

United States District Court
For the Northern District of California

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NOT FOR PUBLICATION

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

GLENBROOK CAPITAL LIMITED
PARTNERSHIP, a limited liability partnership,

No. C07-02377 JSW

**ORDER GRANTING DEFENDANTS’
MOTION TO DISMISS**

Plaintiff,

v.

MALI KUO, DOUGLAS WATSON, DIGITAL
VIDEO SYSTEMS, a Delaware corporation and
DOES 1 THROUGH 100,

Defendants.

Before the Court is Defendants Mali Kuo (“Kuo”), Douglas Watson (“Watson”), and Digital Video Systems, Inc.’s (“DVS”) (collectively, “Defendants”) third motion to dismiss. Plaintiff Glenbrook Capital Limited Partnership (“Plaintiff” or “Glenbrook”) opposes the motion. For the following reasons, the Court GRANTS Defendants’ motion to dismiss.

FACTUAL BACKGROUND

The current shareholder action arises from Defendants’ alleged act of selling substantially all of DVS’s assets – consisting of DVS’s entire stake in another company – without holding the necessary shareholder vote, and without sufficiently disclosing their intent to use the sale proceeds to satisfy the Chief Executive Officer’s personal debts. The material allegations of the Second

1 Amended Complaint (“SAC”), which are taken as true for purposes of the current motion, are as
2 follows.

3 **A. The Parties.**

4 Plaintiff Glenbrook is a Nevada limited partnership. (SAC ¶ 3.) It holds a minority interest
5 in Defendant DVS. (*Id.*)

6 DVS is a Delaware corporation with its principal place of business in Mountain View,
7 California. (*Id.* ¶ 4.) DVS became a public company on May 14, 1996, in an initial public offering
8 registered with the SEC. (*Id.* ¶ 10.) DVS’s shares were originally listed on the NASDAQ, but its
9 shares now trade over-the-counter. (*Id.*) At the time of filing the second amended complaint, DVS’s
10 shares traded at \$0.05 per share. (*Id.* ¶ 48.)¹

11 Defendant Kuo is the current Chairman and Chief Executive Officer (“CEO”) of DVS. (*Id.* ¶
12 5.) She has signed several of DVS’s SEC filings, including the November 21, 2005 Form 10-Q, the
13 December 12, 2005 Form 8-K, the December 30, 2005 Form 8-K, the March 24, 2006 Form 8-K,
14 and the April 18, 2006 Form 8-K. (*Id.*) Kuo is a resident of Santa Clara County. (*Id.*)

15 Defendant Watson is the Chief Operating Officer of DVS and a director. (*Id.* ¶ 6.) Watson
16 had previously served as DVS’s Chief Financial Officer, before resigning on March 19, 2006. (*Id.* ¶
17 45.) He maintains control over DVS’s bank accounts. (*Id.* ¶ 6.) Watson is also a resident of Santa
18 Clara County. (*Id.*)

19 **B. Kuo’s Litigation Against DVS and Control of the Board.**

20 In June 2002, DVS sued Kuo and other former officers and directors in Santa Clara County
21 Superior Court for breach of fiduciary duty.² (*Id.* ¶ 14.) Kuo filed a cross-claim for unpaid
22 compensation and for securities fraud. (*Id.*) On February 1, 2005, a jury found for Kuo, and on
23 April 8, 2005, the court entered judgment against DVS for \$3.42 million. (*Id.*)

25 ¹ After 2002, DVS’s only significant activity was to act as a holding company for a majority
26 ownership position in DVS Korea, Ltd. (“DVSK”). (SAC ¶ 11.) That interest was sold on December
27 29, 2005, in the transaction that is at the heart of this litigation. (*Id.* ¶ 39.) DVS has not filed a financial
report with the SEC since November 21, 2005, but every indication is that DVS is currently a mere
“shell corporation” with no or negligible continuing operations. (*Id.* ¶¶ 12-13.)

28 ² Although Kuo is currently the CEO and Chairman, she was a former employee at the time of
the lawsuit. (SAC ¶ 14.)

1 On April 29, 2005, following the entry of judgment, DVS and Kuo settled. (*Id.* ¶ 15.)
2 Plaintiff alleges that DVS consented to the settlement under duress, when Kuo accompanied her
3 demands with threats immediately to levy upon her judgment and destroy DVS’s business. (*Id.* ¶
4 15.) DVS and Kuo memorialized their settlement in a written agreement entitled “3.42 Million
5 Judgment Equity Conversion Agreement” (“Settlement Agreement.”). (*Id.* ¶ 16.) The Settlement
6 Agreement required DVS to grant 1,001,740 shares of its non-restricted common stock and a
7 warrant to acquire 100,147 shares of its non-restricted common stock to Kuo and her designees.
8 (*Id.*) The Settlement Agreement further provided that DVS was to take steps to register those shares
9 of common stock and that in the meantime it was to issue preferred stock (the “Series D”) to Kuo
10 and her designees. (*Id.*) The Series D bore an 8% dividend, and each share of Series D was
11 convertible into ten shares of DVS common stock. (*Id.*) All of the purported recipients of the shares
12 of Series D were Kuo’s personal creditors, business partners, relatives or nominees. (*Id.* ¶¶ 17-19.)
13 In all, some 18 of Kuo’s creditor-designees received the 100,147 shares of Series D. (*Id.*)

14 In addition to the Series D issuance, the settlement dated April 29, 2005 also obligated
15 DVS’s directors to elect a slate of Kuo’s nominees to the DVS board. (*Id.* ¶ 23.) On May 24, 2005,
16 the DVS Board elected Kuo and two of her nominees to the Board. (*Id.* ¶ 25.) Kuo thereby gained
17 effective control of DVS, and was appointed CEO and Chair. (*Id.*) Since that election, all directors
18 other than Kuo and Watson have resigned. (*Id.*)

19 Following the settlement, on May 18, 2005, DVS, Watson, and Kuo entered into a pledge
20 agreement (the “Pledge Agreement”), which was required by the Settlement Agreement. (*Id.* ¶ 20.)
21 The Pledge Agreement provided in part that all shares of DVSK would be pledged to Kuo upon
22 signing of the Settlement Agreement as collateral for the registration of the common stock provided
23 for in the Settlement Agreement. (*Id.*) Under the terms of the Pledge Agreement, Kuo and her
24 purported creditors were to receive DVS shares, to be registered almost immediately. (*Id.*) If they
25 did not receive the shares, Kuo and the creditors would have the right to foreclose on DVS’s shares
26 in DVSK. (*Id.*) The Pledge Agreement was concealed by Defendants until March 2007, when it
27 was produced by Kuo in litigation between Kuo and a third party. (*Id.* ¶ 22.)
28

1 **C. Kuo Engineers the Sale of DVS's Shares in DVSK.**

2 Defendants intended to satisfy the terms of the Settlement Agreement, and thus Kuo's
3 creditors, by registering the Series D shares, or the common stock into which it was convertible, so
4 that Kuo's creditors could sell their shares on the public markets. (*Id.* ¶ 27.) DVS, however, was
5 not able to register the stock because they did not timely file the required financial information with
6 the SEC. (*Id.* ¶¶ 28-29.) DVS was due to file its Form 10-Q for the first quarter of 2005 on May 17,
7 2005. (*Id.* ¶ 28.) Instead, however, DVS filed a "Notification of Late Filing," which bought it an
8 additional six days. (*Id.*) At or about this time, DVS's outside auditors resigned. (*Id.*) On May 22,
9 2005, DVS filed its Form 10-Q without the auditors' consent. (*Id.*) Absent current financial
10 information, DVS could not register any new shares, either the Series D or new common shares. (*Id.*
11 ¶ 29.)

12 Accordingly, Defendants had to find another way to satisfy Kuo's creditors, as required
13 under the Settlement Agreement. (*Id.* ¶¶ 23, 29.) On or about December 10, 2005, DVS entered
14 into a two-page stock purchase agreement (the "SPA") with Korea Technology Investment Corp.
15 ("KTIC") under which DVS would sell its entire stake in DVSK – substantially all of its assets – for
16 \$12 million. (*Id.* ¶¶ 1, 31, 32.) DVS did not retain an investment banker in connection with the sale,
17 or make any public announcements of it prior to signing the SPA. (*Id.* ¶ 31.) On December 29,
18 2005, the sale of the DVSK stock to KTIC closed. (*Id.* ¶ 34.) The transaction moved so quickly that
19 Kuo's personal attorney has called it a "fire sale." (*Id.* ¶ 31.)

20 Defendants did not disclose the planned sale of DVSK stock in any public filing prior to the
21 date the SPA was signed. (*Id.*) Even though it was a sale of substantially all of DVS's assets, no
22 shareholder vote was held. (*Id.* ¶ 37.) Plaintiff contends that it can confirm that DVS never sought
23 ratification of the agreement by its shareholders because Plaintiff has never been asked to ratify the
24 sale. (*Id.* ¶¶ 34, 37.) In addition, draft minutes from the DVS Audit Committee Meeting on
25 December 15, 2005 disclose that one of the directors stated the proper procedures were not followed
26 in agreeing to the SPA. (*Id.* ¶ 35.) The same minutes indicate that member of the Audit Committee
27 only found out about the sale by accident and other members indicated that Kuo had given them very
28 different reasons for the sale, including that the proceeds would be used to hire an attorney, to buy

1 D&O insurance, or for unspecified “business” needs in India, and contrary to what Kuo had told the
2 Audit Committee, she had already taken \$100,000 in proceeds to pay to her creditors. (*Id.* ¶ 36.)
3 The Form 8-K dated December 12, 2005 omitted the fact that the proceeds went to Kuo’s personal
4 creditors and family members and instead indicated that the completion of the transaction would
5 enable DVS to pursue other strategic alliances. (*Id.* ¶ 38.) The sale of DVSK closed on December
6 29, 2005, without an Information Statement filed with the SEC. (*Id.* ¶ 39.)

7 The SPA was first disclosed in a Form 8-K dated December 12, 2005, two days after the SPA
8 was signed. (*Id.* ¶¶ 31, 32.) On December 30, 2005, DVS filed another Form 8-K, which stated that
9 the sale closed on December 29, 2005. (*Id.* ¶ 40.) Neither of the Forms 8-K disclosed, however,
10 that \$1.5 million of the proceeds of the sale would be used to pay Kuo’s personal creditors. (*Id.* ¶¶
11 33, 36, 55-59.) The Form 8-K dated December 12, 2005 states that DVS obtained written consent
12 for the transaction from the holders of a majority of its shares, but ratification was never obtained
13 from Plaintiff who was never asked to ratify the sale. (*Id.* ¶ 37.) It also promised that DVS would
14 seek shareholder ratification of the sale and the transaction would enable DVS to pursue other
15 strategic interests. (*Id.* ¶ 38.)

16 The sale generated \$12 million in proceeds for DVS. (*Id.* ¶¶ 32, 33.) On December 30,
17 2005, DVS issued checks totaling \$150,000 to Kuo’s personal creditors. (*Id.* ¶ 41.) On January 2,
18 2006, DVS issued another round of checks, totaling \$788,000. (*Id.*) In the end, some \$1.5 million
19 was paid to Kuo’s creditors by DVS. (*Id.*) The remaining proceeds are no longer with DVS. (*Id.* ¶
20 43.) According to Kuo’s testimony in another action quoted verbatim as an allegation in the second
21 amended complaint, the remaining proceeds were allegedly invested in an undisclosed company in
22 China. (*Id.* ¶ 43.)

23 **D. DVS Fails to File Required Reports with the SEC.**

24 As a publicly-traded company, DVS is required to file annual and quarterly reports with
25 the SEC on Forms 10-K and 10-Q. *See generally* 15 U.S.C. § 78m. DVS’s last such filing was its
26 Form 10-Q filed for the third quarter of 2005. (SAC ¶ 44.) Since that date, DVS has not filed either
27 a Form 10-K or a Form 10-Q. (*Id.*) On April 17, 2006, DVS filed a Form 8-K with the SEC stating
28 that it would be unable to file its annual report for the year 2005, claiming an inability to obtain all

1 necessary financial data from DVSK. (*Id.*)

2 Plaintiff alleges that the materially misleading statements and omissions in the December 12
3 and December 30, 2005 Forms 8-K created the false impression that DVS had secured shareholder
4 approval of the sale of DVSK and would use the proceeds for “strategic alliances” when in fact Kuo
5 was already directing that checks be sent to her creditors and the remaining proceeds would go to
6 another, foreign company. (*Id.* at ¶ 46.) Upon announcement of the sale, DVS’s stock price initially
7 increased but has continued to decline since that time. (*Id.*) Plaintiff alleges that the steady decline
8 in the price of DVS stock “is directly tied to the matters omitted from and/or misrepresented in the
9 December 12 and December 30, 2005 Forms 8-K. (*Id.* ¶ 48.) Plaintiff claims that “DVS is an empty
10 shell, having sold its only substantial asset and seen the proceeds removed from the company. To
11 the investing public, DVS now sits idle.” (*Id.*)

12 DVS has also failed to file any proxy materials, and has not held an annual meeting of
13 stockholders since November 18, 2004. (*Id.* ¶ 49.) On August 8, 2007, DVS filed a Form 8-K with
14 the SEC stating that DVS’s Board had approved the calling of an annual meeting of stockholders to
15 be held on October 15, 2007. (*Id.* ¶ 50.) As of the filing of the SAC, DVS had not filed an
16 Information Statement describing the actions to be taken at the meeting and had said nothing more to
17 its stockholders regarding the meeting. (*Id.* ¶¶ 51, 52.) As a result of these failures to file, DVS’s
18 shareholders have no idea what happened to the remainder of the \$12 million.

19 **E. DVS Stock Price Decline.**

20 Plaintiff alleges that DVS’s common stock has declined steeply since December 29, 2005,
21 when the DVSK sale closed. (*Id.* at ¶ 46.) By the end of March 2006, DVS’s shares were trading at
22 \$1.05 per share and by the end of April 2006, the stock was at \$0.86 per share. (*Id.*) By June 15,
23 2006, the shares were trading at \$0.55 per share and on May 2, 2007, the day after Plaintiff filed this
24 suit, the stock closed at \$0.19. Two days later, on May 4, 2007, DVS stock closed at \$0.14 per
25 share. (*Id.* at ¶ 47.) As of August 27, 2008, the stock was trading at under five cents per share. (*Id.*
26 ¶ 48.)

27 **PROCEDURAL BACKGROUND**

28 Plaintiff originally filed this action on May 2, 2007 asserting claims for: (1) securities fraud

1 in violation of Section 10(b) and Rule 10b-5 against all Defendants; (2) failure to follow proxy
2 disclosure rules in violation of Section 14(c) of the 1934 Act and SEC Rule 14c-2 against all
3 Defendants; (3) breach of fiduciary duties in violation of the duty of loyalty against all Defendants;
4 (4) appointment of a receiver pursuant to 8 Delaware Code § 226(a)(3) against DVS; (5)
5 appointment of a receiver pursuant to 8 Delaware Code § 291 against DVS; (6) appointment of
6 receiver or custodian pursuant to Delaware common law against DVS; and (7) compelling annual
7 shareholder meeting against DVS. Defendants previously brought a motion to dismiss, seeking an
8 order dismissing each of Plaintiff's claims. On September 6, 2007, the Court granted Defendants'
9 motion in part, and dismissed Plaintiff's first, second and third claims without prejudice.

10 Plaintiff filed the first amended complaint ("FAC") on October 9, 2007, asserting all of the
11 same claims, save for the third claim. Instead of claiming a breach of fiduciary duties, Plaintiff
12 claimed a violation of Section 20(a) of the 1934 Act (control person liability). Again, Defendants
13 brought a motion to dismiss each of Plaintiff's claims. On April 3, 2008, the Court granted
14 Defendants' motion in part and dismissed Plaintiff's first, second and third claims without prejudice.

15 Plaintiff filed the second amended complaint ("SAC") on May 19, 2008, asserting all of the
16 same claims with further factual allegations. Again, Defendants seek an order dismissing each of
17 Plaintiff's claims.

18 LEGAL STANDARD

19 A. Legal Standard on Motion to Dismiss.

20 A motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6) tests the legal
21 sufficiency of a claim. *Navarro v. Block*, 250 F.3d 729, 732 (9th Cir. 2001). Because the focus of a
22 Rule 12(b)(6) motion is on the legal sufficiency, rather than the substantive merits of a claim, the
23 Court ordinarily limits its review to the face of the complaint. *See Van Buskirk v. Cable News*
24 *Network, Inc.*, 284 F.3d 977, 980 (9th Cir. 2002). In considering a Rule 12(b)(6) motion, the Court
25 accepts the plaintiff's material allegations in the complaint as true and construes them in the light
26 most favorable to the plaintiff. *See Shwarz v. United States*, 234 F.3d 428, 435 (9th Cir. 2000).
27 Generally, dismissal is proper only when the plaintiff has failed to assert a cognizable legal theory or
28 failed to allege sufficient facts under a cognizable legal theory. *See SmileCare Dental Group v.*

1 *Delta Dental Plan of Cal., Inc.*, 88 F.3d 780, 782 (9th Cir. 1996); *Balisteri v. Pacifica Police Dep’t*,
2 901 F.2d 696, 699 (9th Cir. 1988); *Robertson v. Dean Witter Reynolds, Inc.*, 749 F.2d 530, 534 (9th
3 Cir. 1984). In pleading sufficient facts, however, a plaintiff must suggest his or her right to relief is
4 more than merely conceivable, but plausible on its face. *See Bell Atlantic Corp. v. Twombly*, 127 S.
5 Ct. 1955, 1974 (2007).

6 Rule 8(a) of the Federal Rules of Civil Procedure requires only “a short and plain statement
7 of the claim showing that the pleader is entitled to relief.” Accordingly, motions to dismiss for
8 failure to state a claim pursuant to Rule 12(b)(6) are typically disfavored; complaints are construed
9 liberally to set forth some basis for relief, as long as they provide basic notice to the defendants of
10 the charges against them. *In re McKesson HBOC, Inc. Sec. Litig.*, 126 F. Supp. 1248, 1257 (N.D.
11 Cal. 2000). Where a plaintiff alleges fraud, however, Rule 9(b) requires the plaintiff to state with
12 particularity the circumstances constituting fraud. To meet the heightened pleading requirements of
13 Rule 9(b), the Ninth Circuit has held that a fraud claim must contain the following elements: (1) the
14 time, place, and content of the alleged misrepresentations; and (2) an explanation as to why the
15 statement or omission complained of was false or misleading. *In re GlenFed, Inc. Sec. Litig.*, 42
16 F.3d 1541, 1547–49 (9th Cir. 1994).

17 In the securities context, the pleading requirements are even more stringent.

18 **B. Private Securities Litigation Reform Act.**

19 In 1995, Congress enacted the PSLRA to provide “protections to discourage frivolous
20 [securities] litigation.” H.R. Conf. Rep. No. 104-369, 104th Cong., 1st Sess. at 32 (Nov. 28, 1995).
21 The PSLRA strengthened the already-heightened pleading requirements of Rule 9(b). Under the
22 PSLRA, actions based on allegations of material misstatements or omissions must “specify each
23 statement alleged to have been misleading, the reason or reasons why the statement is misleading,
24 and, if an allegation regarding the statement or omission is made on information and belief, the
25 complaint shall state with particularity all facts on which that belief is formed.” 15 U.S.C. §78u-
26 4(b)(1).

27 The PSLRA also heightened the pleading threshold for causes of action brought under
28 Section 10(b) and Rule 10b-5. Specifically, the PSLRA imposed strict requirements for pleading

1 scienter. Under the PSLRA, a complaint must “state with particularity facts giving rise to a strong
2 inference that the defendant acted with the required state of mind.” 15 U.S.C. § 78u-4(b)(2). To
3 qualify as “strong,” an inference of scienter must be more than merely plausible or reasonable – it
4 must be cogent and at least as compelling as any opposing inference of nonfraudulent intent.
5 *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S.Ct. 2499, 2509-10 (2007). The Ninth Circuit, in
6 interpreting the PSLRA, has held that “a private securities plaintiff proceeding under the [PSLRA]
7 must plead, in great detail, facts that constitute strong circumstantial evidence of deliberately
8 reckless or conscious misconduct.” *In re Silicon Graphics Inc.*, 183 F.3d 970, 974 (9th Cir. 1999).
9 If the complaint does not satisfy the pleading requirements of the PSLRA, upon motion by the
10 defendant, the court must dismiss the complaint. *See* 15 U.S.C. §78u-4(b)(1).

11 The PSLRA’s Safe Harbor provision provides that a securities fraud claim may not lie with
12 respect to a statement that is “identified as a forward-looking statement, and is accompanied by
13 meaningful cautionary statements identifying important factors that could cause actual results to
14 differ materially from those in the forward-looking statement.” 15 U.S.C. § 78u-5(c)(1)(A)(I).
15 However, a person may be held liable if the forward-looking statement is made with “actual
16 knowledge ... that the statement was false or misleading.” 15 U.S.C. § 78u-5(c)(1)(B); *No. 84*
17 *Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.*, 320 F.3d
18 920, 936 (9th Cir. 2003); *but see In re Seebeyond Technologies Corp. Sec. Litig.*, 266 F. Supp. 2d
19 1150, 1164-65 (C.D. Cal. 2003) (disagreeing with the analysis in *America West* and finding that a
20 defendant is immune from liability if it satisfies either 15 U.S.C. § 78u- 5(c)(1)(A) or (B)).

21 ANALYSIS

22 A. Section 10(b) of the Securities and Exchange Act and Rule 10b-5.

23 Plaintiff’s first claim is for securities fraud in violation of Section 10(b) and Rule 10b-5.
24 Plaintiff alleges that Defendants sold substantially all of the assets of DVS through the sale of
25 DVSK, without disclosing their intent to use the proceeds to pay off Kuo’s personal creditors. (SAC
26 ¶ 55.) Specifically, Plaintiff alleges that two of DVS’s Forms 8-K, filed on December 12 and
27 December 30, 2005, failed to disclose that the proceeds of the sale would be used to pay Kuo’s
28 personal creditors, with the remainder of the proceeds to be removed from DVS and invested in

1 another company in a foreign country. (*Id.*) Based on the fact that Plaintiff was not asked for its
2 approval, the refusal of Defendants' counsel to provide the identities of approving shareholders, the
3 minutes of the December 15, 2005 Audit Committee meeting and the speed of the execution of the
4 sale without the filing of an Information Statement, Plaintiff alleges that DVS had not obtained
5 approval for the transaction from a majority of shareholders. (*Id.* ¶¶ 56-57.)

6 Section 10(b) of the Exchange Act provides, in part, that it is unlawful "to use or employ in
7 connection with the purchase or sale of any security registered on a national securities exchange or
8 any security not so registered, any manipulative or deceptive device or contrivance in contravention
9 of such rules and regulations as the [SEC] may prescribe." 15 U.S.C. § 78j(b). Rule 10b-5,
10 promulgated under Section 10(b), makes it unlawful for any person to use interstate commerce: (a)
11 to employ any device, scheme, or artifice to defraud; (b) to make any untrue statement of material
12 fact or to omit to state a material fact necessary in order to make the statements made, in light of the
13 circumstances under which they were made, not misleading; or (c) to engage in any act, practice, or
14 course of business which operates or would operate as a fraud or deceit upon any person, in
15 connection with the purchase or sale of any security. 17 C.F.R. § 240.10b-5.

16 For a claim under Section 10(b) and Rule 10b-5 to be actionable, a plaintiff must allege: (1)
17 a misrepresentation or omission; (2) of material fact; (3) made with scienter; (4) on which the
18 plaintiff justifiably relied; (5) that proximately caused the alleged loss. *See Binder v. Gillespie*, 184
19 F.3d 1059, 1063 (9th Cir. 1999). A complaint must "specify each statement alleged to have been
20 misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the
21 statement or omission is made on information and belief, the complaint shall state with particularity
22 all facts on which that belief is formed." 15 U.S.C. § 78u-4(b)(2). As discussed above, in order to
23 avoid having the action dismissed, a plaintiff must "plead with particularity both falsity and
24 scienter." *Ronconi v. Larkin*, 253 F.3d 423, 429 (9th Cir. 2001). The Ninth Circuit, in *Ronconi*,
25 articulated the rule as follows:

26 Because falsity and scienter in private securities fraud cases are generally
27 strongly inferred from the same set of facts, we have incorporated the dual
28 pleading requirements of 15 U.S.C. §§ 78u-4(b)(1) and (b)(2) into a single
inquiry. In considering whether a private securities fraud complaint can
survive dismissal under Rule 12(b)(6), we must determine whether 'particular
facts in the complaint, taken as a whole, raise a strong inference that

1 defendants intentionally or [with] ‘deliberate recklessness’ made false or
2 misleading statements to investors.’ Where pleadings are not sufficiently
3 particularized or where, taken as a whole, they do not raise a ‘strong
4 inference’ that misleading statements were knowingly or [with] deliberate
5 recklessness made to investors, a private securities fraud complaint is properly
6 dismissed under Rule 12(b)(6).

7 *Id.* (citations and internal quotation marks omitted).

8 In this motion, Defendants contend that Plaintiff fails to satisfy the heightened pleading
9 requirements under the PSLRA. In particular, Defendants argue that, with regard to Plaintiff’s first
10 claim for relief: (1) Plaintiff has failed to plead with particularity facts demonstrating a strong
11 inference of scienter as to any Defendant; (2) Plaintiff has failed adequately to plead fraud with
12 particularity; (3) Plaintiff fails adequately to plead loss causation; (4) Plaintiff fails adequately to
13 plead justifiable reliance; and (5) Plaintiff fails adequately to plead that the omissions were material.
14 Defendants also contend that the allegations against Defendant Douglas Watson remain inadequate
15 to state a claim against him. Further, Defendants also contend that Plaintiff’s attempt to add
16 allegations in the second amended complaint in order to redress the deficiencies in the first amended
17 complaint is “illogical, obviously false, internally inconsistent, or in conflict with admissions made
18 in its previous pleadings, and utterly fails to cure the deficiencies of its prior pleadings.” (Br. at 3.)

19 **1. Alleged Omissions from the Forms 8-K.**

20 Defendants contend that Plaintiff has failed to plead the required particularized facts to
21 support the allegations of falsity. These allegations include that the Form 8-K dated December 12,
22 2005 falsely stated that: (1) a majority of DVS’s shareholders had approved the sale transaction; (2)
23 DVS would later seek shareholder ratification of the transaction; and (3) the completion of the
24 transaction would enable DVS to pursue other strategic alliances. Plaintiff further alleges that the
25 Form 8-K dated December 30, 2005 announcing that the SPA effecting the sales of DVS’s shares in
26 DVSK had closed, but did not disclose that proceeds from the sale would be used to pay Kuo’s
27 personal creditors, and that the remaining proceeds would be “removed” from the company.

28 Defendants, quoting *Tellabs*, 127 S.Ct. at 2510, further contend that Plaintiff inadequately
pleads scienter because the pleaded facts must give rise to a “cogent and compelling” inference of
scienter, “in light of other explanations.” (Br. at 4-6.) Defendants proffer five facts that they allege
undermine the requisite scienter: (1) Kuo had a legal right to execute on the company’s assets under

1 Delaware law, including the DVSK shares; (2) Defendants had to sell the DVSK shares because
2 other creditors-designees insisted; (3) the DVSK transaction was fully disclosed and there is no duty
3 to disclose to shareholders the purpose of the transaction when the purpose is a corporation paying
4 its creditors; (4) the transaction was already approved by an outstanding majority of shares thus
5 there was no conceivable motive to conceal it; and (5) Defendants maximized the shareholder value
6 in the shares by waiting until December to go through with the sale. (*Id.* at 6-13.)

7 Plaintiff, in response, argues that each of the challenged allegations is sufficiently pleaded.
8 Plaintiff contends that the factual allegations in the second amended complaint indicate that
9 Defendants acted with at least deliberate recklessness in making the misleading statements and
10 omissions, and specifically argues that: (1) not a single public announcement was made concerning
11 the sale after the SPA had been signed, despite the fact that SEC rules required that an Information
12 Statement be filed prior to the transaction to inform investors of the material facts concerning the
13 transaction; (2) the content of the December 12, 2005 Form 8-K feigned a legitimate corporate
14 purpose in that it represented that the consummation of the transaction would allow DVS to pursue
15 “other strategic interests”; and (3) the draft minutes of the Audit Committee meeting from December
16 15, 2005 reveal that DVS failed to follow proper procedures in agreeing to the SPA and that one of
17 the committee’s members learned of the sale by accident. (Opp. Br. at 5-7.)

18 The Court reviews the law in this area then turns to the facts of this case.

19 Where allegations regarding a statement or omission are made on information and belief, the
20 complaint must state with particularity all facts on which that belief is formed. 15 U.S.C. §
21 78u-4(b)(1). The Reform Act’s information and belief pleading standard focuses on whether there
22 are “adequate corroborating details” in the complaint. *See In re Silicon Graphics*, 183 F.3d at 985.
23 The purpose of this requirement is to prevent a plaintiff from citing vague reports and unspecified
24 sources in the hopes that discovery will turn up something actionable. *Id.*; *see also In re McKesson*
25 *HBOC, Inc. Sec. Litig.*, 126 F. Supp. 2d 1248, 1271 (N.D. Cal. 2000) (citing *In re Silicon Graphics*,
26 183 F.3d at 985). This means that a plaintiff must provide, in great detail, all the relevant facts
27 forming the basis of his belief. *Id.*

28 In discussing the requisite scienter under the PSLRA, the Ninth Circuit has explained:

1 [A] private securities plaintiff proceeding under the PSLRA must plead,
2 in great detail, facts that constitute strong circumstantial evidence of
3 deliberately reckless³ or conscious misconduct. ... [A]lthough facts
4 showing mere recklessness or a motive to commit fraud and
5 opportunity to do so may provide some reasonable inference of intent,
6 they are not sufficient to establish a strong inference of deliberate
7 recklessness. In order to show a strong inference of deliberate
8 recklessness, plaintiffs must state facts that come closer to
9 demonstrating intent, as opposed to mere motive and opportunity.
10 Accordingly, . . . particular facts giving rise to a strong inference of
11 deliberate recklessness, at a minimum, is required to satisfy the
12 heightened pleading standard under the PSLRA.

13 *In re Silicon Graphics*, 183 F.3d at 974 (emphasis added). When considering whether a plaintiff has
14 shown a strong inference of scienter, “the court must consider all reasonable inferences to be drawn
15 from the allegations, including inferences unfavorable to the plaintiffs,” *Gompper v. VISX, Inc.*, 298
16 F.3d 893, 897 (9th Cir. 2002), and “answer the larger question of whether [plaintiffs’] complaint,
17 considered in its entirety, states facts which give rise to a strong inference [of scienter].” *In re*
18 *Silicon Graphics*, 183 F.3d at 985. To qualify as “strong,” an inference of scienter must be more
19 than merely plausible or reasonable – it must be cogent and at least as compelling as any opposing
20 inference of nonfraudulent intent. *Tellabs, Inc.*, 127 S.Ct. at 2509-10.

21 In the instant case, Plaintiff alleges that Defendants’ omissions misled the shareholders as to
22 the purpose of the sale, eventually resulting in harm to their investments. Whether the SAC
23 sufficiently alleges that these omissions were misleading, and whether Plaintiff has adequately pled
24 that Defendants had the requisite scienter to so mislead, are thus the critical questions before the
25 Court.

26 **a. The Omissions Are Alleged With Sufficient Particularity But Are Not**
27 **Sufficiently Misleading.**

28 The Court takes each of the alleged omissions in turn to determine if the SAC sufficiently
alleges that each omission “affirmatively create[d] an impression of a state of affairs that differe[d]
in a material way from the one that actually existe[d,]” and, if based on information and belief, states

³ The Ninth Circuit has defined recklessness in this context as: “[A] highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.” *S.E.C. v. Rubera*, 350 F.3d 1084, 1094 (9th Cir. 2003) (citing *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569 (9th Cir. 1990) (en banc)).

1 with particularity all facts on which the belief is formed. *See Brody*, 280 F.3d at 1006; *In re Silicon*
2 *Graphics*, 183 F.3d at 985.

3 Plaintiff alleges four omissions or misrepresentations: (1) not a single public announcement
4 was made concerning the sale after the SPA had been signed, despite the fact that SEC rules required
5 that an Information Statement be filed prior to the transaction to inform investors of the material
6 facts concerning the transaction; (2) the content of the December 12, 2005 Form 8-K feigned a
7 legitimate corporate purpose in that it represented that the consummation of the transaction would
8 allow DVS to pursue “other strategic interests” instead of disclosing that DVS intended to use the
9 proceeds from the sale of substantially all of the assets of DVS to pay off Kuo’s personal creditors,
10 even though they had disclosed the SPA itself; (3) the draft minutes of the Audit Committee meeting
11 from December 15, 2005 indicate that DVS failed to follow proper procedures in agreeing to the
12 SPA and that one of the committee’s members learned of the sale by accident; and (4) majority
13 consent needed for ratification of the transaction was not properly obtained.

14 Because these allegations are made on the basis of information and belief, Plaintiff must state
15 with particularity all facts on which the belief is formed. Here, Plaintiff alleges facts with sufficient
16 particularity. As the Court previously found, based on the same facts, there are adequate
17 corroborating details in the SAC supporting the allegation that Defendants entered into the SPA to
18 satisfy their judgment to Kuo and pay off her creditors. First, Plaintiff alleges that the Santa Clara
19 County Superior Court entered judgment, in Kuo’s favor, against DVS. To satisfy this judgment,
20 and by the terms of the Settlement Agreement, Plaintiff alleges that DVS distributed Series D stock,
21 and later a portion of the assets of DVS, to Kuo’s creditors. In addition, Plaintiff alleges that
22 specific creditors of Kuo’s were to receive these assets, and corroborates this allegation with a list of
23 such individuals. Finally, Plaintiff alleges that Defendants’ intention to use the proceeds of the sale
24 to pay Kuo’s creditors was omitted from the December 12 and December 30, 2005 Forms 8-K.
25 Thus, Plaintiff has alleged these omissions with sufficient particularity.

26 Next, the Court must determine whether the SAC “specif[ies] the reason or reasons why the
27 statements made by [Defendants] were misleading or untrue, not simply why the statements were
28 incomplete.” *Brody*, 280 F.3d at 1006. To be misleading, the omission must “affirmatively create

1 an impression of a state of affairs that differs in a material way from the one that actually exists.” *Id.*
2 Here, Plaintiff has not met this standard. To be “actionable under the securities laws, an omission
3 must be misleading; in other words it must affirmatively create an impression of a state of affairs
4 that differs in a material way from the one that actually exists.” *Id.* Thus, in this Circuit,

5 neither Rule 10b-5 nor Section 14(e) contains a freestanding completeness
6 requirement; the requirement is that any public statements companies make
7 that could affect security sales or tender offers not be misleading or untrue.
8 Thus, in order to survive a motion to dismiss under the heightened pleading
9 standards of the Private Securities Litigation Reform Act (“PSLRA”), the
10 plaintiffs’ complaint must specify the reason or reasons why the statements
11 made by [the defendant] were misleading or untrue, not simply why the
12 statements were incomplete.

13 *Id.* (citations and footnotes omitted).

14 Here, while Plaintiff alleges that he did not know about the Pledge Agreement at the time the
15 relevant Forms 8-K were filed, Plaintiff does not allege that Kuo’s judgment against DVS, or the
16 resulting Settlement Agreement, were unknown. Therefore, at the time the relevant Forms 8-K were
17 filed, the known state of affairs included the outstanding judgment against DVS and in Kuo’s favor.
18 Thus, Plaintiff has not specified reasons why the alleged omissions regarding the plan for that
19 portion of the proceeds necessary to satisfy the judgment in favor of Kuo were misleading in light of
20 the publicly-known information regarding the judgment. In addition, Plaintiff has failed to carry its
21 burden to demonstrate that the shareholders were misled as to the plan for that portion of the
22 proceeds that were not designated for satisfaction of the judgment. Plaintiff alleges that Kuo
23 testified that the remaining proceeds were invested in an undisclosed, foreign company. (SAC ¶ 43.)
24 It appears from the testimony cited by Plaintiff in the second amended complaint and from the
25 testimony submitted pursuant to Defendants’ request for judicial notice, the remainder of the
26 proceeds were invested overseas. This appears to be consistent with the representation that DVS
27 intended to use the proceeds from the sale to pursue other strategic alliances.

28 Further, Plaintiff alleges that the draft minutes of the Audit Committee indicate that members
believed “proper procedures” were not followed in the ratification of the transaction. There is no
particular representation or omission that follows from the allegation that procedures were not
followed. There is no “rule of completeness” in this circuit requiring disclosure of all facts related to
the transaction when there has been disclosure of some pertinent facts. *See Brody*, 280 F.3d at 1006.

1 In addition, Plaintiff also now alleges that the representation that the majority of shareholders
2 ratified the transaction is demonstrably false because Plaintiff, as a shareholder, was not asked to
3 ratify the sale. However, simply because Plaintiff, a minority shareholder, was not asked to give its
4 assent to the transaction does not in fact imply that a majority of shareholders did give their
5 approval. *See* 8 Del. Code § 228(a) (corporate action taken by written consent of a majority of
6 shareholders in *in lieu* of voting by all shareholders and does not require that every shareholder's
7 signature be obtained or solicited). Further, Plaintiff now contends that it has asked for information
8 about the identities of the consenting majority shareholders, without response from DVS. The fact
9 that Defendants' counsel will not disclose the names of approving shareholders when discovery is
10 stayed as a matter of course, does not create a presumption that the majority of shareholders did not
11 give their consent to the transaction.

12 Therefore, the Court finds that the omissions and representations alleged to have been
13 misleading are not actionable in that there is no showing that they were misleading or untrue. Even
14 if, however, the SAC contained allegations that were sufficiently misleading under *Brody*, the Court
15 must also determine whether the allegations create a sufficient inference of scienter.

16 **b. The Allegations Do Not Create a Sufficient Inference of Scienter.**

17 The Court accepts Plaintiff's allegations as true, and analyzes them collectively, to determine
18 if a reasonable person would deem the inference of scienter at least as strong as any opposing
19 inference. *See Tellabs, Inc.*, 127 S.Ct. at 2511. The SAC sufficiently alleges and supports a strong
20 inference that Defendants entered into the agreement with the intention of using a portion of the
21 proceeds to pay off Kuo's creditors. However, the SAC alleges that Defendants intentionally
22 withheld the purpose of the transaction from the shareholders with the knowledge that such
23 information would be highly material to investors, but states no further particularized facts
24 supporting a strong inference that Defendants acted with the *intent* to deceive, manipulate or
25 defraud. Thus, to establish the requisite scienter, the SAC must support the strong inference that
26 Defendants acted deliberately reckless by making a highly unreasonable omission that is an extreme
27 departure from the standards of ordinary care. *See Rubera*, 350 F.3d at 1094.

28 Plaintiff argues that the content of the Forms 8-K and the timeline of events are demonstrate

1 scienter. (Opp. Br. at 6-9.) As to content, Plaintiff contends that the Forms 8-K omitted the real
2 plan for all of the proceeds of the sale and feigned a legitimate plan, to pursue “other strategic
3 alliances.” (*Id.*) In addition, Plaintiff alleges that the Form 8-K dated December 12, 2005 stated
4 that the transaction was approved by a majority of the shares.⁴

5 First, Plaintiff contends that the timeline of events establishes a strong inference of scienter.
6 As alleged, DVS entered into the SPA with KTIC on December 10, 2005 and only announced that
7 agreement two days after the fact. (SAC ¶¶ 31, 33.) In addition, the sale closed on December 29,
8 2005 and it was not until the next day that Defendants filed the Form 8-K announcing the final sale.
9 (SAC ¶ 39.) Defendants point out, however, that the SPA entered into on December 10, 2005 was
10 only preliminary, and, as the December 12, 2005 Form 8-K stated, either party could cancel the
11 agreement at that time. Thus, in Defendants’ view, the simple timing of the disclosure does not
12 support a strong inference of the requisite scienter. The Court again finds that announcing a
13 preliminary sale agreement two days after it is made, but seventeen days before it is final or binding,
14 does not establish the requisite scienter.

15 On the other hand, Defendants’ main contention regarding scienter is that alternate
16 inferences can be drawn from the facts alleged that foreclose the existence of a “strong inference” of
17 scienter. As alleged, DVS was obligated to satisfy the \$3.42 million judgment against DVS in Kuo’s
18 favor. Defendants intended to satisfy their obligation to Kuo by arranging a registration of stock, but
19 DVS was not able to register the stock because of a failure to file its current financial information
20 with the SEC. Defendants then attempted to satisfy the judgment by selling the DVSK shares.
21 Thus, rather than making an extreme departure from the standard of care, Defendants could have

22
23 ⁴ In the SAC, Plaintiff also realleges that DVS represented it would seek shareholder ratification
24 of the sale and the fact that no shareholder vote was taken establishes scienter and the existence of a
25 fraudulent scheme. Plaintiff, however, does not allege that Defendants made the statement with the
26 actual knowledge that statement was false or misleading. Regardless of whether majority shareholder
27 consent was actually eventually acquired, the Court fails to see how Defendants’ statement that they
28 would seek shareholder ratification shows deliberate recklessness at the time the statement was made,
especially in light of the alleged approval of the sale by a majority of the shares. *See In re Silicon
Graphics*, 183 F.3d at 988 (holding that the heightened standard set by the PSLRA was intended to put
an end to securities fraud lawsuits that plead “fraud by hindsight”); *see also In re GlenFed*, 42 F.3d at
1548-49 & n.8 (holding that “often there is no reason to assume that what is true at the moment plaintiff
discovers it was also true at the moment of the alleged misrepresentation, and there therefore simply
because the alleged misrepresentation conflicts with the current state of facts, the charged statements
must have been false”).

1 been simply fulfilling their obligations under the judgment, the Settlement and the Pledge
2 Agreement. While Plaintiff alleges that there was misconduct at the time that DVS entered into the
3 Settlement and Pledge Agreements, Plaintiff's allegations regarding potential misconduct in the
4 Settlement Agreement is not pleaded with particularity, as is required.⁵ In addition, as before, it is
5 not self-evident how DVS's action of entering into a settlement under duress converts Defendants'
6 later omission regarding the precise plan for the proceeds of the sale into deliberately reckless
7 conduct.

8 The disclosures indicated that the proceeds would be used to pursue "other strategic
9 interests" instead of disclosing that DVS intended to use the proceeds from the sale of substantially
10 all of the assets of DVS to pay off Kuo's personal creditors and somehow to waste the rest of the
11 funds. However, as the Court has found, the company was legally obligated to pay off the judgment
12 it owed to Kuo and her creditors, and the rest of the proceeds were, according to the pleading in the
13 complaint, invested in an overseas company. In view of all of the allegations in the SAC, the Court
14 again finds that these allegations do not rise constitute deliberately false or misleading statements or
15 present strong inferences that Defendants acted with scienter. Defendants were under a duty to
16 satisfy the judgment against them and thus entered into the Settlement and Pledge Agreements.
17 Defendants, after receiving approval from a majority of the shares, sold their only asset to satisfy the
18 judgment, and reported the sale to the public. The fact that the announcements did not include the
19 precise plan for the proceeds, when the judgment was a matter of public record, does not establish
20 that Defendants acted with the requisite scienter under the PSLRA. According to the testimony
21 submitted in this matter, the remaining assets obtained by DVS in the transaction was indeed
22 invested abroad, which can be construed as in conformity with the representation that the transaction
23 was undertaken both to satisfy legal obligations as well as to pursue other strategic alliances. Thus,
24 the Court finds that Plaintiff has not sufficiently pleaded scienter.

25
26
27 ⁵ As in the prior complaints, Plaintiff fails to provide any factual support for the contention that
28 DVS consented to settlement of Kuo's claims under duress. Plaintiff does not identify to whom Kuo
made the settlement threats and promises, when Kuo made them, or what Kuo actually said or did.
There is no description of the actual settlement negotiations or how Kuo created the alleged duress
under which DVS acceded to her settlement demands.

1 **2. Allegations Against Defendant Watson.**

2 Plaintiff has alleged only the third cause of action for control person liability against
3 Defendant Watson and therefore does not include him as directly liable in the first or second cause
4 of action. Therefore, the Court does not need to address the insufficiency of the inference of scienter
5 in connection with Defendant Watson for this claim.

6 **3. Allegations of Loss Causation.**

7 Defendants next argue that Plaintiff failed adequately to plead loss causation with respect to
8 the alleged omissions, as required by *Dura Pharm., Inc. v. Broudo*, 125 S. Ct. 1627, 1633 (2005).
9 Defendants contend that Plaintiff has not adequately shown the causal connection between the
10 decrease in the DVS stock price and the alleged omissions. (Br. at 15-18.) The Court agrees.

11 Even under the liberal pleading guidance of Federal Rule of Civil Procedure 8, to allege loss
12 causation a plaintiff must show the actual economic loss suffered and the causal connection between
13 that loss and the misrepresentation or omission. *See Dura Pharm., Inc.*, 125 S. Ct. at 1634. In *Dura*,
14 the Court explained that securities fraud actions were available, “not to provide investors with broad
15 insurance against market losses, but to protect them against those economic losses that
16 misrepresentations actually cause.” *Id.* at 1633. Plaintiff must therefore provide Defendants with
17 facts demonstrating the causal connection between the alleged misrepresentations and the losses.
18 *See id.*

19 In the original complaint, Plaintiff alleged that Defendants’ material omissions caused a
20 significant loss to Plaintiff and that, as a result of the sale of DVSK, DVS stock was, at the time the
21 complaint was filed, traded at 14 cents a share. (Complaint ¶ 55.) In its prior order dated September
22 7, 2007, the Court found that Plaintiff did not plead facts establishing the necessary direct link
23 between particular omissions by Defendants and the decrease in the stock price. Then, in the first
24 amended complaint, Plaintiff alleged that DVS shares had not traded over \$1.00 since April 27,
25 2006, ten days after DVS announced it would not be able to file its Form 10K. (FAC ¶¶ 43, 60.)
26 The Court previously found that Plaintiff had linked the decrease in stock prices to DVS’s
27 announcement that it would not be able to file its Form 10K in April 2006 and therefore that there
28 was no connection between the alleged omissions and the loss incurred, as required under *Dura*.

1 (See Order at 19-20.)

2 Now, in its second amended complaint, Plaintiff seeks to replace its prior allegation that the
3 stock prices were tied to the failure to file the Form 10K in April 2006, and rather now alleges that
4 the decline in stock value was directly tied to and started with the alleged omissions and
5 misrepresentations in the Forms 8-K from December 12 and December 30, 2005. Now, Plaintiff
6 contends that the Forms 8-K concealed material facts regarding the purpose of the transaction and
7 “as investors have figured this out by DVS’s failure to [file] any required reports and continued
8 idleness, they have punished DVS and its stock has dropped. This all started with the
9 misrepresentations and omissions in the December 12 and December 30, 2005 Forms 8-K.” (Opp.
10 Br. at 10.)

11 Plaintiff alleges, and the Court takes as true, that on announcement of the sale, DVS’s stock
12 price actually increased, from \$0.91 on December 12, 2005, to \$1.60 on December 30, 2005 on
13 increased volume. (SAC ¶ 46.) Plaintiff alleges, however, that since that time the price of DVS’s
14 stock has declined and that by the end of March 2006, DVS’s shares were trading at \$1.05 per share.
15 (*Id.*) By the end of April 2006, the stock was at \$0.86 per share. (*Id.*) By June 15, 2006, it was
16 trading at \$0.55 per share. (*Id.*) On May 2, 2007, the day Plaintiff filed this lawsuit, DVS stock
17 closed at \$0.19 and two days later, on May 4, 2007, DVS stock closed at \$0.14 per share. (*Id.* ¶ 47.)
18 At the time of filing the SAC, DVS stock trade at less than \$0.05 a share. (*Id.* ¶ 48.)

19 It appears from the three iterations of the complaint in this case, that Plaintiff seeks to avoid
20 the holding of this Court on its ruling on the motion to dismiss the first amended complaint by
21 amending the facts alleged to give rise to the decline in the stock value. The first amended
22 complaint clearly linked the decline in value with the announcement that DVS was unable to file its
23 Form 10-K. (FAC ¶ 43.) Here, in the second amended complaint, Plaintiff fails to allege how the
24 asserted cause of the decline – the alleged omissions and misrepresentations in the company’s Forms
25 8-K – led to declines in value long after the alleged precipitous event. Plaintiff is unable to identify
26 when or how such a decline in the market was the result, not of, as previously the company’s failure
27 to file quarterly reports, but rather the alleged misrepresentations and omissions in the Forms 8-K.
28 While “the court assumes that the facts alleged in a complaint are true, it is not required to indulge

1 unwarranted inferences in order to save a complaint from dismissal.” *Metzler Investment GMBH v.*
2 *Corinthian Colleges, Inc.*, 540 F.3d 1049, 1064-65 (9th Cir. 2008). Plaintiff’s original explanation
3 for the decline in value, its inability to file a Form 10-K, is much more plausible explanation of the
4 precipitous decline thereafter in May through June of 2006.

5 Plaintiff has not alleged facts sufficient to show a direct connection between the alleged
6 omissions and the loss caused, as required by *Dura*. 125 S.Ct. at 1634 (explaining that Plaintiff
7 failed to allege that the share price fell significantly after the truth became known).

8 **4. Materiality and Justifiable Reliance.**

9 Next, Defendants contend that Plaintiff failed to plead that the alleged omission was material
10 and that Plaintiff justifiably relied on it, as is required under Rule 10b-5. (Br. at 18-19.) In
11 response, Again, Plaintiff contends that Defendants’ arguments raise fact questions that are not
12 appropriate for resolution in this Motion. (Opp. Br. at 11-12.)

13 An omission is material if there is a substantial likelihood that the disclosure of the omitted
14 fact would have been viewed by the reasonable investor as important. *See Basic Inc. v. Levinson*,
15 485 U.S. 224, 231 (1988); *TSC Industries, Inc. v. Nothwary, Inc.*, 426 U.S. 438, 449 (1976);
16 *Abramson v. American Pacific Corp.*, 114 F.3d 898, 902 (9th Cir. 1997). The ultimate
17 determination of materiality includes consideration of “both the magnitude of the potential loss and
18 the likelihood that it will actually take place.” *Abramson*, 114 F.3d at 902. A presumption of
19 reliance “is generally available to plaintiffs alleging violations of section 10(b) based on omissions
20 of material fact.” *Binder v. Gillespie*, 184 F.3d 1059, 1063 (citing *Kramas v. Security Gas & Oil,*
21 *Inc.*, 672 F.2d 766, 769 (9th Cir.1982)).

22 Here, Plaintiff alleges that the misrepresentations and omissions in the company’s December
23 12 and December 20, 2005 Forms 8-K were material. (SAC ¶ 60.) Defendants contend, however,
24 that Plaintiff does not allege why a reasonable investor would have considered DVS’s act of paying
25 down part of the \$3.4 million Kuo judgment by \$1.5 million out of \$12 million in DVSK stock sales
26 proceeds important in making an investment decision, in light of the fact that the DVSK stock had
27 been pledged to Defendant Kuo and her creditor-designees. *See Gluck v. Agemian*, 495 F. Supp.
28 1209, 1214 (S.D.N.Y. 1980) (quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449

1 (1976)) (“There is simply no theory under which [the disclosure to shareholders of the terms of a
2 cash sale or pledge] can be deemed material, in the sense of ‘assum(ing) actual significance in the
3 deliberations of the reasonable shareholder’ or ‘significantly alter(ing) the “total mix” of information
4 made available.’”) Additionally, the amount alleged to have been paid to Kuo was legitimately due
5 and owing, according to Plaintiff’s own allegations, as a result of the judgment in her favor and there
6 is no showing why a loss was likely to occur as a result of the payment to DVS’s creditors.

7 There are repeated assertions that Plaintiff reasonably relied on DVS’s statements in the
8 December 12 and December 30, 2005 Forms 8-K that DVS had received majority shareholder
9 approval of the transaction and that the proceeds of the DVSK transaction would be used to pay
10 Kuo’s creditors and family members and the remainder would be invested in another, foreign
11 company. (SAC ¶¶ 61, 71.) There is no allegation in the complaint, however, that Plaintiff actually
12 relied on the representations or that the reliance caused it to purchase or sell stock or to suffer
13 damages. (*Id.* ¶ 71.) Again, Plaintiff merely contends that it has sufficiently pled reliance and the
14 issue is not properly resolved on a motion to dismiss and argues only that would have sought to
15 enjoin the transaction. (*Id.* at ¶ 72.) It is unclear why Plaintiff could not have sought an injunction
16 under the facts as pled, but in any case. the Court need not reach the issue of reliance given
17 Plaintiff’s repeated failure sufficiently to allege scienter, loss causation or that the alleged omissions
18 or misrepresentations were misleading.

19 For these reasons, the Court GRANTS Defendants’ motion to dismiss Plaintiff’s first claim
20 for violation of Section 10(b) and Rule 10b-5.

21 **C. Section 14(c) – Information Statement and Violation of Proxy Disclosure Rules.**

22 Plaintiff’s second claim is for violation of the proxy disclosure rules, Section 14(c) of the
23 1934 Securities Exchange Act, 15 U.S.C. § 78n(c), and SEC Rule 14c-2, 17 C.F.R. § 240.14c-
24 2(a)(1), (b). Plaintiff claims that because Defendants planned to sell substantially all of DVS’s
25 assets, they needed shareholder authorization and therefore had to circulate an information statement
26 containing the information specified in Schedule 14C at least 20 days prior to the earliest date on
27 which the action could be taken. Plaintiff contends that Defendants’ action violated Exchange Act
28 Rule 14c-2, promulgated pursuant to Section 14(c), which requires an information statement prior to

1 corporate action “by the written authorization or consent of security holders.” 17 C.F.R. § 240.14c-
2 2(a)(1).

3 Section 14(c) mandates the distribution of an “information statement” to certain shareholders
4 prior to an annual or special meeting of shareholders whenever management fails to solicit proxies
5 to the extent necessary to trigger Section 14(a). 15 U.S.C.A. § 78n(b)(2). The information
6 statement contains the same information as a Section 14(a) proxy statement and is subject to the
7 same anti-fraud provisions as a proxy statement. In other words, Section 14(c) requires
8 management, when no proxy vote is undertaken, nonetheless to disseminate information statements
9 to shareholders that contain substantially the same information required to be provided in a proxy
10 solicitation. *Ciro, Inc. v. Gold*, 816 F. Supp. 253, 269 (D. Del. 1993).

11 In the previous motion to dismiss in this case, Defendants argued that Plaintiff, as a minority
12 shareholder, had no private right of action to assert this claim because no economic harm resulted
13 from Defendants’ nondisclosure. Alternatively, Defendants contended that Plaintiff had failed to
14 satisfy the pleading requirements for securities fraud under 15 U.S.C. § 78u-4(b) and Rule 9(b).
15 After analyzing the relevant case law, the Court declined to address whether a private right action
16 exists under Section 14(c), and instead found that the original complaint, read in light of the
17 Supreme Court’s guidance in *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083 (1991),
18 militated against the creation of an implied cause of action under Section 14(c) in cases, such as this,
19 where minority shareholders seek relief from a transaction that they apparently could not have
20 prevented. The Court noted that in the original complaint Plaintiff alleged that the injury was not
21 caused by Defendants’ failure to send out a timely notice, but rather, was caused by the mere fact
22 that Plaintiff, as a minority shareholder, was powerless to stop the DSVK stock sale. The Court
23 further noted that to the extent that Plaintiff, or a critical mass of the other shareholders, could have
24 stopped or otherwise influenced the DSVK stock sale, such facts were not alleged in the operative
25 complaint.

26 In this third motion to dismiss, Defendants again contend that the SAC does not remedy the
27 defects the Court noted in its two previous orders. In the SAC, Plaintiff newly alleges that as a
28 result of Defendants’ failure to file an information statement, Plaintiff was harmed because it was

1 denied the opportunity to seek on its own to enjoin the sale of the DVSK stock and subsequent use
2 of the proceeds to pay Kuo's personal creditors, or to enlist other stockholders in an effort to stop the
3 transaction. (SAC ¶ 72.) In response, Defendants contend that Plaintiff still does not allege facts
4 showing that Plaintiff, or a mass of other unidentified shareholders, would have been able to stop or
5 influence the DVSK stock sale or any reason a court would have enjoined the transaction a majority
6 of the shareholders approved. (Br. at 22.) Defendants further contend that Plaintiff could not have
7 enjoined the sale because DVS was required to sell the stock to satisfy the Settlement Agreement,
8 the stock was pledged to the judgment creditors and the sale was approved by a majority of DVS's
9 shareholders. (Reply at 11.)

10 As in its prior order, the Court finds that the Supreme Court's guidance in *Virginia*
11 *Bankshares*, 501 U.S. 1083, militates against the creation of an implied cause of action under
12 Section 14(c) in cases, such as this case, where minority shareholders seek relief from a transaction
13 that they apparently could not have prevented. In addition, under the particular circumstances
14 presented here, to the extent Plaintiff alleges that the nondisclosure was material as they would have
15 sought to enjoin the sale of DVSK, as the Court has already found, Plaintiff was aware of the sale in
16 December 2005 and took no action to halt the transaction. To the extent Plaintiff claims that it only
17 would have sought to enjoin the transaction had it known the intent of DVS to pay off a judgment
18 against it, according to the facts as pled, should such an injunction been issued, the creditors would
19 have been entitled to foreclose on the stock in any case. Therefore, the alleged omission would be
20 immaterial. *See CalPERS v. Chubb Corp.*, 394 F.3d 126, 144 (3d Cir. 2004). Either there is no
21 implied private right of action under Section 14(c) under these circumstances, or the alleged
22 violation of the proxy rules was immaterial under the facts as pled.

23 For these reasons, the Court GRANTS Defendants' motion to dismiss Plaintiff's second
24 claim for violation of Section 14(c).

25 **D. Section 20(a) – Control Person Liability.**

26 Plaintiff's third claim is for a violation of Section 20(a) of the 1934 Securities Exchange Act,
27 15 U.S.C. § 78t, or control person liability. Defendants contend that liability under this section
28 depends on the existence of a primary violation of the provisions of the Exchange Act. (Br. at 25.)

1 The Court agrees.

2 Section 20(a) of the Securities Exchange Act provides derivative liability for those who
3 control others found to be primarily liable under the Act. *See In re Ramp Networks, Inc. Sec. Lit.*,
4 201 F. Supp. 2d 1051, 1063 (N.D. Cal. 2002); *see also Johnson v. Aljian*, 490 F.3d 778, 781 n.11
5 (9th Cir. 2007). Where a plaintiff asserts a Section 20(a) claim based on an underlying violation of
6 Section 10(b), the pleading requirements for both violations are the same. *See In re Ramp Networks*,
7 201 F. Supp. 2d at 1063. “To be liable under section 20(a), the defendants must be liable under
8 another section of the Exchange Act.” *Heliotrope General, Inc. v. Ford Motor Co.*, 189 F.3d 971,
9 978 (9th Cir.1999).

10 Here, Plaintiff has not stated a claim against Defendants under the Securities and Exchange
11 Act and thus there can be no primary liability under the act from which the control person liability
12 under Section 20(a) derives. Plaintiff does not contend otherwise.

13 For these reasons, the Court GRANTS Defendants’ motion to dismiss Plaintiff’s third claim
14 for violation of Section 20(a).

15 **E. Leave to Amend is Denied.**

16 Because there have already been three iterations of the complaint filed in this matter and the
17 Court is not satisfied that Plaintiffs would be able to plead any additional facts, the first, second and
18 third claims are dismissed with prejudice. *See, e.g., Moore v. Kayport Package Express, Inc.*, 885
19 F.2d 531, 540-41 (9th Cir. 1989) (upholding denial of leave to file third amended complaint to allege
20 securities fraud where investors had failed to cure pleading deficiencies of earlier complaints).

21 **F. Remaining State Law Claims**

22 Plaintiff’s fourth, fifth, and sixth claims are for the appointment of a receiver pursuant to
23 Title 8 Delaware Code Sections 226(a)(3), 291, and Delaware common law, respectively. Plaintiff’s
24 seventh and final claim seeks an order compelling Defendants to hold an annual shareholder
25 meeting pursuant to 8 Delaware Code § 211(c). Defendants contend that if the Court dismisses the
26 federal claims, the Court should decline to exercise supplemental jurisdiction over these state law
27 claims. (Br. at 25.) Plaintiff argues that the Court should retain jurisdiction over these claims.
28 (Opp. Br. at 16-17.)

1 As long as the complaint sets forth a claim “arising under” federal law, the district court may
2 adjudicate state law claims that are transactionally related to the federal claim. *See* 28 U.S.C. §
3 1367(a). The fact that the Court rules against Plaintiff and dismisses the federal claims prior to trial
4 does not automatically oust the court of supplemental jurisdiction. *See* Judge William W. Schwarzer
5 et al., *Federal Civil Procedure Before Trial*, § 2:145.2 (2006). The dismissal is a factor for the
6 Court to consider in deciding whether to decline to exercise its supplemental jurisdiction. A court
7 has discretion to retain the supplemental state law claim and grant relief thereon. 28 U.S.C. §
8 1367(c)(3); *see United Mine Workers v. Gibbs*, 383 U.S. 715, 728 (1966); *Brady v. Brown*, 51 F.3d
9 810, 816 (9th Cir. 1995). The court may decline to exercise supplemental jurisdiction where any of
10 the following factors exist: (1) the state law claim involves a novel or complex issue of state law; (2)
11 the state law claim substantially predominates over the claim on which the court’s original
12 jurisdiction is based; (3) the district court has dismissed the claims on which its original jurisdiction
13 was based; or (4) “in exceptional circumstances, there are other compelling reasons for declining
14 jurisdiction.” 28 U.S.C. § 1367(c)(1)-(4).

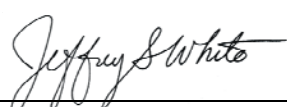
15 Here, because the Court has, after three iterations of the complaint, denied Plaintiff leave to
16 amend its claims that arise under federal law, and because this case is its early procedural stages and
17 the Court has not addressed the merits of the state claims, the Court will decline to exercise its
18 discretion to retain supplemental jurisdiction over the remaining state law claims. *See* 28 U.S.C. §
19 1367(c)(3). The Court therefore DENIES Defendants’ motion to dismiss on the state law claims.

20 **CONCLUSION**

21 For the foregoing reasons, the Court GRANTS Defendants’ motion to dismiss without leave
22 to amend. A separate judgment shall issue and the Clerk shall close the file.

23
24 **IT IS SO ORDERED.**

25
26 Dated: March 30, 2009



JEFFREY S. WHITE
UNITED STATES DISTRICT JUDGE