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UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF CALIFORNIA

AI-DAIWA, LTD.,  
Plaintiff,  
v.  
APPARENT, INC., et al.,  
Defendants.

Case No. [13-cv-04156-VC](#)

**ORDER GRANTING IN PART AND  
DENYING IN PART PLAINTIFF'S  
MOTION TO DISMISS DEFENDANT'S  
COUNTERCLAIM**

Re: Dkt. No. 59

**INTRODUCTION**

In December 2011, plaintiff AI-Daiwa and defendant Apparent entered into a contract under which AI-Daiwa would manufacture products, known as MGi devices, for Apparent. Apparent was the designer of the devices, but contracted with AI-Daiwa to produce them. AI-Daiwa sued, alleging Apparent had failed to pay for the products. Apparent filed a counterclaim against AI-Daiwa, and after receiving permission from the Court, filed an amended counterclaim in May 2014. Apparent's amended counterclaim asserts eight causes of action: (1) breach of contract; (2) breach of express and implied warranties; (3) breach of implied covenant of good faith and fair dealing; (4) fraud; (5) negligent misrepresentation; (6) unfair business practices; (7) unjust enrichment; and (8) declaratory relief. AI-Daiwa has filed a motion to dismiss the claims for fraud, negligent misrepresentation, breach of express warranty, and breach of implied covenant of good faith and fair dealing. The motion is granted in part and denied in part.

**DISCUSSION**

**A. Fraud**

Apparent alleges two instances of fraud. First, Apparent claims there was fraud when, in December 2011, a company called Advanced Innovations, USA, LLC, (which had previously

1 contracted with Apparent to manufacture the devices) formed a joint venture with Daiwa, Ltd., to  
2 form an entity called AI-Daiwa, and convinced Apparent to transfer the Purchase Order for the  
3 production of the MG*i* devices from Advanced Innovations to AI-Daiwa. Apparent alleges that  
4 AI-Daiwa committed "promissory fraud," arguing that Robert O'Donnell, a director of AI-Daiwa,  
5 lied to Apparent about the joint venture's ability and intention to perform its obligations under the  
6 contract. However, while Apparent alleges O'Donnell's promises were "false when made," the  
7 counterclaims contain no allegations to support this conclusory statement. Apparent simply relies  
8 on alleged defects in the products as support for the notion that AI-Daiwa never intended to  
9 perform. More would be needed to plead a fraud claim, particularly considering that even though  
10 the product failure rate was allegedly higher than the contract allowed, most of the products  
11 worked as intended. Apparent has not alleged sufficient facts to convert this breach of contract  
12 claim into the tort of fraud. Apparent's fraud claim with respect to the purchase order transfer is  
13 dismissed with prejudice, because Apparent received an opportunity to amend the counterclaim  
14 after having received notice of its defects from AI-Daiwa's prior motion to dismiss.  
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17 Apparent also alleges that AI-Daiwa committed fraud by falsifying test results related to  
18 the performance of the MG*i* devices. According to its amended counterclaim, in November 2012,  
19 Apparent, concerned over the number of defective products it received in an earlier shipment,  
20 requested that AI-Daiwa re-test the products that were to be delivered in a December 2012  
21 shipment, and that it do so using a testing protocol developed by Apparent. AI-Daiwa allegedly  
22 agreed to re-test the products so long as Apparent would agree to pay an inflated price for them.  
23 Apparent alleges that AI-Daiwa did not actually perform those tests, even though Robert  
24 O'Donnell and James Chong represented to Apparent that two AI-Daiwa staff, Felix Lau and  
25 Seamus Ennis, had performed the tests and the products had passed. Apparent alleges it relied on  
26 this representation and paid an inflated price for the December 2012 shipment. This sufficiently  
27 pleads a fraud claim, and puts AI-Daiwa on notice of the conduct alleged to be fraudulent.  
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1 Although AI-Daiwa argues in its briefs that it could not possibly have submitted fraudulent test  
2 results without Apparent knowing of it, that conclusion cannot be drawn from the allegations in  
3 the counterclaim itself, and therefore the argument is of no help to the Rule 12(b)(6) motion. AI-  
4 Daiwa's motion to dismiss this portion of the fraud claim is denied.

5 **B. Negligent misrepresentation**

6 The parties agree that negligent misrepresentation is a form of fraud, and that under the  
7 facts as alleged in the amended counterclaim, Apparent's negligent misrepresentation claims  
8 should live or die with the fraud claims. Therefore, AI-Daiwa's motion to dismiss the negligent  
9 misrepresentation claim is granted with prejudice with respect to the alleged inducement to  
10 transfer the purchase order, and is denied with respect to the alleged falsification of test results.

11 **C. Breach of Express Warranty**

12 AI-Daiwa moves to dismiss Apparent's breach of express warranty claim on the ground  
13 that Apparent failed to provide notice of the product defects within a reasonable time, as required  
14 by California Commercial Code § 2607(3)(A). However, Apparent alleges in its counterclaim that  
15 it discovered defects in the devices some time after April 2012, and it complained to AI-Daiwa of  
16 multiple defects "in mid-2012." Any delay between "April 2012" and "mid-2012" cannot be  
17 deemed unreasonable per se, such that the claim should be dismissed at the pleading stage.

18 AI-Daiwa relies on a declaration provided by Dan Tran, an employee at Apparent,  
19 submitted in support of Apparent's motion to dismiss AI-Daiwa's First Amended Complaint. In  
20 this declaration, Tran stated: "I received the products on March 2, 2012. On July 27, 2012, in  
21 meetings with AI-Daiwa, I identified defects with 11 of the products shipped and began working  
22 with AI-Daiwa to implement corrective action." (Request for Judicial Notice, Exhibit 2).  
23 According to AI-Daiwa, this declaration suggests that Apparent waited four months from learning  
24 of the defect before it notified AI-Daiwa. Citing to *Ice Bowl v. Spalding Sales Corp.*, 56  
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1 Cal.App.2d 918 (1943), AI-Daiwa argues that a four month gap between discovering a defect and  
2 providing notice is unreasonable as a matter of law. But even if it would be appropriate to use a  
3 declaration of a party witness to defeat the allegations in that party's own counterclaim for  
4 purposes of a Rule 12(b)(6) motion, the declaration does not speak to when Tran first discovered  
5 the defect, as opposed to simply receiving the products. For that matter, the declaration does not  
6 speak to when Tran initially identified the defects to AI-Daiwa; it merely describes a July meeting  
7 without specifying whether that was the first communication between the parties about the defects.  
8 Furthermore, *Ice Bowl*, a case from 1945 concerning ice skates, did not hold that a four month  
9 delay is unreasonable as a matter of law. Therefore, AI-Daiwa's motion to dismiss the breach of  
10 express warranty claim is denied.<sup>1</sup>

12 **D. Breach of Implied Covenant of Good Faith and Fair Dealing**

13 AI-Daiwa has moved to dismiss the breach of implied covenant of good faith and fair  
14 dealing claim, arguing that Apparent has not sufficiently alleged that AI-Daiwa consciously  
15 intended to frustrate the purposes of the contract. To the extent the Court is allowing Apparent's  
16 fraud claim to go forward, the Court also allows Apparent's breach of implied covenant of good  
17 faith and fair dealing claim to go forward, for the same reasons. Apparent has also alleged that AI-  
18 Daiwa breached the covenant of good faith and fair dealing because AI-Daiwa "engaged in  
19 conduct with putative customers to interfere with Apparent Inc's business opportunities." (¶32 at  
20 16:1-7). But Apparent alleged no facts in its counterclaim to support this conclusory allegation.  
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22 And since Apparent has already been given one opportunity to amend its counterclaim, the breach  
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26 <sup>1</sup> In its Reply brief, AI-Daiwa raises, for the first time, a contract provision that appears to have  
27 required Apparent to provide notice within ten days of receiving a product if the product was not  
28 acceptable. But because it is unclear the extent to which this provision applies, and because  
Apparent has not had a chance to respond to AI-Daiwa's argument, the Court finds that this  
contract provision is not sufficient grounds at this point to prevent Apparent's breach of express  
warranty claim from going forward.

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of implied covenant of good faith and fair dealing claim, as it relates to AI-Daiwa's alleged interference with Apparent's business opportunities, is dismissed with prejudice.

**IT IS SO ORDERED.**

Dated: August 15, 2014



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VINCE CHHABRIA  
United States District Judge