UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

THOMAS CULLINAN, Individually and On Behalf of All Others Similarly Situated, Plaintiff, v. CEMTREX, INC., SAAGAR GOVIL, ARON GOVIL, and RENATO DELA RAMA, Defendants.	Case No.: 2:17-cv-01067 (JFB) (AYS)

DEFENDANTS' REPLY MEMORANDUM OF LAW IN SUPPORT OF THEIR MOTION TO DISMISS THE AMENDED COMPLAINT

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Defendants Cemtrex, Inc., Aron Govil, Saagar Govil, and Renato Dela Rama respectfully submit this reply brief in further support of their motion to dismiss the Amended Complaint with prejudice.[1]

I. PRELIMINARY STATEMENT

Plaintiffs' opposition to defendants' motion to dismiss confirms that the Amended Complaint is based on completely disconnected allegations cherry-picked from self-interested blog posts. These accusations may have worked to scare investors to the benefit of short-sellers, but they cannot satisfy the demanding pleading requirements of the Reform Act and Rule 9(b). Plaintiffs have failed to identify and plead with particularity any false or misleading statement, much less that defendants made any false or misleading statement with scienter. This is not surprising, since plaintiffs do not, and cannot, allege a motive for fraud.

Recognizing the challenges they face, plaintiffs' opposition simply re-shuffles the Amended Complaint's allegations — reminiscent of the Amended Complaint simply re-shuffling assertions from the blog posts — barely bothering to address defendants' arguments. Plaintiffs' opposition reduces to a request that the Court should lower their pleading burden. But Congress meant for plaintiffs' burden to be heavy and the hurdles to be high, to prevent plaintiffs from distracting defendants from their business with opportunistic litigation. The Reform Act and Rule 9(b) require dismissal — and with prejudice, since plaintiffs' claims suffer from structural problems that no amendment could fix.

[1] References to parties' respective memoranda of law and the Amended Complaint are hereinafter cited as: Defendants' memorandum of law in support of their motion to dismiss – "Defs.' Br. __"; Plaintiffs' memorandum of law in opposition to defendants' motion – "Pls.' Br. __"; and Amended Complaint – "¶ __." Capitalized terms not otherwise defined herein shall have the same meaning as in defendants' memorandum of law in support of their motion to dismiss.

II. ARGUMENT

A. Plaintiffs Fail to Plead a False or Misleading Statement

The heightened pleading standards under the Reform Act and Rule 9(b) require a plaintiff to specify which statements the plaintiff contends were false or misleading, plead with particularity why each was false or misleading, and plead a strong inference of scienter. *Lerner v. Fleet Bank, N.A.*, 459 F.3d 273, 290 (2d Cir. 2006); *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 89 (2d Cir. 2007). None of plaintiffs' allegations meet this stringent standard.

1. Saagar's Opinions and Projections Surrounding Cemtrex's Acquisition of Periscope were not False or Misleading

The following challenged statements pertaining to Paderborn are clearly statements of opinion, and thus false only if they were not sincerely believed by the speaker at the time that they were expressed. *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318, 1327 (2015); *Tongue v. Sanofi*, 816 F.3d 199, 210 (2d Cir. 2016). Whether any statement is misleading "always depends on context," and meeting the standard "is no small task for an investor." *Omnicare*, 135 S. Ct. at 1330, 1332.

The Challenged Statements

(1) "The Company has consolidated the revenue of its new subsidiary, which is expected to generate an estimated roughly $33 million over the next 12 months." ¶ 219; Ex. 18 (September 2016 press release);

(2) "We are extremely optimistic about the opportunities in front of us and our ability to leverage them with our growing organization." ¶ 220; Ex. 19 (Saagar's quote in a December 2016 press release); and

(3) "The Periscope acquisition also gives Cemtrex a strong footing in the dynamic automobile industry." ¶¶ 234–35; Ex. 3 at 99.1, page 4 (Saagar's statement in a February 2017 investor conference call).

Plaintiffs contend defendants knew the above statements were false when made, because Cemtrex later decided to close the Paderborn facility. Plaintiffs try to back-cast this business

decision to demonstrate that the earlier statements of opinion were somehow false when made, citing to an alleged statement by the general manager of ROB Cemtrex that the decision to close Paderborn was based on reduced sales numbers, and "[Paderborn] had to take back the plans month after month." Pls.' Br. 11; ¶¶ 238, 241. But it does no such thing: allegations of vague "reduced sales numbers" and "tak[ing] back the plans" "month after month," do not demonstrate in detail that the statements were false when made.

Plaintiffs' attempt to plead that these true opinions were misleading misconstrues the context standard of *Omnicare* and *Sanofi*. Plaintiffs essentially allege the statements about the EMS segment's prospects were misleading because they did not disclose that "Paderborn's future was in jeopardy." Pls.' Br. 12.[2] But *Omnicare* does not require a speaker to be perfectly prescient: as the Second Circuit has explained, "Defendants were only tasked with making statements that 'fairly align[ed] with the information in the issuer's possession at the time.'" *Sanofi*, 816 F.3d at 210 (quoting *Omnicare*, 135 S. Ct. at 1329). And it is undisputed that, just as forecast, Paderborn contributed to $12 million in new orders; as of September 2016, the Periscope acquisition contributed to increased revenues of $19 million; and in the six-month period ending March 2017, it is clear that the Periscope acquisition contributed to at least $31 million in revenue. *See* Defs.' Br. 12–13.

Thus, plaintiffs do not and cannot provide a factual basis to undermine Saagar's optimism. There is no allegation demonstrating that closing the Paderborn facility was "in jeopardy" or otherwise inconsistent with the challenged statements. After the acquisition of Periscope to its EMS segment, Cemtrex maintained two EMS facilities in Germany: the original in Neulingen and then Paderborn. *See* Ex. 8 at F-19; Ex. 18. Companies routinely consolidate

[2] Plaintiffs' opposition only addresses the Saagar's February 2017 statement.

operations after mergers, and plaintiffs fail to account for the logical inference that the closing of Paderborn was such a decision. Plaintiffs' suggestion that Cemtrex acquired Periscope with a secret plan to abandon the business makes no sense.

2. Cemtrex's Consolidated Financial Statements did not Mislead Investors as to the Company's International Operations

The allegations that defendants falsely reported in the Company's 2015 Form 10-K and Amended Form 10-K that it owned Cemtrex India are completely conclusory. ¶ 188; Pls.' Br. 14–15. The Company's Consolidated Financial Statements reflect a 100% attributable interest — not ownership interest — for Cemtrex India. ¶ 188; Ex. 10 at F-9; Ex. 20 at F-9; *see also* Defs.' Br. 14. Plaintiffs do not challenge the Company's application of accounting guidelines regarding its consolidated financial statements. Pls.' Br. 14–15 n.10–11. Yet they allege that because Aron, not Cemtrex, appears to be the majority shareholder in Cemtrex India, defendants "gave the false impression that Cemtrex was a multinational company thriving in emerging markets around the world." ¶ 190. This type of conclusory allegation fails the requirement that plaintiffs "demonstrate with specificity" why each statement was false. *Rombach v. Chang*, 355 F.3d 164, 172–74 (2d Cir. 2004).

With no actual allegations about Cemtrex India, plaintiffs' allegations appear to amount an attack on Cemtrex's international presence. Yet plaintiffs plead nothing false or misleading about what Cemtrex has said about its office space in India or operations in Germany, Hong Kong, and Romania. Ex. 10 at 12; ¶ 188.

3. Opinions as to the Effectiveness of the Company's Disclosure Controls and Section 16(a) Compliance were not False

Plaintiffs fail to adequately plead statements about the effectiveness of the Company's internal disclosure controls and Section 16(a) compliance were false or misleading. Pls.' Br. 16. The allegations again fail to explain with specificity why the challenged statements were false.

Rombach, 355 F.3d at 172–74. Plaintiffs' only attempt is hopelessly vague: "[t]hese statements were false because each of the Individual Defendants made inaccurate or incomplete filings concerning their stock transaction." Pls.' Br. 16. This pleading deficiency is unsurprising given the reality of the transactions complained of: in 2013, Saagar purchased 1,667 shares (Ex. 25); in 2014, Saagar purchased 350 shares (*id.*); in 2015, Saagar purchased a total of 67 shares (*id.*) and Renato sold a total of 12,833 and purchased 500 shares (Ex. 26); and in 2016 Renato sold a total of 7,500 shares (*id.*). The belated filing of Form 4s for these inconsequential transactions—purchases by Saagar and small sales by Renato at unremarkable prices (no more than $4.50 per share) —cannot sustain a claim for securities fraud.

Furthermore, the challenged statements about Cemtrex's disclosure controls are statements of opinion that are not false unless plaintiffs demonstrate that the defendants did not genuinely believe them. *Omnicare*, 135 S. Ct. at 327. Plaintiffs do not even try to meet this standard. Nor could they. It is undisputed that Cemtrex's annual proxy statements and Form 10-Ks disclosed accurate stock ownership. *See* Pls.' Br. 23 n.20. The fact that certain Form 3s and 4s were untimely filed does not render the opinion as to the effectiveness of the Company's disclosure controls and procedures false. *C.D.T.S. No. 1 A.T.U. Local 132 Pension Plan v. UBS AG*, 2013 WL 6576031, at *4 (S.D.N.Y. Dec. 13, 2013) (finding inadequate, alleged statements touting controls "had to have been false" because controls failed to prevent a problem).

B. Plaintiffs Do Not and Cannot Plead a Motive to Commit Fraud

Implicitly acknowledging their pleading deficiencies, plaintiffs ask this Court to "relax the required pleading standards" for scienter. Pls.' Br. 17. The cases plaintiffs cite are inapplicable, as none of those cases permitted a plaintiff to plead scienter with bare-bones allegations based on "information and belief." *Id.* Plaintiffs here must meet the Reform Act's requirement for pleading scienter: to state with particularity defendant's intention "to deceive,

manipulate, or defraud." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007). The Amended Complaint's cobbled-together conclusory allegations fail to show that each defendant had a motive to perpetuate a fraud nor any evidence of conscious misbehavior or recklessness. *See Kalnit v. Eichler*, 264 F.3d 131, 138–39 (2d Cir. 2001).

1. Defendants' Stock Transactions Fail to Show a Motive to Defraud

Plaintiffs' most basic allegation is that defendants made false and misleading statements to inflate the price of Cemtrex stock so that they could sell their holdings and "line their pockets." *See* Pls.' Br. 1–2. Yet, despite dedicating almost one-third of the Amended Complaint to an incomprehensible attempt to show that Aron and Saagar surreptitiously sold Cemtrex stock (¶¶ 103–173), plaintiffs' opposition, is strikingly silent. Through their silence, plaintiffs concede — as they must — that Aron and Saagar did not sell any of their own shares. *See Kalnit*, 264 F.3d at 139 ("[P]laintiffs must assert a concrete and personal benefit to the individual defendants resulting from the fraud.").

Having effectively abandoned their theory that Aron and Saagar improperly sold their own holdings, plaintiffs cling to non-party Ducon's and Renato's modest sales of Cemtrex stock. Pls.' Br. 23. The Amended Complaint alleges Ducon failed to file Form 4s for its sale of 330,268 shares. ¶¶ 122–23. In their opposition, plaintiffs concede that Ducon was never required to file a Form 4, and instead, argue without basis that "[Aron] was obligated to disclose those sales." Pls.' Br. 15 n.12; *Rowley v. City of New York*, 2005 WL 2429514, at *6 (S.D.N.Y. Sept. 30, 2005) ("[A]n argument raised in a footnote . . . may not be properly considered."). Regardless, plaintiffs fail to adequately allege how Ducon's sale of its shares *personally* benefited any of the defendants. *See* Pls.' Br. 23. Similarly, plaintiffs cannot show Renato had a motive to defraud based only on the allegation that he sold approximately 20% of his shares over the 5-year class period, amounting to an average of only $12,000 per year. ¶ 215; *see also infra*

II.A.3. Plaintiffs do not allege — and cannot allege — that any of the defendants entered into stock transactions "so 'unusual' as to support an inference of motive." *Ressler v. Liz Claiborne, Inc.*, 75 F. Supp. 2d 43, 58 (E.D.N.Y. 1998).

2. Plaintiffs Misconstrue Properly Disclosed Related-Party Transactions and Investor Relations Campaigns

Because each of the defendants lack motive to properly plead scienter, plaintiffs must make a greater showing of conscious misbehavior or recklessness. *Kalnit*, 264 F. 3d at 142; *see* Pls.' Br. 21. Plaintiffs allege that defendants engaged in improper related-party transactions. Pls.' Br. 18. Yet, as defendants explained and plaintiffs ignored, see Defs.' Br. 22, the terms of the transactions were fully disclosed and there are no allegations that any of the transactions were substantively unfair. Equally unavailing, plaintiffs contend the use of stock promoters was suspicious, but agree they are permissible and in this case did not violate any securities laws. Pls.' Br. 19, 21 n.16. None of the foregoing allegations show a reckless disregard for the truth. *Kalnit*, 264 F. 3d at 142.

3. Plaintiffs' Sinister Spin on Cemtrex's Corporate Growth Does Not Plead Scienter

Plaintiffs improperly bolster their claims with self-serving allegations, including allegations pre-dating the Class Period, to purposefully mischaracterize Cemtrex's corporate growth. For example, beginning in 2007, Cemtrex traded on the Over-the-Counter Bulletin Board ("OTCBB") until it was uplisted on the NASDAQ in 2015. ¶¶ 53, 345. Plaintiffs assert that during those early years, when listed on the OTCBB, Cemtrex's "sporadic[]" SEC reporting allowed Aron to "engage in unchecked and self-interested transactions." Pls.' Brf. 3; ¶¶ 41–44. In doing so, they selectively ignore the reality that Cemtrex's sales and shareholder equity grew

from $13.7 million and $1.1 million, respectively, in 2013 to $120.6 million and $39 million, respectively, in 2017. Ex. 30 at 15; Ex. 31 at F-4 and F-5.[3]

Accordingly, these conclusory allegations fail to render an inference of scienter *at least as likely* as any plausible nonfraudulent inference. *Tellabs*, 551 U.S. at 328. Instead, the more compelling, non-culpable inference is that Cemtrex started as a small, closely-held company, listed on the OTCBB with different reporting obligations, and wisely chose to fund company growth by leveraging related-party connections and credit rather than pursuing disproportionately more expensive forms of traditional financing. *See* Defs.' Brf. 5 (identifying Cemtrex's fundraising through loans from financial institutions). Indeed, when Cemtrex withdrew its Form S-3 registration statement, the Company reiterated to investors that it was not yet in a position to pursue traditional debt and equity financing to raise funds. ¶ 101.[4]

C. The Blog Posts are not Corrective Disclosures and Cannot Support Plaintiffs' Loss Causation Allegations

Underscoring the attenuated nature of their loss causation allegations, plaintiffs argue that "[t]he Second Circuit has declined to apply the pleading requirements of Rule 9(b) and the PSLRA to loss causation." Pls.' Br. 24. This is incorrect. The Second Circuit has not yet determined whether these standards apply to allegations of loss causation. *See Acticon AG v. China N. E. Petroleum Holdings Ltd.*, 692 F.3d 34, 38 (2d Cir. 2012) (recognizing the Circuit split but finding it unnecessary to resolve at the time). In *Van Dongen v. CNisure Inc.*, cited by plaintiffs, the court only noted that loss causation is not subject to heightened pleading standards *in the Southern District of New York*. 951 F. Supp. 2d 457, 467 n.7 (S.D.N.Y. 2013). Various

[3] All exhibits ("Ex.__") are attached to the Supplemental Declaration of Tiffany A, Miao, filed concurrently herewith. Defendants respectfully request that the court take judicial notice of these exhibits for the same reasons cited in their Request for Judicial Notice. (ECF 51).

[4] Plaintiffs incorrectly allege the SEC "rejected" the Company's Form S-3 registration; Cemtrex made the decision to withdraw the Form S-3 after receiving initial comments from the SEC. Pls.' Br. 4, 20; ¶ 100–01.

Circuit Courts and courts in this District have applied a heightened pleading requirement to loss causation. *See, e.g.*, *Orlan v. Spongetech Delivery Systems, Inc.*, 2017 WL 1131900, at *3 (E.D.N.Y. Mar. 24, 2017); *see also Oregon Pub. Emps. Ret. Fund v. Apollo Grp. Inc.*, 774 F.3d 598 (9th Cir. 2014); *Katyle v. Penn Nat'l Gaming, Inc.*, 637 F.3d 462, 471 & n.5 (4th Cir.2011); *Tricontinental Indus., Ltd. v. PricewaterhouseCoopers, LLP*, 475 F.3d 824, 842 (7th Cir. 2007); *but see Lormand v. U.S. Unwired, Inc.*, 565 F.3d 228, 258 (5th Cir. 2009) (declining to do so).

Plaintiffs agree that under either standard, "[a] plaintiff cannot simply plead an artificially inflated purchase price to sufficiently allege loss causation," but instead, must point to a statement that, because it corrected a prior falsehood, caused the security's price to drop. Pls.' Br. 24 (internal quotation marks omitted). The Second Circuit has held that a corrective disclosure must reveal new facts and cannot be based on public information. *See In re Omnicom Grp., Inc. Sec. Litig.*, 597 F.3d 501, 511 (2d Cir. 2010); *Fila v. Pingtan Marine Enter. Ltd.*, 195 F. Supp. 3d 489, 496–99 (S.D.N.Y. 2016) (finding cases pre-dating *Omnicom* that suggest a different legal standard no longer persuasive).

Here, the Amended Complaint fails to identify a viable corrective disclosure. A corrective disclosure must reveal new information to the market, and "the fact that the sources used in the [alleged corrective disclosure] were already public is fatal to the Investors' claim of loss causation." *Meyer v. Greene*, 710 F.3d 1189, 1198 (11th Cir. 2012); *see also Bonanno v. Cellular Biomedicine Grp., Inc.*, 2016 WL 2937438, at *5 (N.D. Cal. May 20, 2016) ("An anonymous poster's opinion cannot reveal to the market the falsity of CBMG's misrepresentations.").

Plaintiffs do not — and cannot — dispute that the bloggers' analyses and opinions are based on already available, public information. *See* Pls.' Br. 24. Pearson's analysis of Aron's,

Saagar's, Renato's, and Ducon's holdings was based solely on the Company's public SEC filings. *See* Ex. 12 at 10. Similarly, Unemon1 explained that Cemtrex India's corporate information was obtained from India's Ministry of Corporate Affairs and information on Paderborn was from a German news article reporting on the Company's announcement of the factory's intended closure. *See* Ex. 16 at 2; Pls.' Br. 14 n.9; ¶¶ 249, 338, 339, 342. Because none of the alleged disclosures revealed a previously hidden truth — about the Periscope acquisition, Cemtrex India, or purported insider stock sales — and none of the blog posts claim any of the information was non-public, plaintiffs cannot plausibly allege loss causation. *See Fila*, 195 F. Supp. at 498 (quoting *Omnicom*, 597 F.3d at 512) (finding analyst's article represented "precisely the sort of 'negative journalistic characterization of previously disclosed facts' that cannot be the basis for loss causation in this Circuit").

D. Leave to Amend Should be Denied Because the Amended Complaint is Structurally Unsalvageable

Plaintiffs' claims suffer from structural flaws that amendment cannot fix. Amendment cannot create stock sales that do not exist. Amendment cannot undo Saagar's stock purchases. Amendment cannot create a corrective disclosure. Apparently recognizing this, plaintiffs have not proffered any new facts or theories they might assert if given leave to amend. *See City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG*, 752 F.3d 173, 188 (2d Cir. 2014).[5]

III. CONCLUSION

For the foregoing reasons, this court should dismiss the Amended Complaint with prejudice.[6]

[5] Moreover, the Court should disregard plaintiffs' request for leave to amend. *See* Pls.' Br. 25, n.22; *Rowley*, 2005 WL 2429514, at *6 ("[A]n argument raised in a footnote . . . may not be properly considered.").
[6] Because plaintiffs fail to allege a primary violation under Section 10(b), their claim under Section 20(a) should also be dismissed. *See Ganino v. Citizens Utilities Co.*, 228 F.3d 154, 170 (2d Cir 2000).

Dated: October 4, 2018

Respectfully submitted,

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