 543,844 shares of Marathon common stock in the open market. Feinberg, is also the trustee of the Personal Trust which acquired 1,000,000 shares of Marathon common stock and 500,000 warrants through the 2016 Offering (Complaint, ¶¶ 12, 18).

Ankner is a Massachusetts resident and the trustee of the Family Trust which acquired 333,333 shares of Marathon common stock and 166,666 warrants through the 2016 Offering (Complaint, ¶ 19).

Between May 2014 and December 2015, Feinberg acquired a substantial ownership interest in Marathon through purchases of common stock on the open market. During this period Feinberg's ownership in Marathon fluctuated based on his in-person meetings and telephone calls with Defendants, wherein Defendants touted the strength of Marathon's financial condition and its ability to monetize its patent portfolio (Complaint, ¶ 32).

Plaintiffs allege these statements were made with the purpose to induce Feinberg to retain his substantial stake in Marathon, even though it reported disappointing financial performance and unfavorable litigation verdicts (Complaint, ¶¶ 33).

On March 30, 2016, Marathon reported that 2015 revenues decreased by 11% while the direct cost of revenue increased 41%, prompting Croxall to label 2015 as a "building year" for

Marathon (Complaint, ¶ 34). Based on Marathon's disappointing financial performance in 2015, Feinberg took steps to liquidate his investment in Marathon, selling at least 202,018 shares of Marathon common stock that he acquired from the open market between April 19, 2016 and May 12, 2016 (Complaint, ¶ 35).

On May 12, 2016, Feinberg allegedly halted his sales of Marathon stock based on new representations by Croxall projecting that Marathon's licensing and infringement business 2016 revenues could surpass $40 million, and announcing the hiring of a director of acquisitions, Eric Spangenberg (Complaint, ¶ 35-7). As a result, Feinberg halted his sales of Marathon stock and purchased a total of 594,951 additional shares of Marathon common stock on the open market between May 26, 2016 and July 21, 2016, making him one of the largest shareholders of Marathon (Complaint, ¶ 38).

On August 15, 2016, another conference call was held between Feinberg and Croxall, wherein Croxall reaffirmed the strength of Marathon's business and financial condition (Complaint, ¶ 39). Feinberg purchased 7,910 additional shares of Marathon between October 12, 2016 and November 4, 2016 (Complaint, ¶ 40-41).

On November 14, 2016, despite the prior representations by Croxall, Marathon reported disappointing revenues of $43,113 in the third quarter ending September 2016 (Complaint, ¶ 42). Thereafter, Croxall urged investors to evaluate Marathon's performance on a yearly basis, downplayed the significance of Marathon's financial performance, and further represented that he held positive prospects for Marathon. Feinberg allegedly refrained from selling additional Marathon stock and even acquired 100,000 additional shares on December 1, 2016 based on the new representations (Complaint, ¶ 45).

In December 2016, Defendants solicited Feinberg and Anker to purchase Marathon stock during the 2016 Offering. Plaintiffs allege that Defendants made misrepresentations or failed to disclose material facts related to Marathon's then-existing financial condition and its future prospects. Defendants allegedly repeatedly assured plaintiffs that Marathon was performing within its public guidance and repeatedly touted that Marathon was on track with achieving its aggressive revenue projections. Furthermore, Croxall and Knuettel, represented that the funds raised would be sufficient to cover Marathon's operating expenses and it would not be required to raise additional capital in 2017 (Complaint, ¶ 3).

Plaintiffs allege that Defendants were aware that plaintiffs owned millions of dollars' worth of Marathon stock and made the misrepresentations to plaintiffs to avoid the negative impact the sale of plaintiffs' stock would have on Marathon (Complaint, ¶ 5).

On April 18, 2017, just weeks after assuring Plaintiffs that Marathon would not need to raise additional capital in 2017, Marathon announced that it was selling 3.8 million shares of Marathon stock in a dilutive sale. Marathon further disclosed that proceeds from the sale would be used to fund its 2017 operations. As a result of this news, the stock price of Marathon dropped 22.9% on April 18, 2017 (Complaint, ¶ 7).

On May 15, 2017, Marathon announced its first quarter 2017 results, revealing that its core patent licensing and infringement business generated $78,000 (Complaint, ¶¶ 74). Thereafter, Feinberg liquidated all of its holdings in Marathon, suffering millions of dollars of losses (Complaint, ¶ 76).

Feinberg subsequently commenced this action by filing the original complaint which alleged causes of action for violations of the Securities Act and fraud-based claims. Thereafter, on January 17, 2019, upon a motion to dismiss by Defendants, the court dismissed the original complaint with leave to replead for lack of standing and lack of specificity (tr 1/16/2019, 22:2-23:9, 26:23-27:2).

On February 15, 2019, Plaintiffs filed an amended complaint asserting violations of the Securities Acts in the first, second, and third causes of action (the Securities Claims) and state law causes of action in its fourth, fifth, and sixth causes of action (the Holder Claims).

DISCUSSION

I. Standing/Statute of Limitations

As a threshold matter, the Court finds that Marathon's Securities Claims are not barred by the statute of limitations. It is undisputed that the governing statute of limitations for the Securities Claims is one year pursuant to 15 USC § 77(m). Therefore, the latest date that plaintiffs can argue that they discovered the basis for its causes of action is May 2017, the date which they liquidated their Marathon holdings.

Feinberg filed the original complaint on March 27, 2018, within the one-year statute of limitations period. However, the Securities Claims were dismissed because the Trusts lacked capacity to assert the claims (tr 1/16/2019, 22:2-23:9). Nonetheless, Feinberg clearly had the capacity to assert the Holder Claims and, therefore, preserved timeliness of the action by filing the

original complaint on March 27, 2018 under the relation back doctrine, which "enables a plaintiff to correct a pleading error--by adding either a new claim or a new party--after the statutory limitations period has expired," and gives "courts sound judicial discretion to identify cases that justify relaxation of limitations strictures...to facilitate decisions on the merits if correction will not cause undue prejudice to plaintiff's adversary" (*Buran v Coupal*, 87 NY2d 173, 177 [1995] [internal quotation marks and citations omitted]). Furthermore, the original complaint asserts identical causes of action as the Complaint, and therefore, provides "notice of the transactions, occurrences, or series of transactions or occurrences to be proved pursuant to the amended pleading" (CPLR 203 [f]).

"On a motion to dismiss pursuant to CPLR 3211, the pleading is to be afforded a liberal construction" (*Leon v Martinez*, 84 NY2d 83, 87 [1994]). We accept the facts as alleged in the complaint as true, accord plaintiffs the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory" (*id.* at 87-88) "Under CPLR 3211(a)(1), a dismissal is warranted only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law" (*id.* at 88). "In assessing a motion under CPLR 3211(a)(7), however, a court may freely consider affidavits submitted by the plaintiff to remedy any defects in the complaint" and "the criterion is whether the proponent of the pleading has a cause of action, not whether he has stated one" (*id.* [internal quotation marks and citations omitted]).

II. Securities Claims

Plaintiffs allege that Defendants violated sections 11, 12(a)(2), and 15 of the Securities Act in its first, second and third causes of action, respectively. These provisions of the Securities Act "impose liability on certain participants in a registered securities offering when the publicly filed documents used during the offering contain material misstatements or omissions"
(*In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F3d 347, 358 [2d Cir 2010]).

"Section 11 applies to registration statements, and section 12(a)(2) applies to prospectuses and oral communications" (*id.* [citation omitted]). "Section 15, in turn, creates liability for individuals or entities that control [any] person liable under section 11 or 12" (*id.* [internal quotation marks and citation omitted]). "Thus, the success of a claim under section 15 relies, in part, on a plaintiffs ability to demonstrate primary liability under sections 11 and 12" (*id.* [internal citations omitted]).

Despite plaintiffs' contentions to the contrary, the Securities Claims utilize wording and imputations classically associated with fraud: "the Registration Statement contained *untrue* statements of material fact, *omitted to state* other facts necessary to make the statements made not misleading (Complaint, ¶ 93); and "[t]he Offering Documents contained *untrue* statements of material facts and *concealed* and failed to disclose material facts, as detailed above" (Complaint, ¶ 104; *Rombach v Chang*, 355 F3d 164, 172 [2d Cir 2004] [finding that the pleading sounded in fraud "where the gravamen of the complaint is plainly fraud and no effort is made to show any other basis for the claims levied at the Prospectus"]).

Consequently, the Securities Claims sound in fraud and are required to be pled with particularity under Rule 9(b) of the Federal Rules of Civil Procedure (Rule 9(b)) and CPLR 3016(b). "To state a cause of action for fraud, a plaintiff must allege a representation of material fact, the falsity of the representation, knowledge by the party making the representation that it was false when made, justifiable reliance by the plaintiff and resulting injury" (*Kaufman v Cohen*, 307 AD2d 113, 119 [1st Dept 2003] [internal citations omitted]). "In alleging fraud or mistake a party must state with particularity the circumstances constituting fraud or mistake" (FRCP 9 [b]). Malice, intent, knowledge, and other conditions of a persons mind may be alleged generally (*id.*).

A. Section 11

Pursuant to section 11 of the Securities Act, "any signer, officer of the issuer or underwriter may be held liable for a registration statement containing an untrue statement of a material fact or omitting to state a material fact...necessary to make the statements therein not misleading" (*Acacia Nat. Life Ins. Co. v Kay Jewelers, Inc.*, 203 AD2d 40, 44 [1st Dept1994] [internal brackets and quotation marks omitted]). "The statute is violated when material facts are omitted or presented in such a way as to obscure or distort their significance" (*id.*). "The test to be applied in determining whether a prospectus is materially misleading is whether defendants representations, taken together and in context, would have misled a reasonable investor about the nature of the investment" (*id.* [internal quotation marks and brackets omitted]). "While disclosure is not a 'rite of confession' a prospectus must openly disclose material objective factual matters in a manner designed to accurately inform rather than mislead prospective buyers" (*id.* [internal citation omitted]).

Section 11 of the Securities Act prohibits materially misleading statements or omissions in registration statements filed with the SEC (15 U.S.C. § 77 [k] [a]). "In the event of such a misdeed,

the statute provides for a cause of action by the purchaser of the registered security against the security's issuer, its underwriter, and certain other statutorily enumerated parties" (*In re Morgan Stanley* at 358). "To state a claim under section 11, the plaintiff must allege that: (1) she purchased a registered security, either directly from the issuer or in the aftermarket following the offering; (2) the defendant participated in the offering in a manner sufficient to give rise to liability under section 11; and (3) the registration statement contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading" (*id.* [internal quotation mark omitted]).

Plaintiffs argue that Defendants violated section 11 of the Securities Act, specifically Item 303 (Item 303) and Item 503 (Item 503) of SEC Regulation S-K.

"Item 303(a)(3)(ii) essentially says to a registrant: "[i]f there has been an important change in your company's business or environment that significantly or materially decreases the predictive value of your reported results, explain this change in the prospectus" (*Oxford Asset Mgmt., Ltd. v Jaharis*, 297 F3d 1182, 1192 [11th Cir 2002]). "The obvious focus is on preventing the latest reported results from misleading potential investors, thereby promoting a more accurate picture of the registrants future prospects" (*id.*)

Plaintiffs allege that Marathon violated Item 303 by failing to disclose both the existence of a dramatic decline in revenue and the negative effect this trend was likely to have on Marathon's financial performance (Complaint, ¶ 58). Plaintiffs contend that even though Marathon's revenue has previously fluctuated quarter over quarter, this decline continued for three consecutive quarters and was greater in magnitude than in the past. As a result, plaintiffs argue this was not a mere fluctuation, but Marathon's core business failing. Plaintiffs allege upon information and belief that Marathon possessed information that would establish that the capital raised via the 2016 Offering would be insufficient to cover its 2017 operations (Complaint, ¶ 62). Therefore, plaintiffs allege that it strains credulity that Marathon was not aware that their core business was failing (Complaint, ¶ 61).

Defendants argue that the Offering Documents clearly stated Marathon's "revenues are unpredictable and this may harm our financial condition" and further states that Marathon's "revenues may vary substantially from quarter to quarter, which could make our business difficult to manage, adversely affect our business and operating results, cause our quarterly results to fall

below market expectations and adversely affect the market price of our common stock" (Sherman Aff., Exhibit 10, at 7).

Furthermore, Marathon counters that the fluctuations were disclosed in the Offering Documents and that those fluctuations were not as a result of a known trend or change in the business environment. Rather, the fluctuations are one of the risks associated with Marathon's business. Moreover, plaintiffs fail to identify a known trend or change in the business environment, and merely allege upon information and belief that Defendants possessed financial information that would allow them to conclude that it was reasonably likely that Marathon's performance would fail to meet expectations, which is insufficient to satisfy the particularity requirement for pleading causes of action sounding in fraud under CPLR 3016(b) and Rule 9(b) (CPLR 3016 [b]; FCRP 9 [b]).

Plaintiffs concede in the Complaint that Marathon's revenues were prone to fluctuations, with Marathon experiencing a decline of revenues in third quarter of 2013, the fourth quarter of 2014, the second quarter of 2015, and the third quarter of 2016. This supports Marathon's argument that the fluctuations do not establish plaintiff's alleged ongoing and dramatic decline in revenue (Complaint, ¶ 59).

Plaintiffs argue that under Item 503, Marathon was required to provide a discussion of the factors that would make the 2016 Offering speculative or risky. Specifically, plaintiffs allege that Marathon failed to highlight three known risks; (1) Marathon was experiencing a severe and on-going revenue decline in its core business; (2) Marathon would be unable to meet its previously communicated public guidance without significant, new revenue generating events; and (3) Marathon would be forced to raise additional capital to fund operations if the revenue collapse continued.

With respect to the first risk factor, as stated *supra*, the Offering Documents clearly indicated that Marathon's revenues would fluctuate from quarter to quarter and plaintiffs have failed to allege facts that would support a conclusion that a persistent decline in revenue existed (Sherman Aff., Exhibit 10, at 7).

With respect to the second risk factor, Marathon disclosed, in its Offering Documents that their customers "generally enter into non-exclusive, non-assignable license agreements with [Marathon] in return for a one-time, non-recurring, upfront license fee and settlement payment and these customers do not generally engage in recurring business activity with us" (*id.* at 2).

With respect to the third risk factor, the Prospectus Supplement clearly states that shareholders "may experience future dilution as a result of future equity offerings" (*id.* at Exhibit 12, at S-8). In addition, Marathon's Form 10-Q clearly states that Marathon's:

> "management is uncertain that [Marathon's] existing cash and accounts receivable will be sufficient to fund its operations through at least the next twelve months. If we do not meet our revenue and profit projections or the business climate turns negative then we will need to raise additional funds to support [Marathon's] operations"

(*id.* at Exhibit 13, at 36).

The court finds that Marathon properly disclosed the risks in the Offering Documents under Item 503. Although plaintiffs contend that the disclosures were generic and boilerplate cautionary language, plaintiffs fail to identify any specific omission that would render the disclosures untrue (*see Steinberg v PRT Grp., Inc.*, 88 FSupp2d 294, 309 [SDNY 2000] [finding that there was no material omission, when company disclosed its major customers as required by the SEC, but made no representations with respect to its expectations of generating new business or retaining the customers as clients]).

Accordingly, the first cause of action is dismissed.

B. Section 12

"Section 12(a)(2) provides similar redress where the securities at issue were sold using prospectuses or oral communications that contain material misstatements or omissions" (*In re Morgan Stanley*, 592 F3d at 359 [citation omitted]). "Whereas the reach of section 11 is expressly limited to specific offering participants, the list of potential defendants in a section 12(a)(2) case is governed by a judicial interpretation of section 12 known as the 'statutory seller' requirement" (*id.* [citations omitted]).

"An individual is a 'statutory seller'—and therefore a potential section 12(a)(2) defendant—if he: (1) passed title, or other interest in the security, to the buyer for value, or (2) successfully solicited the purchase of a security, motivated at least in part by a desire to serve his own financial interests or those of the securities' owner" (*id.* [internal quotations marks, brackets, and citations omitted]). "[T]he elements of a prima facie claim under section 12(a)(2) are: (1) the defendant is a statutory seller; (2) the sale was effectuated by means of a prospectus or oral communication"; and (3) the prospectus or oral communication included an untrue statement of a material fact or omit[ted] to state a material fact necessary in order to make the statements, in light

of the circumstances under which they were made, not misleading" (*id.* [internal quotations marks, brackets, and citation omitted]).

Plaintiffs allege that Knuettel misrepresented the following facts during a December 1, 2016 telephone call with Feinberg to solicit plaintiffs' participation in the 2016 Offering that Marathons business was on track and remained on track to meet its public guidance for 2016 and to conservatively generate between $52 and $60 million for the 2017 fiscal year (Complaint, ¶ 47). Plaintiffs allege that, during a December 6, 2016 telephone call, Croxall made the following misrepresentations that Marathon:

> "was well-positioned to undergo substantial revenue growth in 2017, having recently acquired significant patent assets from companies like Siemens and General Electric,"
>
> "based on Marathon's then-current financial condition, the Company's patent licensing and infringement activities were and remained on track to generate $65 million to $70 million in revenue in 2017, $100 million in revenue in 2018, and $123 million in revenue by 2019", and
>
> "based on Marathon's then-existing financial condition the Company would not need to raise capital through additional equity and/or debt offerings in 2017"

(Complaint, ¶ 48-49). Croxall's representations were repeated on March 30, 2017 during a conference call to discuss Marathon's fourth quarter 2016 results and provide public guidance for the 2017 fiscal year (Complaint, ¶¶ 69-71).

The court finds that Croxall and Knuettel's statements do not violate section 12 of the Securities Act because the statements are forward looking opinions which are not actionable. Further, the statements are not false and are protected by the safe harbor provision of the Private Securities Litigation Reform Act (PSLRA).

"The PSLRA requires securities fraud complaints to specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed" (*Coronel v Quanta Capital Holdings Ltd.*, 2009 WL 174656, at *24 [SD NY 2009] [internal quotation marks and citation omitted]). "While the PSLRA does not require plaintiffs to plead every single fact upon which their beliefs

concerning false or misleading statements are based, it does require the facts alleged to be sufficient to support a reasonable belief as to the misleading nature of the statement or omission" (*id.* [internal quotation marks omitted]).

It has been held that "[i]f something is 'on track' it is reasonable to assume that it could go 'off track'" (*In re Fairway Grp. Holdings Corp. Sec. Litig.*, 2015 WL 4931357, at *22 [SDNY 2015]). "Thus, the challenged statements are vague expressions of opinion which are not sufficiently concrete or specific to impose a duty to update" (*id.*).

Plaintiffs have failed to establish that Croxall and Knuettel's statements were false when made with any particularity and only allege in conclusory fashion that Marathon's core business was experiencing a collapse and that it would not be able to reverse this trend without other revenue events. Furthermore, Croxall and Knuettel's statements are protected under the PSLRA's safe harbor provision (*see Slayton v American Exp. Co.*, 604 F3d 758, 766 [2d Cir 2010] ["a defendant is not liable if the forward-looking statement is identified and accompanied by meaningful cautionary language *or* is immaterial *or* the plaintiff fails to prove that it was made with actual knowledge that it was false or misleading"] [emphasis in original]).

"The PSLRA includes several definitions of a forward-looking statement, including a statement containing a projection of income (including income loss), earnings (including earnings loss) per share, or other financial items and a statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management" (*id.* at 766-767 [internal quotation marks and citation omitted]).

Croxall and Knuettel's statements clearly fall within the definition of a forward looking statement under the PSLRA as statements of future economic performance and projection of income (Complaint, ¶ 47). Furthermore, plaintiff's allegation that:

> "it strains credulity that Defendants were not aware that Marathon's core business was failing to generate revenue anywhere near the levels represented to Plaintiffs Feinberg and Ankner and that this failure was not adversely impacting (or was reasonably likely to impact) Marathon's financial condition at the time of the 2016 Offering"

(Complaint, ¶ 61), is insufficient to establish that Croxall and Knuettel had actual knowledge of the falsity of the statements when made and is fatal to its cause of action under section 12 (*see In re Fairway Group*, 2015 WL 4931357 at *22 [It is insufficient to argue in hindsight that

defendant's statement ultimately was false; plaintiff must allege that the statement was false at the time it was made]). Thus, "allegations that defendants should have anticipated future events and made certain disclosures earlier than they actually did do not suffice to make out a claim of securities fraud" (*Novak v Kasaks*, 216 F3d 300, 309 [2d Cir 2000]). Further "as long as the public statements are consistent with reasonably available data, corporate officials need not present an overly gloomy or cautious picture of current performance and future prospects" (*id.*). "Where plaintiffs contend defendants had access to contrary facts, they must specifically identify the reports or statements containing this information" (*id.*).

Consequently, the second cause of action shall be dismissed.

C. Section 15

Under section 15 of the Securities Act,

> "[e]very person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency or otherwise, controls any person liable under section 11 or 12 of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist"

(*Acacia Natl. Life Ins. Co. v Kay Jewelers*, 203 AD2d 40, 45 [1st Dept 1994]) [internal citations omitted]).

Liability may be imposed under section 15 of the Securities Act on individuals who directly or indirectly exert control over a primary violator of the securities laws (*see Caruso v Metex Corp.*, 1993 WL 305945 [EDNY 1993]). To establish a claim, a plaintiff must allege facts that set forth a primary violation of the securities laws and a defendant's control person status (*see Acacia* 203 AD2d at 45).

In light of the dismissal of the first and second causes of action, plaintiffs are unable to establish the primary violation necessary to sustain a cause of action under section 15 (*see In re Refco, Inc. Sec. Litig.*, 503 F Supp 2d 611, 637 [SDNY 2007] ["control-person liability exists only where there is a primary violation, and so the conclusion that misstatements in the Offering Memorandum cannot give rise to liability requires the further conclusion that those misstatements cannot give rise to control-person liability"]).

III. Holder Claims

Plaintiffs' Holder Claims, comprised of the fourth cause of action for actual fraud and fraudulent concealment, the fifth cause of action for constructive fraud, and the sixth cause of action for negligent misrepresentation, each allege that plaintiffs were induced by Defendants misrepresentations and omissions of material facts to refrain from liquidating their holdings of Marathon. However, the Holder Claims are impermissible under New York law (*see Varga v McGraw Hill Fin., Inc.*, 147 AD3d 480, 481 [1st Dept 2017] ["To the extent plaintiffs allege 'holder' claims, i.e., fraudulent inducement to continue to hold the securities, these claims violate the 'out-of-pocket' rule governing damages recoverable for fraud, and are not actionable"]).

It is well established that "the true measure of damages for fraud is indemnity for the actual pecuniary loss sustained as the direct result of the wrong" (*Starr Found. v American Intl Grp., Inc.*, 76 AD3d 25, 27 [1st Dept 2010] [internal quotation marks, citation and brackets omitted]). "Such damages are to be calculated to compensate plaintiffs for what they lost because of the fraud, not to compensate them for what they might have gained, and there can be no recovery of profits which would have been realized in the absence of fraud" (*id.* [internal quotation marks and citation omitted]).

Plaintiffs argue in a footnote that California law should be applied to the Holder Claims. Even assuming *arguendo* that California law did apply, the Holder Claims would still be dismissed for the failure to plead fraud with the requisite particularity.

"In California, fraud must be pled specifically; general and conclusory allegations do not suffice" (*Small v Fritz Companies, Inc.*, 30 Cal 4th 167, 184 [Cal 2003]). "Thus the policy of liberal construction of the pleadings . . . will not ordinarily be invoked to sustain a pleading defective in any material respect" (*id.* [internal quotation marks and citation omitted]). "This particularity requirement necessitates pleading *facts* which show how, when, where, to whom, and by what means the representations were tendered" (*id.* [internal quotation marks and citation omitted] [emphasis in original]). "The plaintiff must allege actions, as distinguished from unspoken and unrecorded thoughts and decisions, that would indicate that the plaintiff actually relied on the misrepresentations" (*id.* [internal quotation marks omitted]). "Plaintiffs who cannot plead with sufficient specificity to show a bona fide claim of actual reliance do not stand out from the mass of stockholders who rely on the market . . . [S]uch persons cannot bring individual or class actions for fraud or misrepresentation" (*id.* at 184-185[internal citation omitted]).

The Complaint merely alleges generally that Feinberg was induced from liquidating his holdings, but does not provide any of the specificity as to the amount of shares or the timing of the intended sales of stock and instead repeats that they were induced to hold Marathon shares generally throughout the Complaint (Complaint, ¶¶ 35, 45). These allegations are insufficient to support the Holder Claims under California law (*id.* at 184-85 ["plaintiff must allege specific reliance on the defendants' representations: for example, that if the plaintiff had read a truthful account of the corporations financial status the plaintiff would have sold the stock, how many shares the plaintiff would have sold, and when the sale would have taken place"]).

Accordingly, the Holder Claims are dismissed. It is hereby,

ORDERED that the motion of defendants to dismiss the Complaint is granted in its entirety; and it is further

ORDERED that, within 30 days from service of a copy of this order with notice of entry, defendants shall file a copy of this order with notice of entry and proof of service of the foregoing on counsel for plaintiffs; and it is further

ORDERED that such service upon the Clerk of the Court and the Clerk of the Part shall be made in accordance with the procedures set forth in the *Protocol on Courthouse and County Clerk Procedures for Electronically Filed Cases* (accessible at the "E-Filing" page on the court's website at the address www.nycourts.gov/supctmanh); and it is further

ORDERED that, upon the timely filing of the foregoing, the Clerk of the Court shall enter judgment dismissing the action; and it is further

ORDERED that in the event of non-compliance, counsel are directed to appear for a status conference on Tuesday, May 19, 2020 at 10:30 AM in Part 49, Courtroom 252, 60 Centre Street, New York, New York.

This constitutes the decision and order of the court.

DATED: March 13, 2020

E N T E R,

O. PETER SHERWOOD J.S.C.