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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

LIFEVOXEL VIRGINIA SPV, LLC;
SCOTT MARSCHALL; DEBBIE
GALLO; KEVIN SINAGRA; SCOTT
POOLE; and PETER BERSHATSKY,
Plaintiffs,
v.
LIFEVOXEL.AI, INC., a Delaware
Corporation; KOVEY KOVALAN, an
individual; and LINH LE, an individual,
Defendants.

Case No.: 22-CV-01917-GPC-MMP
**ORDER GRANTING DEFENDANTS’
MOTION TO DISMISS WITH
LEAVE TO AMEND**
[ECF No. 73]

INTRODUCTION

Before the Court is Defendant LifeVoxel.AI, Inc.; Kovey Kovalan; and Linh Le’s (collectively “Defendants”) Motion to Dismiss Plaintiffs LifeVoxel Virginia SPV, LLC (“LifeVoxel Virginia”); Scott Marschall; Debbie Gallo; Kevin Sinagra; Scott Poole; and Peter Bershatsky’s (collectively “Plaintiffs”) Second Amended Complaint (“SAC”). ECF No. 73. For the reasons below, the motion to dismiss is GRANTED with leave to amend.

///

1 **BACKGROUND**

2 Defendants Kovey Kovalan (“Kovalan”) and Linh Le (“Le”) are spouses and
3 owners and officers of Defendant LifeVoxel.AI, Inc. (“LifeVoxel”). ECF No. 65
4 (“SAC”) ¶ 2. Plaintiffs allege that Kovalan and Le fraudulently induced them to invest
5 \$3.5 million in LifeVoxel through Simple Agreements for Future Equity (“SAFE
6 Notes”). SAC ¶ 3. “SAFE Notes are a type of security which allow investors to
7 contribute capital to a business entity in exchange for the ability to purchase shares of the
8 company at a discounted rate upon a liquidity event.” SAC ¶ 3. They are not a stock or a
9 debt with a maturity date. SAC ¶ 80. SAFE Notes are classified as securities by the
10 United States Securities and Exchange Commission (“the SEC”). SAC ¶ 79.

11 **I. Development of LifeVoxel**

12 Kovalan has developed multiple patents relating to medical records and imaging
13 technology (the “Kovalan Patents”), and according to the SAC, he and his wife
14 Defendant Le have “formed multitudes of businesses, changed business names, changed
15 ownerships, operated under assumed business names, and facilitated transactions among
16 the business entities and themselves that did not maintain arms-length” in attempt to
17 monetize those patents. SAC ¶ 58-59. In 2007, Kovalan and Le organized “Voxcell
18 Cloud.” SAC ¶ 61. In 2016, Kovalan incorporated “AI Visualize” and assigned several
19 of the Kovalan Patents to it. SAC ¶¶ 62-63. At some point, Voxcell Cloud became a
20 wholly owned subsidiary of AI Visualize, and AI Visualize licensed the Kovalan Patents
21 to Voxcell Cloud, which contracted with third parties for services covered by the Kovalan
22 Patents. SAC ¶¶ 66, 69. Voxcell Cloud achieved “moderate success” and Plaintiffs
23 allege that Kovalan and Le “frequently paid for their personal expenses . . . with funds
24 from Voxcell Cloud but deliberately misclassified such payments as business expenses.”
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1 SAC ¶ 70. In November 2019, Defendant LifeVoxel was incorporated in Delaware “as a
2 wholly owned subsidiary of AI Visualize.”¹ SAC ¶ 71.

3 Kovalan met Sekhar Puli, “an experienced entrepreneur and investor,” in July 2021
4 and eventually hired Puli to be Co-Founder, President, and Chief Executive Officer
5 (“CEO”) of AI Visualize and CEO and President of LifeVoxel to “raise capital and grow
6 the business.” SAC ¶¶ 84, 88, 92. Puli and other advisors recommended an “Action
7 Plan” “to result in profitability and achievement of an eventual liquidity event” for
8 investors. SAC ¶¶ 93-94. The Action Plan included (1) assigning contracts and assets
9 from Voxcell Cloud to LifeVoxel; (2) licensing the Kovalan Patents to LifeVoxel; (3)
10 arranging a share buyback of minority shareholders of AI Visualize; (4) using the equity
11 freed up from the buyback “to raise capital or provide sweat equity to key stakeholders
12 like Puli and then spin off LifeVoxel so that it is a separate entity”; (5) winding up
13 operation of Voxcell Cloud; and (6) raising capital for LifeVoxel. SAC ¶ 94. The SAC
14 alleges that Kovalan and Le agreed to implement the Action Plan. *See* SAC ¶¶ 95, 98.
15 They signed a special resolution agreeing to spin LifeVoxel off as a separate entity and
16 license the Kovalan Patents to it, SAC at 48-49 (Exhibit B), and also told Puli that
17 Voxcell Cloud would transfer its business to LifeVoxel and cease operations, SAC ¶ 96.

18 **II. Plaintiffs Invest in LifeVoxel SAFE Notes**

19 Soon after starting as CEO and President of both LifeVoxel and AI Visualize in
20 September 2021, Puli began to solicit investment. SAC ¶¶ 100-01. As part of this effort,
21 Kovalan, “or someone at his direction,” created a series of very similar presentation
22 decks with marketing information about LifeVoxel. SAC ¶¶ 103, 109-10. Plaintiffs
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25 ¹¹ Just a few months earlier, Voxcell Cloud filed an application to operate under the
26 assumed business name of “LifeVoxel.AI,” SAC ¶ 68, but it is a distinct entity from
27 Defendant LifeVoxel.AI, Inc., which the Court refers to throughout this order as
28 “LifeVoxel.”

1 allege that the presentations included multiple misrepresentations. First, the presentations
2 listed financial information for LifeVoxel for the years 2018, 2019, and 2020 which was
3 actually the financial information of Voxcell Cloud. SAC ¶¶ 105, 109-10. Second, the
4 presentations stated that investment funds would be used: 60% to enrich intellectual
5 property through research and development, 20% on market outreach, and 20% on
6 “growth development,” i.e. business development and sales and marketing.² SAC ¶¶
7 106, 109-10. Third and finally, the presentations represented that “previous capital
8 contributed to LifeVoxel was non-dilutive.” SAC ¶¶ 108-10.

9 In September 2021, Puli conveyed this information to some of the Plaintiffs either
10 by emailing them the presentations or in oral conversations. *See* SAC ¶¶ 112-13
11 (Plaintiff Peter Bershatsky); ¶ 118 (Plaintiff Scott Poole); ¶ 119 (Plaintiffs Debbie Gallo
12 and Scott Marschall), ¶¶ 124, 119 (Plaintiff Kevin Sinagra). Puli also arranged for
13 Kovalan to meet with his network of friends and family, the shareholders of Plaintiff
14 LifeVoxel Virginia, at his home in Virginia on September 10, 2021. SAC ¶ 114. During
15 the meeting Kovalan showed a presentation including the alleged misrepresentations and
16 conveyed some of them orally as well. SAC ¶¶ 116-17. Defendants and Puli provided
17 each Plaintiff with a SAFE Note agreement and a capitalization table (“cap
18 table”)—which breaks down who or what owns a company’s equity and in what
19 form—showing that AI Visualize owned 100% of LifeVoxel’s equity. SAC ¶ 8.

20 Together the Plaintiffs purchased \$3.5 million in LifeVoxel SAFE Notes. SAC ¶¶
21 126, 3, 174. The agreement for these SAFE Notes proscribes that the conversion events
22 triggering the option to purchase equity are a private buyout, an initial public offering, or
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25 ² The SAC indicates that one of the presentations did not include this slide, but it is not
26 clear to Court which of the presentations this was. SAC ¶ 110; ECF No. 67 at 18
27 (sealed); ECF No. 67-1 at 11 (sealed).

1 a direct listing under the Securities Act. SAC ¶¶ 22-23. In total, LifeVoxel received over
2 \$5 million in SAFE Notes, including investment from individuals or entities who are not
3 part of this suit. SAC ¶ 3.

4 **III. Alleged Fraud**

5 Not long after, in October 2021, after an outside accounting firm notified Puli that
6 Voxcell Cloud was still invoicing customers for contracts, Puli spoke with Le who
7 eventually told him that “she and [Kovalan] were running their personal expenses
8 through Voxcell Cloud and would continue to do so using proceeds from the non-
9 transferred contracts.” SAC ¶ 143. The SAC alleges that LifeVoxel was therefore
10 “collecting only 80% of the revenue due to it.” SAC ¶ 150.

11 In November 2021, Defendants and Puli used about \$500,000 of the SAFE Notes
12 invested in LifeVoxel to buy out minority shareholders in AI Visualize. SAC ¶¶ 137,
13 147, 151. The presentations and information provided to investors stated that their SAFE
14 Note investments would be used 60% to enrich intellectual property, 20% on market
15 outreach, and 20% on “growth development”—they did not mention share buybacks for
16 the parent company. SAC ¶¶ 106, 109-10. Although Puli assumed that the amount
17 would be repaid to LifeVoxel in some form, “to use as employee stock compensation and
18 to sell to investors, including Puli,” SAC ¶¶ 16, 24, the repurchased AI Visualize shares
19 were then purchased by Kovey, LLC, a company owned by Kovalan and Le. SAC ¶¶
20 147, 51.

21 In the process of contacting minority shareholders in AI Visualize and in
22 attempting to put LifeVoxel’s accounts in order, Puli learned that Kovalan had already
23 granted shares in LifeVoxel to a presumed AI Visualize shareholder and had promised
24 shares in LifeVoxel to employees and an independent contractor. SAC ¶¶ 138-40. This
25 was contrary to the statements made to investors that all prior investment in LifeVoxel
26 was “non-dilutive.” SAC ¶ 141. The SAC explained that “[t]he additional, undisclosed
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1 equity interests mean that the value of the SAFE Notes is materially less than presented
2 to Plaintiffs because in the event of a Conversion Event the value per share will be spread
3 across more equity holders.” *Id.*

4 Because of these incidents Kovalan and Puli’s relationship began to deteriorate in
5 late November 2021. SAC at 29-30. Puli sent an email detailing some of his concerns.
6 SAC at 158 (Exhibit I). In response, Kovalan explained that “the plans for AI Visualize
7 is much larger as I have shared with you, [and] I perceive its shares as currency to
8 capitalize its vision, so [I] want to make sure we are aligned on its vision and cap table.”
9 *Id.* Kovalan also “told Puli that he wanted to continue operating AI Visualize and
10 LifeVoxel according to his own wishes.” SAC ¶ 153. The SAC alleges that after Puli
11 offered to resign on the condition that investors would receive their money back and
12 Kovalan agreed, Puli was fired, SAC ¶ 156, but Puli’s resignation email suggests that his
13 resignation was unconditional, SAC at 162-64 (Exhibit J).

14 The SAC also alleges that, unknown to investors, Kovalan had licensed some of
15 the Kovalan Patents to entities in Russia, Germany, and India without a written
16 agreement in place, SAC ¶ 161, had failed to use proper accounting and recording
17 practices, SAC ¶ 162, had misclassified personal expenses as business expenses, SAC ¶
18 70, and had previously declared bankruptcy for another company related to the Kovalan
19 Patents, SAC ¶ 36.

20 **IV. Procedural History**

21 In April 2022, Plaintiffs filed a substantially similar complaint to the instant one
22 (“*LifeVoxel I*”) against the same Defendants. *See LifeVoxel Virginia SPV, LLC et al v.*
23 *LifeVoxel.AI, Inc. et al*, Case No. 22-cv-00566 (S.D. Cal. Apr. 22, 2022). The Court
24 dismissed *LifeVoxel I* in a reasoned decision after Plaintiffs failed to file an opposition to
25 Defendants’ Motion to Dismiss. *See LifeVoxel Virginia SPV, LLC v. LifeVoxel.AI, Inc.*,
26 622 F. Supp. 3d 935 (S.D. Cal. 2022).

1 On December 2, 2022, Plaintiffs filed the initial complaint in the present action.
2 ECF No. 1. After fully briefing Defendants’ motion to dismiss the initial complaint,
3 Plaintiffs moved for leave to amend. ECF No. 16. The Court granted Plaintiffs leave to
4 amend, ECF No. 43, and Plaintiffs filed a First Amended Complaint, ECF No. 46.
5 Defendants filed a Motion to Dismiss, ECF No. 50, which the Court granted in its
6 entirety with leave to amend, ECF No. 62. Plaintiffs timely filed the operative SAC, and
7 Defendants again moved to dismiss, filing the instant motion. ECF No. 73. Plaintiffs
8 responded, ECF No. 82, and Defendants replied, ECF No. 85.

9 PLEADING STANDARDS

10 I. Federal Rule of Civil Procedure 12(b)(6)

11 Federal Rule of Civil Procedure (“Rule”) 12(b)(6) requires dismissal for failure to
12 state a claim upon which relief can be granted, and Rule 8(a)(2) dictates that a pleading
13 must contain “a short and plain statement of the claim showing that the pleader is entitled
14 to relief.” A plaintiff is not required to provide “detailed factual allegations,” but must
15 plead sufficient facts that, if accepted as true, “raise a right to relief above the speculative
16 level.” *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007). A complaint will survive a
17 motion to dismiss when it contains enough facts to “state a claim to relief that is plausible
18 on its face.” *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Twombly*, 550 U.S. at
19 570). A claim is plausible when the factual allegations permit “the court to draw the
20 reasonable inference that the defendant is liable for the misconduct charged.” *Id.* at 678.
21 The Court must assume that all factual allegations are true but is not required to accept as
22 true “allegations that are merely conclusory, unwarranted deductions of fact, or
23 unreasonable inferences.” *In re Gilead Scis. Sec. Litig.*, 536 F.3d 1049, 1055 (9th Cir.
24 2008) (citation omitted).

1 sufficiently strong inference of scienter when the culpable, “malicious inference is at
2 least as compelling as any opposing innocent inference.” *Zucco*, 552 F.3d at 991. A
3 court must review the allegations collectively, not just independently, to determine if a
4 strong inference of intentional conduct or deliberate recklessness has been adequately
5 alleged. *Id.* at 991-92.

6 “Rule 9(b) and the PSLRA create a significant barrier for private securities
7 plaintiffs. But it is not an impossible barrier[.]” *Schueneman v. Arena Pharms., Inc.*, 840
8 F.3d 698, 710 (9th Cir. 2016).

9 DISCUSSION

10 The SAC asserts six causes of action: (1) violation of Section 10(b) of the
11 Securities Exchange Act of 1934; (2) violation of Section 20(a) of the Securities
12 Exchange Act; (3) violation of the Virginia Securities Act, Va. Code § 13.1-522; (4)
13 violation of the Virginia Securities Act, Va. Code § 13.1-522(C); (5) common law
14 fraud/fraud in the inducement; and (6) civil conspiracy. ECF No. 65 at 35-41.

15 Defendants move to dismiss all claims.

16 I. Count I: Section 10(b) of the Securities Exchange Act

17 Plaintiffs first allege a violation of Section 10(b) of the Securities Exchange Act
18 and Rule 10(b)-5 promulgated thereunder. Section 10(b) makes it unlawful for “any
19 person . . . [t]o use or employ, in connection with the purchase or sale of any security
20 registered on a national securities exchange . . . any manipulative or deceptive device or
21 contrivance in contravention of such rules and regulations as the Commission may
22 prescribe as necessary or . . . for the protection of investors.” 15 U.S.C. § 78(j)(b). “SEC
23 Rule 10(b)-5 implements this provision by making it unlawful to, among other things,
24 ‘make any untrue statement of material fact or to omit to state a material fact necessary in
25 order to make the statements made, in light of the circumstances under which they were
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1 made, not misleading.” *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 37 (2011)
2 (quoting 17 C.F.R. § 240.10b-5(b)).

3 To state a claim under Section 10(b) and Rule 10(b)-5, Plaintiff must allege: (1) a
4 material misrepresentation or omission; (2) made intentionally, knowingly, or with
5 deliberate recklessness; (3) in connection with the purchase or sale of a security; (4)
6 reliance by the plaintiff on the misrepresentation or omission; (5) economic loss; and (6)
7 a causal nexus between the misrepresentation or omission and the loss, i.e., loss
8 causation. *Id.* at 37-38; *VeriFone*, 704 F.3d at 701. The Court holds that Plaintiffs
9 adequately allege material misrepresentations and scienter but have failed to sufficiently
10 show economic loss.

11 **A. Materially Misleading Statements and Omissions**

12 Misleading statements are “any untrue statement of material fact or [omission of] a
13 material fact necessary in order to make the statements made, in light of the
14 circumstances under which they were made, not misleading.” 17 C.F.R. § 240.10b-5(b).
15 “[I]n other words it must affirmatively create an impression of a state of affairs that
16 differs in a material way from the one that actually exists.” *Brody v. Transitional Hosps.*
17 *Corp.*, 280 F.3d 997, 1006 (9th Cir. 2002). The standard is an objective one, and the
18 complaint must allege facts sufficient to support the inference that there is “a substantial
19 likelihood that the disclosure of the omitted fact would have been viewed by the
20 reasonable investor as having significantly altered the total mix of information made
21 available.” *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (internal quotation marks
22 and citation omitted).

23 Plaintiffs allege multiple misleading statements and omissions, all supporting the
24 overall allegation that “the core fraud perpetrated against the investors in the SAFE Notes
25 was the material omission that Defendants were soliciting the funds to benefit themselves
26 and to grow the value of Kovey’s shares in the parent company AI Visualize – not to
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1 benefit LifeVoxel or its shareholders through the implementation of the Action Plan.”
2 ECF No. 82 at 14. Specifically, Plaintiffs identify three alleged misleading statements or
3 omissions: (1) failing to inform Plaintiffs that Defendants intended to use the SAFE Note
4 funds to buy back minority shares of AI Visualize and instead representing that they
5 would use the funds for other purposes; (2) misrepresenting Voxcell Cloud’s income and
6 profits as LifeVoxel’s, especially given that Defendants did not transfer all of Voxcell
7 Cloud’s contracts and assets to LifeVoxel; (3) misrepresenting that all prior capitalization
8 in LifeVoxel was non-dilutive. ECF No. 82 at 18-28. The Court agrees that these were
9 material misrepresentations.

10 *a. Omission of the fact that Defendants intended to use SAFE*
11 *Notes to buy back minority shares of AI visualize*

12 Plaintiff contends that “the first material omission is Defendants’ intent to use the
13 SAFE Note funds to buy out the minority shareholders of AI Visualize.” ECF No. 82 at
14 18. As in the FAC, the SAC adequately alleges this was a material misrepresentation
15 because it specified the particular information omitted, when and where it was omitted,
16 by whom, and why it is misleading. *See* 15 U.S.C. § 78u-4(b)(1)(B) (PSLRA pleading
17 standard); *Swartz*, 476 F.3d at 764 (Rule 9(b) pleading standard). Here, Plaintiffs plead
18 facts showing that Kovalan or Puli, either through presentation, email, or conversation
19 informed each Plaintiff how investment funds would be used: 60% for research and
20 development, 20% for app marketplace outreach, and 20% for business development,
21 sales, and marketing.³ SAC ¶¶ 106, 109, 117-19, 124. The SAC further clarifies that
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24 ³ The SAC does not allege that Bershatzky received a presentation with this particular
25 breakdown, but incorporates an email from Puli to Bershatzky in which Puli states that
26 the “[p]rimary usage of funds is to build – product develop, support and sales
27 organization along with targeted market development initiatives,” and clarifies that “[w]e
28 are not expecting to spend any of these funds on general G&A[.]” SAC at 151.

1 neither Defendants nor Puli informed Plaintiffs that some of the SAFE Note funds would
2 be used to buy AI Visualize shares. SAC at ¶¶ 127-28.

3 While “[s]ilence, absent a duty to disclose, is not misleading,” *Basic Inc.*, 485 U.S.
4 at 239 n.17, Defendants and Puli told Plaintiffs explicitly how the SAFE Note funds
5 would be used, “affirmatively create[ing] an impression of a state of affairs that differs in
6 a material way from the one that actually exists.” *Brody*, 280 F.3d at 1006. As such,
7 “Defendants were under a duty to disclose that investment funds would be used to buy
8 back shares from earlier AI Visualize investors.” ECF No. 62 at 13.

9 *b. Representations Regarding LifeVoxel’s Income*

10 Plaintiffs next contend that the income and profit from 2018 to 2020 that
11 Defendants and Puli conveyed as LifeVoxel’s was a material misrepresentation because
12 the data came from Voxcell Cloud. ECF No. 82 at 20; *see* ECF No. 67 at 11 (sealed);
13 ECF No. 67-1 at 10 (sealed). The SAC adequately alleges the content of the alleged
14 misrepresentation and how and when Defendants and Puli conveyed it to Plaintiffs. SAC
15 at ¶ 103 (Kovalan created or directed someone to create the LifeVoxel Long
16 Presentation), ¶ 105 (the LifeVoxel Long Presentation contained the misrepresentation),
17 ¶¶ 109-10 (the other presentations contained the information), ¶ 113 (Puli emailed
18 Bershatsky the information), ¶ 117 (Kovalan presented the presentation to Plaintiff
19 LifeVoxel Virginia), ¶ 118 (presentation emailed to Poole), ¶ 119 (Puli tells Gallo and
20 Marschall the information), ¶ 124 (Puli tells Sinagra the information).

21 As Defendants highlight, the Court previously held that this was not a material
22 misrepresentation:

23 While Defendants could have more clearly laid out the business history and
24 restructuring plan for Plaintiffs and other investors, it was reasonable for
25 Defendants to assume potential investors were mostly concerned with “the
26 LifeVoxel brand and its intellectual property[’s] capacity to produce
27 revenue.” The presentations simply did not draw a distinction between
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1 Voxcell Cloud, AI Visualize, and the other names under which Defendants
2 conducted business with the [Kovalan] Patents.

3 ECF No. 62 at 14-15; ECF No. 73-1 at 18.

4 Nonetheless, upon reconsideration, the Court finds that stating Voxcell Cloud's
5 financial information for 2018-2020 as if it were LifeVoxel's is a material
6 misrepresentation. Whether something is materially misleading is an objective standard,
7 *see Basic Inc.*, 485 U.S. at 231, and a reasonable investor would be misled by the fact that
8 the income and profit reported were not LifeVoxel's. Investors in LifeVoxel do not
9 receive investment returns from Voxcell Cloud just because the companies are owned by
10 the same parent. And while investors may be interested to know the financial history of
11 other companies within "the brand" and the shared "intellectual property's capacity to
12 produce revenue," ECF No. 73-1 at 20, that the data does not come from the company
13 they are investing in but from another company within the brand is material to their
14 decision on how or what to invest. This is evident from other allegations in the SAC
15 which indicate that contrary to the Action Plan, roughly 20% of Voxcell Cloud's
16 contracts and assets were *not* transferred to LifeVoxel, SAC ¶¶ 143, 150, meaning that
17 Voxcell Cloud's income and profits were not an accurate approximation of LifeVoxel's.
18 In short, the representation that Voxcell Cloud's income and profit was LifeVoxel's
19 "create[s] an impression of a state of affairs that differs in a material way from the one
20 that actually exists." *Brody*, 280 F.3d at 1006.

21 *c. Statements that all prior capitalization was non-dilutive*

22 Finally, Plaintiffs assert that Defendants falsely characterized all previous
23 capitalization in LifeVoxel as non-dilutive and provided a cap table showing that AI
24 Visualize owned 100% of the equity in LifeVoxel. ECF No. 82 at 22. Plaintiffs
25 previously characterized the error only as providing an incorrect cap table and the Court
26 held that the FAC failed to plead with specificity under Rule 9(b) and the PSLRA

1 because it did not allege how the cap table was conveyed or who created it. ECF No. 62
2 at 15-16. The Court holds that the SAC remedies this issue.

3 The SAC incorporates the presentations which include the bullet point: “Previous
4 capital: non-dilutive including innovation grants[.]” ECF No. 67 at 18 (sealed); ECF No.
5 67-1 at 11 (sealed). It alleges that Kovalan or someone at his direction made the
6 presentations, SAC ¶ 103, 109, and that Kovalan delivered the presentation or Puli
7 emailed it or discussed it with each of the Plaintiffs except Bershatsky. SAC ¶¶ 110, 113,
8 117-19, 124. Regarding the cap table, the SAC alleges that Kovalan created it in July
9 2021 and that Defendants and Puli provided it with the SAFE Note agreement itself.
10 SAC ¶¶ 8, 125. Thus, the SAC alleges with sufficient particularity that Defendants made
11 the misleading statement that all prior capitalization in LifeVoxel was non-dilutive, either
12 by stating as such or by showing it through the cap table.

13 The Court finds that taking the allegations in the SAC as true, this statement was
14 materially misleading. The SAC alleges that there were other undisclosed equity owners
15 in LifeVoxel, contradicting the statement that all capitalization was undiluted. SAC ¶¶
16 29, 131. Specifically, the SAC alleges that when Puli contacted the AI Visualize
17 minority shareholders, he discovered that one was an equity owner in LifeVoxel, with
18 paperwork to support their ownership of LifeVoxel shares. SAC ¶ 138. Puli later learned
19 that Kovalan orally promised equity to an independent contractor and to LifeVoxel
20 employees. SAC ¶ 139-40. Taking these allegations as true, the Court agrees with
21 Plaintiffs that the statement that prior capitalization was non-dilutive was materially
22 misleading. There is “substantial likelihood that the disclosure of [this] fact would have
23 been viewed by the reasonable investor as having significantly altered the total mix of
24 information made available.” *Basic Inc.*, 485 U.S. at 231-32 (internal quotation marks
25 and citation omitted).

1 Defendants argue that LifeVoxel was entirely owned by AI Visualize and that all
2 capitalization was non-dilutive and support their argument by submitting an email from
3 Kovalan. ECF No. 73-1 at 24. But the Court may not consider materials outside the
4 pleadings in a Rule 12(b)(6) motion and therefore will not consider the email, Exhibit A
5 to the Declaration of Sara E. Thompson.⁴ Fed. R. Civ. P. 12(d); *Hal Roach Studios, Inc.*
6 *v. Richard Feiner & Co.*, 896 F.2d 1542, 1555 n.19 (9th Cir. 1989). Defendants also
7 argue that Plaintiffs’ SAFE Notes would not be diluted because they grant Plaintiffs the
8 right to preferred shares upon a conversion event, not common shares, and that the
9 preferred shares cannot be diluted. ECF No. 73-1 at 25. The SAFE Notes do grant
10 Plaintiffs preferred shares upon the occurrence of a conversion event. SAC at 51.
11 Nonetheless, it is unclear from the SAC and attachments what the parameters of
12 LifeVoxel preferred stock are in contrast to its common stock. The Court therefore
13 agrees with Plaintiffs that “Defendants provide no authority for their claim that there
14 would be no dilutive impact on the preferred shares if there were additional, undisclosed
15 common shares omitted from the cap table. That is [a] question of fact that cannot be
16 resolved as part of a motion to dismiss.” ECF No. 82 at 24.

17 Accordingly, Plaintiffs have adequately alleged all three material
18 misrepresentations.
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23 ⁴ To the extent Defendants argue that the Court may consider their exhibit because it was
24 referenced or integral to the complaint, ECF No. 73-1 at 24, the Court rejects the
25 argument. Although the Court may consider a document “if the plaintiff refers
26 extensively to the document or the document forms the basis of the plaintiff’s claim,”
27 *Khoja v. Orexigen Therapeutics, Inc.*, 899 F.3d 988, 1002 (9th Cir. 2018), the SAC does
28 not refer to or even mention the email included as Defendants’ exhibit.

1 **B. Scierter**

2 To properly allege a securities fraud claim under Section 10(b), the complaint must
3 plead, with particularity, the defendant’s intent, knowledge, or deliberate recklessness in
4 making the misleading statements, i.e. an intent to defraud or a deliberate recklessness in
5 doing so. *VeriFone Holdings*, 704 F.3d at 702. Deliberate recklessness involves “an
6 extreme departure from the standards of ordinary care, and which presents a danger of
7 misleading buyers . . . that is either known to the defendant or is so obvious that the actor
8 must have been aware of it.” *Hollinger*, 914 F.2d at 1569 (citation omitted). A strong
9 inference of scierter exists when the “malicious inference [from the facts pled] is at least
10 as compelling as any opposing innocent inference.” *Zucco*, 552 F.3d at 991. In assessing
11 whether the culpable inference is at least as compelling as the innocent inference(s), the
12 Court must consider the allegations collectively. *Id.* at 992.

13 In dismissing the FAC, the Court held that the FAC failed to allege scierter
14 because its allegations were too conclusory. It explained that the FAC alleged only
15 motive—that Defendants would benefit from committing fraud—which was insufficient
16 on its own. ECF No. 62 at 13. It held that Puli’s involvement in communicating with the
17 Plaintiffs made the innocent inference more compelling than the malicious one because
18 the Plaintiffs do not contend that Puli was attempting to con them. *Id.* at 14, 15.

19 The Court finds that the SAC has remedied these problems. The SAC alleges a
20 series of facts that taken together make the inference that Defendants acted with reckless
21 disregard in making the alleged misstatements and omissions at least as compelling as the
22 inference that they acted innocently. To show scierter, Plaintiffs primarily rely on the
23 content of the misstatements and omissions themselves and how they contradict the
24 Action Plan. ECF No. 82 at 17-18. They argue that Kovalan and Le agreed with the
25 Action Plan and acknowledged that spinning off LifeVoxel as a separate entity with
26 licenses to the Kovalan Patents from AI Visualize was the only way to raise capital and
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1 grow the business. SAC ¶¶ 94-95, at 46. And then Kovalan and Le acted against
2 LifeVoxel’s interest by using funds to buy out AI Visualize minority shareholders and
3 keeping the shares for themselves and by failing to transfer all of Voxcell Cloud’s
4 contracts to LifeVoxel. ECF No. 82 at 17.

5 The Court finds this somewhat persuasive, but much more convincing are the
6 statements made by Kovalan and Le regarding this behavior. The SAC alleges that Le
7 explicitly told Puli that she and Kovalan “were running their personal expenses through
8 Voxcell Cloud and would continue to do so using proceeds from the non-transferred
9 contracts.” SAC ¶ 143. Only a month or two earlier, Le and Kovalan had agreed that
10 Voxcell Cloud “would cease all operations and be wound up, with all business thereafter
11 to be completed by LifeVoxel” and Puli and Kovalan had represented Voxcell Cloud’s
12 income and profit as LifeVoxel’s to investors. SAC ¶ 96. Moreover, the SAC also
13 alleges that Kovalan told Puli “that he wanted to continue operating AI Visualize and
14 LifeVoxel to his own wishes,” and that Kovalan wrote in a November 21, 2021 email that
15 “the plans for AI Visualize is much larger as I have shared with you, [and] I perceive its
16 shares as the currency to capitalize its vision.” SAC ¶¶ 153-54. These statements
17 support the conclusion that Defendants never planned to comply with the Action Plan,
18 which they agreed was necessary to grow LifeVoxel.⁵

19 Defendants argue Plaintiffs were never aware of the Action Plan so even if
20 Defendants did not intend to comply with it, Plaintiffs could not have relied on it in
21 investing in LifeVoxel. ECF No. 73-1 at 19. But whether Plaintiffs were aware of the
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24 ⁵ Plaintiffs also allege multiple times that Kovalan fired Puli after he raised many of these
25 issues, supporting the malicious inference. SAC ¶¶ 35, 155-58. However, the Court does
26 not find this persuasive because in the email attached to the SAC, Puli appears to resign
27 unconditionally. SAC at 162-64.

1 Action Plan or not, that Defendants agreed it was necessary to grow LifeVoxel and then
2 soon after violated it suggests that they did not intend to grow LifeVoxel, SAC ¶¶ 94-96,
3 supporting the inference that they acted intentionally or with deliberate recklessness in
4 making the misleading statements.

5 Other miscellaneous allegations in the SAC also support the inference of scienter.
6 That Kovalan licensed the Kovalan Patents to foreign companies without a written
7 agreement and without informing investors, SAC ¶ 161, that he and Le misclassified
8 personal expenses as business expenses and failed to use proper accounting and recording
9 practices, SAC ¶¶ 162, 70, and that he did not implement appropriate internal controls,
10 SAC ¶ 38(b)-(c), 134, collectively support the finding that Kovalan acted with at least
11 deliberate recklessness in misleading investors.

12 The Court must also consider the innocent inferences that could be drawn from
13 these facts, but Defendants have failed to provide a persuasive innocent inference. First,
14 Defendants contend that they did not intend to mislead investors by omitting the fact that
15 they would use SAFE Note funds to buy back AI Visualize shares because they made the
16 decision to buy back AI Visualize shares after the investors purchased the SAFE Notes.
17 ECF No. 73-1 at 22-23. But the Action Plan, agreed upon in August 2021 before the
18 SAFE Notes were purchased, included a provision to buy back AI Visualize minority
19 shareholders, SAC ¶¶ 94-95, and Kovalan later stated that he “perceive[d] [AI
20 Visualize’s] shares as the currency to capitalize its vision,” SAC ¶¶ 153-54. Second,
21 Defendants argue that they were in the process of transferring Voxcell Cloud’s contracts
22 and assets to LifeVoxel and had already transferred 80% of them, and therefore that the
23 financial data presented to investors as LifeVoxel’s was, in effect, accurate. ECF No. 73-
24 1 at 21. However, Le explicitly told Puli that she did not intend to transfer all of Voxcell
25 Cloud’s contracts to LifeVoxel. SAC ¶ 143. Finally, Defendants do not explain the
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1 misrepresentation regarding non-dilutive capital except to argue that there was no
2 misrepresentation at all, an argument which the Court has already rejected.

3 Another innocent explanation the Court considers is that Defendants simply
4 assumed that investors did not care that some of their money would be invested in AI
5 Visualize, that the revenue provided was from another company in the same brand
6 regarding the same intellectual property, and that there were other equity owners of
7 LifeVoxel. But if this were true, Defendants would not have made the misleading
8 statements. There was no reason not to include AI Visualize minority shareholder
9 buybacks in their description of how they were going to spend the funds, to state that the
10 financial data was LifeVoxel's instead of Voxcell Clouds', or to represent that prior
11 capitalization was non-dilutive.

12 Finally, the Court also considers that Defendants made a series of mistakes but did
13 not intend to defraud anyone and did not act recklessly in doing so. The Court finds that
14 this is the most plausible of the innocent explanations, but that it is still not as compelling
15 as the inference that they acted with deliberate recklessness in making misleading
16 statements and omissions. Le's statement that she would not transfer Voxcell Cloud's
17 contracts to LifeVoxel, SAC ¶ 143, and Kovalan's statements that he would operate the
18 companies to his own wishes and that he "perceive[s] [AI Visualize's] shares as the
19 currency to capitalize its vision," SAC ¶¶ 153-54, are decisive for the Court. These
20 statements are more consistent with a scienter of intent or deliberate recklessness than
21 simple mistakes.

22 The Court previously held that "it is difficult to infer malicious intent considering
23 that Plaintiffs were in Puli's extended social and familial network" and Puli was aware of
24 the plan to buy back AI Visualize shares and that the reported income of LifeVoxel was
25 that of Voxcell Cloud. ECF No. 62 at 14. But the SAC clarifies that, at the time
26 Plaintiffs purchased the SAFE Notes, Puli did not know that Defendants would use the
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1 funds to buy AI Visualize shares without repaying LifeVoxel or using the freed-up equity
2 to LifeVoxel’s benefit. SAC ¶¶ 17, 24. And even though Puli was aware that the
3 reported revenue was that of Voxcell Cloud instead of LifeVoxel, the SAC alleges that he
4 thought all of Voxcell Cloud’s contracts and assets would be transferred to LifeVoxel,
5 meaning that the revenue would have been effectively accurate. SAC ¶¶ 26, 96. Thus,
6 Puli’s involvement provides little support for the innocent inferences discussed above.

7 Taking all of these facts as true and viewing them holistically, *VeriFone Holdings*,
8 704 F.3d at 701-03, the Court finds the inference that Defendants acted with at least
9 deliberate recklessness is at least as compelling as the innocent inferences.

10 **C. Economic Loss**

11 Defendants also allege that the SAC fails to state a claim because it does not allege
12 economic loss. ECF No. 73-1 at 26; *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27,
13 37 (2011) (listing the elements of a Section 10(b) claim). There is no heightened
14 pleading standard for economic loss; the complaint must only provide a “short and plain
15 statement” of the economic loss Plaintiffs suffered. *Dura Pharms., Inc. v. Broudo*, 544
16 U.S. 336, 346 (2005). The existence of economic loss in securities fraud cases is
17 generally straightforward, but the nature of the SAFE Note makes the question more
18 difficult here.

19 SAFE Notes are a vehicle for investors to contribute capital to a business “in
20 exchange for the ability to purchase shares of the company at a discounted rate upon a
21 liquidity event.” SAC ¶ 75. They are “not debt, and thus do not accrue interest or have a
22 specified maturity date.” SAC ¶ 80. Unlike stocks, there is no way to determine the
23 present value of a SAFE Note, and unlike a more traditional convertible note or debt,
24 there is no maturity date after which it is clear that the debt is unpaid, *see, e.g., Brady v.*
25 *Delta Energy & Commc ’ns, Inc.*, No. 521-CV-01843, 2023 WL 2683203, at *7 (C.D.
26 Cal. Jan. 25, 2023). In this case, the SAFE Note converts into equity “upon the
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1 occurrence of a Conversion Event, including a private Buyout, Direct Listing under the
2 Securities Act or an [Initial Public Offering].” SAC ¶ 102.

3 In its prior decisions the Court held that Plaintiffs had not adequately pled
4 economic loss and loss causation because “Plaintiffs did not plead facts showing that a
5 conversion event was impossible, but rather, Plaintiffs asserted that Defendants’ actions
6 had simply made it more difficult for a conversion event to occur.” ECF No. 62 at 17-18.
7 Defendants follow this line of reasoning in the instant motion. Because LifeVoxel still
8 exists and a conversion event could conceivably happen, Defendants argue that “there is
9 no factual scenario presented in this case which forecloses an eventual return on
10 [Plaintiff’s] investment.” ECF No. 85 at 3. Plaintiffs say little in response, contending
11 only that Defendants’ actions made a conversion event “untenable” and rendered
12 LifeVoxel (and Plaintiffs’ investments) less profitable. ECF No. 82 at 24.

13 Because no other court has addressed how a SAFE Note holder can show
14 economic loss for a claim under the Securities Exchange Act, the Court looks to the
15 general principles governing economic loss and loss causation. The goal of private
16 securities fraud actions is “not to provide investors with broad insurance against market
17 losses, but to protect them against those economic losses that misrepresentations actually
18 cause.” *Dura Pharms.*, 544 U.S. at 345. And as the Supreme Court has explained, there
19 are a “tangle of factors” affecting the value of a security other than the misleading
20 statements and omissions. *Id.* at 343. In fact, in *Dura Pharmaceuticals*, the Supreme
21 Court rejected the Ninth Circuit’s finding that purchasing shares at an inflated price
22 without more was enough to allege economic loss—because purchase at an artificially
23 high price does not necessarily mean a later loss. *Id.* at 342-43.

24 To show a loss on a SAFE Note, Plaintiffs must do more than show that a loss on
25 their investment is possible or even likely. Purchasing shares at an inflated price makes a
26 loss possible, but the Supreme Court held that it was insufficient to show economic loss
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1 and loss causation because it was “far from inevitably so” that the investors would suffer
2 a loss. *Id.* at 342-43. But nor can it be that the only way for Plaintiffs to show economic
3 loss is to show that LifeVoxel dissolved or went bankrupt, meaning that recouping their
4 investment would be literally impossible. Rather, drawing from the language of *Dura*
5 *Pharmaceuticals*, Plaintiffs must show that it is inevitable that they will not recover their
6 investment. Though they need not show that LifeVoxel has dissolved, they need to show
7 that it is inevitable that the company will fail or will not realize a conversion event. The
8 Court holds that the SAC has failed to do so.

9 The SAC alleges the following core facts to show that “there is no likelihood of a
10 Conversion Event”:

- 11 (1) “There is no room on LifeVoxel’s cap table or the cap table of AI Visualize to
12 raise additional funds or grant sweat equity necessary to attract individuals with
13 the experience and talent [to] grown and develop LifeVoxel’s business[.]”
- 14 (2) Defendants failed to transfer all of Voxcell Cloud’s contracts and revenue to
15 LifeVoxel, contrary to the Action Plan and special resolution.
- 16 (3) The failure to maintain appropriate books, records, and internal controls, and to
17 protect LifeVoxel’s intellectual property rights prevents LifeVoxel from
18 producing audited financial statements as required for an IPO, Direct Listing or
private buyout.

19 SAC ¶¶ 38(a)-(d), 148, 177. In the alternative, the SAC alleges that, even if a conversion
20 event occurs, the equity in LifeVoxel is diluted, and will represent a loss for Plaintiffs,
21 because Defendants represented to Plaintiffs that all prior capitalization was non-dilutive
22 even though some other parties owned or were promised equity interests in LifeVoxel.

23 SAC ¶¶ 39, 179.

24 These allegations do not show that it is inevitable that a conversion event will not
25 occur. Plaintiffs purchased SAFE Notes less than three years ago, SAC ¶ 3 (purchases in
26 August and September 2021), a period of time shorter than the maturity period on many
27 convertible notes, a comparable financial vehicle, *see, e.g., Nuveen Mun. High Income*

1 *Opportunity Fund v. City of Alameda, Cal.*, 730 F.3d 1111, 1117 (9th Cir. 2013) (five-
2 year maturity period on Revenue Bond Anticipation Notes). Nor have Plaintiffs alleged
3 facts to show that Defendants have acted against LifeVoxel’s interest in the last two and a
4 half years following Puli’s departure from LifeVoxel and AI Visualize, except to note
5 that Defendants “consistently failed to sign documents necessary for the proper record
6 keeping” “through at least April 2022.” SAC ¶ 134. In fact, the SAC alleges that the
7 majority of Voxcell Cloud’s assets and contracts were transferred to LifeVoxel and that
8 LifeVoxel “was collecting 80% of the income due to it,” SAC ¶ 150, suggesting that it
9 still has significant ability to generate income. And though \$500,000 of the SAFE Notes
10 were funneled to the AI Visualize minority shareholder buyout, SAC ¶ 151, that left over
11 \$4 million for LifeVoxel, SAC ¶ 174 (stating that investors, Plaintiffs and others,
12 invested over \$5 million in LifeVoxel via SAFE Notes). Thus, while these allegations
13 demonstrate Defendants made decisions that may have harmed LifeVoxel, and possibly
14 even intentionally so, they do not show that these decisions were fundamentally
15 destructive of the company and its ability to achieve a conversion event.

16 Plaintiffs’ first contention that LifeVoxel cannot grow because there is no room on
17 its cap table and therefore nothing to offer investors, SAC ¶ 38(a), is not exactly true.
18 The SAC acknowledges that LifeVoxel could raise additional capital by authorizing the
19 issuance of new shares. SAC ¶ 40. Lack of room on the cap table is not fatal to the
20 company’s growth. Plaintiffs’ second contention, that some of Voxcell Cloud’s contracts
21 were not transferred to LifeVoxel, does not indicate that LifeVoxel is about to go under;
22 80% of the contracts and assets were transferred to LifeVoxel. SAC ¶ 150. Plaintiffs’
23 third contention—that Defendants’ lack of internal controls and improper accounting
24 procedures would prevent a conversion event, SAC ¶ 38(b)-(c), also fails to indicate that
25 LifeVoxel’s demise is inevitable. Defendants’ failure in 2021 to implement proper
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1 internal controls and accounting practices does not mean that they will not implement
2 them in the future, and the SAC does not provide facts to suggest otherwise.

3 Finally, Plaintiffs also seem to suggest that Defendants’ alleged intent not to grow
4 LifeVoxel and to use the SAFE Note funds for personal benefit indicate that a conversion
5 event will never occur. SAC ¶ 38(d). But while the Court held that the SAC adequately
6 alleges scienter, it did not find that Defendants *never* intend to grow LifeVoxel, only that
7 there is a strong inference that they intentionally or with deliberate recklessness misled
8 investors. To demonstrate economic loss, Plaintiffs must show that LifeVoxel’s failure is
9 inevitable—a separate question from whether Defendants acted with scienter in making
10 misleading statements. The scienter allegation to show loss is therefore unpersuasive.

11 The Court also rejects Plaintiffs’ alternative argument that even if a conversion
12 event occurs, the value of the SAFE Notes would be “substantially diminished because
13 the undisclosed equity shareholders in LifeVoxel plainly dilute the value of the SAFE
14 Notes.” SAC ¶ 39. The SAC similarly contends that the issuance of additional shares, to
15 garner new investment, would further dilute the value of the SAFE Notes. SAC ¶ 40.
16 But “economic loss does not necessarily accompany dilution, so such conclusory
17 assertions of loss are insufficient.” *New York City Employees’ Ret. Sys. v. Jobs*, 593 F.3d
18 1018, 1023-24 (9th Cir. 2010), *overruled on other grounds by Lacey v. Maricopa Cnty.*,
19 693 F.3d 896 (9th Cir. 2012) (holding that a complaint did not allege economic loss
20 where it pled economic loss in the form of dilution of the shareholders’ interests in a
21 Section 14(a) claim). Even if the shares were heavily diluted, depending on the purchase
22 price in a buyout or the value of the shares in an IPO, Plaintiffs could still recoup the
23 entirety of their investment.

24 Accordingly, the SAC fails to adequately allege economic loss. Without economic
25 loss, Plaintiffs also cannot show loss causation, i.e. that Defendants’ misrepresentations
26 have a nexus with the loss. On these grounds, Plaintiffs’ Section 10(b) claim fails and the
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1 Court GRANTS the motion to dismiss Count I. Because this issue is one of first
2 impression, and the parties focused almost exclusively on the questions of material
3 misrepresentations and scienter in briefing the motion to dismiss, the Court dismisses the
4 claim with leave to amend.

5 **II. Counts II through VI**

6 Count II for a violation of Section 20(a) of the Securities Exchange Act fails
7 because it requires an underlying primary violation of the Securities Exchange Act. *In re*
8 *Rigel Pharms., Inc. Secs. Litig.*, 697 F.3d 869, 886 (9th Cir. 2012). For the reasons stated
9 above, Plaintiffs have failed to adequately plead a right to relief under Section 10(b) and
10 their Section 20(a) claim therefore also fails. The Court GRANTS the motion to dismiss
11 Count II with leave to amend.

12 Count III for a violation of the Virginia Securities Act fails because Plaintiffs did
13 not sufficiently plead economic loss, i.e. damages. Plaintiffs argue, and the Court
14 previously acknowledged, that Va. Code § 13.1-522(A) does not require a showing of
15 scienter, reliance, or causation, but they do not mention economic loss. *See* ECF No. 82
16 at 26 (absence); ECF No. 62 at 20 (prior order). The Court's prior order relied in part on
17 the proposition that the Va. Code § 13.1-522(A) requires a showing of economic loss,
18 ECF No. 62 at 21, and Plaintiffs do not now argue otherwise, ECF No. 82 at 26. The
19 Court therefore GRANTS the motion to dismiss Count III with leave to amend.

20 Count IV alleges control person liability under the Virginia Securities Act, Va.
21 Code § 13.1-522(C), and fails because it requires an underlying primary violation of Va.
22 Code § 13.1-522(A)-(B). The Court therefore GRANTS the motion to dismiss Count IV.
23 Because the Court grants leave to amend on Count III for Va. Code § 13.1-522(A), it also
24 grants leave to amend on Count IV.

25 Count V for common law fraud also fails for failure to show economic loss or
26 damages. *See Stephenson v. Capano Dev., Inc.*, 462 A.2d 1069, 1074 (Del. 1983)

1 (stating the elements of common law fraud). The Court therefore GRANTS the motion
2 to dismiss Count V with leave to amend.

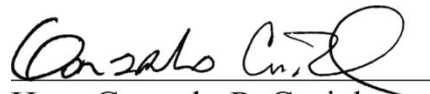
3 Finally, Count VI for civil conspiracy fails because it “is not an independent cause
4 of action, and . . . must be predicated upon an underlying wrong.” *Tracinda Corp. v.*
5 *DaimlerChrysler AG*, 197 F. Supp. 2d 42, 74 (D. Del. 2002). Because Plaintiffs have
6 failed to sufficiently allege an underlying wrong, they cannot state a cause of action
7 under Count VI. The Court GRANTS the motion to dismiss Count VI with leave to
8 amend.

9 **CONCLUSION**

10 For the reasons stated above, the Court GRANTS the motion to dismiss without
11 prejudice. Plaintiffs have 30 days from the issuance of this order to file a Third Amended
12 Complaint which addresses the damages issues identified herein.

13 **IT IS SO ORDERED.**

14 Dated: May 7, 2024

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16 Hon. Gonzalo P. Curiel
17 United States District Judge
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