



1 ("Roth"); Brean Murray, Carret & Co., LLC; and Global Hunter  
2 Securities, LLC (the "Underwriter Defendants"). (See generally  
3 Order Granting in Part and Denying in Part Motions to Dismiss and  
4 Strike ("Order"), Docket No. 128.) Lead Plaintiff has since filed  
5 the SCAC. Presently before the Court is the Underwriter  
6 Defendants' Motion to Dismiss Lead Plaintiff's Section 11 claim.  
7 ("Motion"). (Docket No. 134.)

8 Yuhe buys chickens, raises them to produce eggs, hatches the  
9 eggs and then sells the live day-old chicken (sometimes referred to  
10 as broilers). (SCAC ¶ 18.) At issue in this case are various  
11 allegedly false statements concerning Yuhe's acquisition of  
12 thirteen chicken breeder farms in China from the Weifang Dajiang  
13 Corporation ("Dajiang"), an acquisition that would have  
14 approximately doubled the number of Yuhe's breeder farms. (Id. ¶¶  
15 2, 45-46.) Lead Plaintiff alleges that the purchase of these farms  
16 never occurred. (Id. ¶ 2.) The Underwriter Defendants managed  
17 Yuhe's October 20, 2010 offering, with Roth serving as the lead  
18 underwriter. (Id. ¶¶ 23-27.) Lead Plaintiff alleges that the  
19 Prospectus Supplement for the October 20, 2010 offering, which was  
20 issued as part of the Registration Statement for that offering,  
21 falsely stated that Yuhe had acquired chicken breeder farms from  
22 Dajiang. (Id. ¶¶ 140-61.)

## 23 **II. Legal Standard**

24 A complaint will survive a motion to dismiss when it contains  
25 "sufficient factual matter, accepted as true, to state a claim to  
26 relief that is plausible on its face." Ashcroft v. Iqbal, 556 U.S.  
27 662, 678 (2009) (quoting Bell Atl. Corp. v. Twombly, 550 U.S. 544,  
28 570 (2007)). When considering a Rule 12(b)(6) motion, a court must

1 "accept as true all allegations of material fact and must construe  
2 those facts in the light most favorable to the plaintiff." Resnick  
3 v. Hayes, 213 F.3d 443, 447 (9th Cir. 2000). Although a complaint  
4 need not include "detailed factual allegations," it must offer  
5 "more than an unadorned, the-defendant-unlawfully-harmed-me  
6 accusation." Iqbal, 556 U.S. at 678. Conclusory allegations or  
7 allegations that are no more than a statement of a legal conclusion  
8 "are not entitled to the assumption of truth." Id. at 679. In  
9 other words, a pleading that merely offers "labels and  
10 conclusions," a "formulaic recitation of the elements," or "naked  
11 assertions" will not be sufficient to state a claim upon which  
12 relief can be granted. Id. at 678 (citations and internal  
13 quotation marks omitted).

14 "When there are well-pleaded factual allegations, a court should  
15 assume their veracity and then determine whether they plausibly  
16 give rise to an entitlement of relief." Id. at 679. Plaintiffs  
17 must allege "plausible grounds to infer" that their claims rise  
18 "above the speculative level." Twombly, 550 U.S. at 555-56.  
19 "Determining whether a complaint states a plausible claim for  
20 relief" is a "context-specific task that requires the reviewing  
21 court to draw on its judicial experience and common sense." Iqbal,  
22 556 U.S. at 679.

### 23 **III. Analysis**

24 The Underwriter Defendants seek to dismiss the Section 11  
25 claims of subclass members who bought shares traceable to the  
26 October 20, 2011 offering. "Section 11 of the Securities Act of  
27 1933, 15 U.S.C. § 77(k), provides a cause of action to any person  
28 who buys a security issued under a materially false or misleading

1 registration statement." In re Century Aluminum Co. Sec. Litig.,  
2 No. 11-15599, 2013 WL 1633094, at \*1 (9th Cir. Apr. 17, 2013). To  
3 have standing to sue under Section 11, plaintiffs must show that  
4 they "have purchased shares in the offering made under the  
5 misleading registration statement," or if they purchased their  
6 shares in the aftermarket, standing will be found "provided they  
7 can trace their shares back to the relevant offering." Id. The  
8 latter approach is "often impossible," and conclusory allegations  
9 in the complaint that the shares are traceable will not suffice.  
10 Id. at \*2-3. Plaintiffs "must do more than allege facts that are  
11 merely consistent with both their explanation and defendants'  
12 competing explanation." Id. at \*4. They must "allege[] facts  
13 which, accepted as true, tend[] to exclude the possibility that the  
14 defendant['s]" competing explanation is correct. Id.

15       The Court previously dismissed Subclass members whose shares  
16 were only traceable to the October 20, 2010 offering: "[S]ince  
17 Plaintiff seeks to represent members of the Subclass who purchased  
18 Yuhe stock that is traceable to the secondary offering, and since  
19 Lead Plaintiff does not provide any detailed analysis as to how  
20 these Subclass members' shares can be traced to the relevant  
21 offering, the Court dismisses the Section 11 claims of these  
22 subclass members." Order at 14:4-9.

23       Lead Plaintiff amended the definition of the Subclass to "all  
24 persons and entities who purchased or otherwise acquired newly  
25 issued Yuhe shares at the Offering price of \$7.00 per share  
26 pursuant to and traceable (for purposes of the Section 11 claim) to  
27 a secondary offering Yuhe made on or about October 20, 2010 and who  
28

1 were damaged thereby." (SCAC ¶ 36.)<sup>1</sup> Lead Plaintiff also alleges  
2 that Yuhe sold all of the shares issued pursuant to the October 20,  
3 2010 offering on November 2, 2010. (Id. ¶¶ 61-62.) The Court  
4 takes judicial notice that from October 19, 2010, the day before  
5 the relevant offering, through March 22, 2011, Yuhe's shares were  
6 not traded in the open market at an amount equal to or less than  
7 \$7.00.<sup>2</sup> (Plaintiff's Request for Judicial Notice ("PRJN" EX. E));  
8 Lee v. City of Los Angeles, 250 F.3d 668, 689 (9th Cir. 2001)  
9 (holding that "[a] court may take judicial notice of matters of  
10 public record without converting a motion to dismiss into a motion  
11 for summary judgment. But a court may not take judicial notice of  
12 a fact that is subject to reasonable dispute") (internal quotation  
13 marks and citations omitted).<sup>3</sup> That shares in the second offering  
14 were sold at \$7.00, and that in the open market Yuhe shares were  
15 traded at over that amount through March 22, 2011, "tend[s] to  
16 exclude the possibility" that the Subclass members who bought Yuhe  
17 stock at a price of \$7.00 per share prior to March 23, 2011 bought  
18 stock that was not traceable to the October 20, 2010 offering. See  
19 In re Century Aluminum Co. Sec. Litig., No. 11-15599, 2013 WL  
20 1633094, at \*4. Therefore Subclass members who bought Yuhe stock  
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22 <sup>1</sup>While this definition suffices at the motion to dismiss  
23 stage, more than the price of purchased shares will have to be  
24 shown to ultimately prove tracing at trial. In order to show that  
25 shares purchased at \$7 are directly traceable to a sale from Yuhe  
26 or its agent, Lead Plaintiff will have to follow the shares' chain  
27 of possession and eventually show that they match a sale or sales  
28 from Yuhe or its agent in the secondary offering.

26 <sup>2</sup>Yuhe used to be listed on Nasdaq. (SCAC ¶ 18.)

27 <sup>3</sup>The Underwriter Defendants have not disputed the accuracy of  
28 Yuhe's stock price, nor have they objected to the Court taking  
judicial notice of them.

1 at \$7.00 per share from October 20, 2010 to March 22, 2011 have  
2 standing.

3       However, Subclass members who purchased Yuhe stock on or after  
4 March 23, 2011 do not have standing, because Lead Plaintiff has not  
5 alleged sufficient facts that these members' shares are traceable.  
6 Indeed, Lead Plaintiff seemed to acknowledge as much in its  
7 opposition brief: "Therefore, it is plausible that a subclass  
8 member, such as Lead Plaintiff, who purchased shares at a price of  
9 \$7.00 on or after October 20, 2010 until the date thereafter when  
10 the stock price traded at or below \$7.00, purchased shares  
11 traceable to the Offering." Docket No. 135 at 22:13-17.

12       The Underwriter Defendants also state that a due diligence  
13 affirmative defense is established on the face of the SCAC, because  
14 it alleges that they reasonably relied on CVB, Yuhe's auditor, in  
15 preparing the Registration Statement for the secondary offering and  
16 documents that were part of that statement. See McCalden v.  
17 California Library Ass'n, 955 F.2d 1214, 1219 (9th Cir. 1990)  
18 (holding that an affirmative defense "must appear on the face of  
19 the pleading" for a complaint to be dismissed). Section 11  
20 requires a plaintiff to prove "(1) that the registration statement  
21 contained an omission or misrepresentation, and (2) that the  
22 omission or misrepresentation was material, that is, it would have  
23 misled a reasonable investor about the nature of his or her  
24 investment." Rubke, 551 F.3d at 1161 (internal quotation marks and  
25 citation omitted). Section 11 generally holds "the issuer of the  
26 securities . . . absolutely liable." Ernst & Ernst v. Hochfelder,  
27 425 U.S. 185, 208 (1976). However, experts "who have prepared  
28 portions of the registration statement are accorded a 'due

1 diligence' defense. In effect, this is a negligence standard."  
2 Id. The expert must prove it acted with due diligence. Id.  
3 "An underwriter need not conduct due diligence into the  
4 'expertised' parts of a prospectus, such as certified financial  
5 statements." In re Software Toolworks Inc., 50 F.3d 615, 623 (9th  
6 Cir. 1994). An underwriter "need only show that it 'had no  
7 reasonable ground to believe, and did not believe ... that the  
8 statements therein were untrue or that there was an omission to  
9 state a material fact required to be stated therein or necessary to  
10 make the statements therein not misleading.'" Id. Courts look to  
11 plaintiffs to point to red flags that should have indicated to the  
12 underwriter that the financial statements were untrustworthy. See  
13 id. at 623-24. In In re Countrywide, a district court allowed an  
14 underwriter to establish the due diligence defense at the motion to  
15 dismiss stage, because "underwriters may reasonably rely on  
16 auditors' statements, absent red flags that the underwriters were  
17 in a position to see." 588 F.Supp. 2d at 1175. This Court  
18 previously dismissed Lead Plaintiff's Section 11 claim because it  
19 pointed to no red flags that should have cautioned the Underwriter  
20 Defendants against relying on CVB, Yuhe's auditor. (Order at 19:7-  
21 20:2.)

22 Lead Plaintiff has stated a sufficient Section 11 claim  
23 against the Underwriter Defendants. The SCAC alleges: "The  
24 Offering also states that 20 breeder farms are in operation,  
25 including five of the Dajiang farms." (SCAC ¶ 98.) The SCAC  
26 alleges that Yuhe never acquired the Dajiang farms. (Id. ¶¶ 2,  
27 98.) At the time of the October 20, 2010 offering, CVB had not  
28 represented that the five Dajiang farms were operational. The

1 first representation that these five farms were operational  
2 occurred in Yuhe's July 19, 2010 Form 8-K,<sup>4</sup> which was incorporated  
3 by reference into the October 20, 2010 Prospectus Supplement and  
4 which was filed more than three months after CVB's audit report was  
5 made public. (Id. ¶ 97.) The Prospectus Supplement was "issued to  
6 and as part of the Registration Statement." (Id. ¶ 141.)

7 The Underwriter Defendants dispute the significance of the  
8 representation about the five Dajiang farms being operational by  
9 referencing several filings that CVB audited, which indicate that  
10 the Dajiang farms would become operational in 2010. (Docket No.  
11 137 at 9:16-10:7.) But the Underwriter Defendants were only  
12 entitled to "reasonably rely on auditors' statements, absent red  
13 flags," not assume that Yuhe's predictive statements had, in fact,  
14 come to fruition. See In re Countrywide 588 F.Supp.2d at 1175. As  
15 this Court has previously ruled, the Underwriter Defendants were  
16 allowed to rely on the expertised portions of CVB's audit report.  
17 But the Underwriter Defendants were not permitted to, as the SCAC  
18 alleges, elevate the audited expectancies into an accomplished  
19 fact. In other words, an expectation that the farms to would  
20 become operational is one thing, stating they are operational  
21 indicates something more-it indicates that the Dajiang transaction  
22 is being successfully.

23 Thus, on the face of the SCAC, the Underwriter Defendants  
24 relied on Yuhe's statements that five of the Dajiang farms, a  
25 quarter of Yuhe's operational farms, were operational.

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27 <sup>4</sup>The July 19, 2010 Form 8-K was incorporated by reference into  
28 the October 20, 2010 Prospectus Supplement. (Id. ¶ 97; PRJN Ex. B  
at 66.)



1 Accordingly, and because due diligence should generally be reserved  
2 for a jury to determine, Lead Plaintiff has alleged sufficient  
3 facts for a Section 11 claim. See In re Software Toolworks Inc.,  
4 50 F.3d 615, 621, 626 (9th Cir. 1994) ("For its due diligence  
5 investigation of these sales, however, the Underwriters did little  
6 more than rely on Toolworks' assurances that the transactions were  
7 legitimate. A reasonable inference from this evidence is that  
8 Toolworks fabricated the June sales to ensure that the offering  
9 would proceed and that the Underwriters knew, or should have known,  
10 of this fraud."); Leasco Data Processing Equip. Corp., 332 F.Supp.  
11 544, 582 (E.D.N.Y.1971) ("Tacit reliance on management is  
12 unacceptable; the underwriters must play devil's advocate."); see  
13 also Chris-Craft Indus., Inc. v. Piper Aircraft Corp., 480 F.2d  
14 341, 370 (2d Cir. 1973) ("Prospective investors look to the  
15 underwriter-a fact well known to all concerned and especially to  
16 the underwriter-to pass on the soundness of the security and the  
17 correctness of the registration statement and prospectus.").

#### 18 **IV. Conclusion**

19 For the reasons stated herein, the Underwriter Defendants'  
20 Motion is DENIED, except that the Court dismisses with prejudice  
21 Lead Plaintiff's Section 11 claim on behalf of Subclass members who  
22 bought Yuhe stock on or after March 23, 2011. However, the only  
23 Section 11 allegations against the Underwriter Defendants that  
24 survive are those related to the Prospectus Supplement's statement  
25 that five of the Dajiang farms were operational. The remaining

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1 Section 11 allegations against the Underwriter Defendants are  
2 dismissed with prejudice.

3 IT IS SO ORDERED.  
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6 Dated: July 10, 2013  
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DEAN D. PREGERSON  
United States District Judge

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