

United States District Court
For the Northern District of California

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

IN RE ACCURAY, INC. SHAREHOLDER
DERIVATIVE LITIGATION

No. 09-05580 CW

ORDER GRANTING
DEFENDANTS'
MOTION TO DISMISS

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Defendants Euan S. Thomson, Wayne Wu, Li Yu, Robert S. Weiss, Elizabeth Dávila, John P. Wareham, Robert E. McNamara, John R. Adler, Jr. and nominal Defendant Accuray Incorporated move to dismiss this shareholder derivative complaint. Derivative Plaintiffs Thomas Beebe, Sanjayh Israni, Eric Bachinski and Christopher Borrelli oppose the motion. The matter was heard on August 12, 2010. Having considered all of the papers filed by the parties and oral argument on the motion, the Court GRANTS Defendants' motion to dismiss and grants leave to amend.

BACKGROUND

Plaintiffs are shareholders of nominal Defendant Accuray. Plaintiffs bring this shareholder derivative suit against eight of Accuray's directors. Accuray designs, develops and sells the CyberKnife, an image-guided robotic radiosurgery system designed to treat solid tumors. The CyberKnife is Accuray's sole product.

Defendant Thomson is Accuray's Chief Executive Officer and has

1 been on the Board of Directors since March, 2002. Defendant
2 McNamara was Accuray's Senior Vice President and Chief Financial
3 Officer from December, 2004 until his resignation on September 11,
4 2008. Defendant Wu is Accuray's Chairman of the Board and has been
5 a Director since April, 1998. Defendant Yu is the Chairman of the
6 Compensation Committee, a member of the Audit Committee and has
7 been a Director since June, 2004. Defendant Weiss is the Chairman
8 of the Audit Committee and has been a Director since January, 2007.
9 Defendant Dávila is the Vice Chairman of the Board, a member of the
10 Audit Committee and Compensation Committee, and has been a Director
11 since February, 2008. Defendant Wareharm was a Director from
12 February, 2008 until his resignation on January 7, 2010. Defendant
13 Tu was a Director from May, 2004 to November, 2008. Defendant
14 Adler was a founder of Accuray and was a Director from December,
15 1990 to July, 2009.

16 Plaintiffs allege that Defendants made material
17 misrepresentations about Accuray's revenues and, specifically,
18 about Accuray's backlog. On February 7, 2007, the day Accuray
19 initiated the initial public offering (IPO), it defined backlog as
20 "deferred revenue and future payments that our customers are
21 contractually committed to make, but which we have not yet
22 received. Backlog includes contractual commitments from CyberKnife
23 system purchase agreements, service plans and minimum payment
24 requirements associated with our shared ownership programs."

25 Accuray's registration statement, which accompanied the IPO
26 and was filed with the SEC, included several disclosures detailing
27 the risk related to the business. For instance, Accuray stated:

1 Because of the high unit price of the CyberKnife system, and
2 the relatively small number of units installed each quarter,
3 each installation of a CyberKnife system can represent a
4 significant component of our revenue for a particular
5 quarter. Therefore, if we do not install a CyberKnife
6 system when anticipated, our operating results may vary
7 significantly and our stock price may be materially harmed.

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9 Events beyond our control may delay installation and the
10 satisfaction of contingencies required to receive cash
11 inflows and recognize revenue, such as . . . customer
12 funding or financing delay Therefore, delays in the
13 installation of CyberKnife systems or customer cancellations
14 would adversely affect our cash flows and revenue, which
15 would harm our results or operations and could cause our
16 stock price to decline.

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18 If third-party payors do not continue to provide sufficient
19 coverage and reimbursement to healthcare providers for use
20 of the CyberKnife system, our revenue would be adversely
21 affected.

22 Request for Judicial Notice (RJN),¹ Ex. A at 12-13 (Comp., Ex. 1 at
23 12-13). Accuray further noted that it "may be unable to convert
24 all of this backlog into recognized revenue due to factors outside
25 our control." Id. at 44 (Id. at 44). These disclosures were
26 included in Accuray's quarterly and annual filings throughout the
27 time period during which Plaintiffs allege Defendants' wrongdoing.

28 In a May 1, 2007 press release, Accuray announced that as of
March 31, 2007, it had changed its definition of backlog. The new
definition included "signed non-contingent contracts as well as
backlog under signed contingent contracts that the Company believes
have a substantially high probability of being booked as revenue."

¹The Court takes judicial notice of the documents filed with
the SEC. See Dreiling v. American Exp. Co., 458 F.3d 942, 946 (9th
Cir. 2006).

1 Comp. ¶ 69 (Comp. ¶ 61). Accuray stated, "Contingencies under
2 customer contracts included in backlog include customer acceptance
3 of the Company's legal terms and conditions of sale, hospital board
4 approvals, customer establishment of necessary financing or legal
5 entities and, in U.S. states, governmental approval of a
6 certificate of need (CON) for the operation of a radiosurgery
7 system." Id. (Comp., Ex. 5).

8 Also on May 1, 2007, Thomson and McNamara held an earnings
9 conference call to discuss the third fiscal quarter of 2007. In
10 that call, Thomson stated, "On balance, we feel confident that 90%
11 of the total backlog reported will be converted to revenue." Id.
12 ¶ 80 (Comp., Ex. 6 at 5). He also noted that the "total backlog
13 reported this quarter, taken in conjunction with reported revenue,
14 is a good and reliable indicator that [sic] the new business
15 generated during a given quarter." Id. (Comp., Ex. 6 at 5).
16 McNamara also expressed "confidence that at least 90% of the quoted
17 backlog will convert to revenue." Id. ¶ 81. (Comp., Ex. 6 at 8).
18 He also stated, "We believe that our current definition of backlog
19 is a more meaningful metric for Accuray as an indicator of future
20 revenue." Id. (Comp., Ex. 6 at 8). He also noted, "On a quarterly
21 basis, the company will review each contingent contract to
22 determine whether progress towards satisfaction of contingencies is
23 sufficient to support inclusion of the contract within the
24 backlog." Id. (Comp., Ex. 6 at 8). Accuray announced increased
25 revenues and backlogs throughout the rest of fiscal year 2007.

26 Plaintiffs allege that these statements were false when made
27 because the revised backlog definition was not a better metric than
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1 the previous backlog definition and that Defendants knew that they
2 would not realize 90% of the new backlog definition. Plaintiffs
3 specifically claim that the backlog included risky contingent
4 contracts that did not have a substantial likelihood of resulting
5 in future revenue and orders that had little chance of becoming
6 finalized CyberKnife installations. Plaintiffs also allege that
7 cancelled orders were not timely removed from the backlog figures.

8 On August 30, 2007, Directors Thomson, Wu, Yu, Weiss, Tu and
9 Adler authorized the repurchase of \$25 million of Accuray shares.
10 Over the course of the next year, Accuray repurchased \$23.9 million
11 of its own stock. Plaintiffs claim that these Defendants, as well
12 as Dávila and Wareham, who were later appointed to the Board,
13 consciously disregarded their fiduciary duties when they allowed
14 this stock to be repurchased. Plaintiffs allege that the stock was
15 trading at an artificially inflated price due to the false and
16 misleading statements made by Defendants.

17 On January 30, 2008, Accuray announced its second quarter 2008
18 earnings in a press release. Comp. ¶ 105. (Comp., Ex. 26). It
19 reported total revenue of \$54 million, which was a 98% increase
20 over second quarter 2007 earnings. Id. It also claimed that its
21 backlog had increased to approximately \$660 million. Id. (Comp.,
22 Ex. 26). However, Accuray adjusted its "revenue guidance for
23 fiscal 2008" from \$250-270 million to \$210-230 million. Id.
24 (Comp., Ex. 26). Accuray claimed that this adjustment was due to
25 "current economic conditions, specifically, the tightening of
26 credit markets in the United States." It stated, "While this was a
27 positive quarter with respect to revenue and backlog growth, we

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1 believe that broader credit market issues are having a short-term
2 impact on some of our U.S. customers' purchase and installation
3 timelines, as obtaining financing has become more difficult." Id.
4 (Comp., Ex. 26). In a conference call on the same day, Thomson
5 stated that Accuray removed "a number of contracts from backlog in
6 order to give our investors greater visibility into the potential
7 effect of this market adjustment." Id. ¶ 106. (Comp., Ex. 27 at
8 4-5). Thomson also stated that the group of customers who were
9 experiencing credit issues were the same group who might be
10 negatively impacted by a rule change in the way Medicare would
11 reimburse providers for procedures conducted with the CyberKnife.
12 The next day, Accuray's stock fell 36% percent.

13 On April 29, 2008, Accuray reported total revenue of \$58.5
14 million for the third quarter of fiscal year 2008, which was a 57%
15 increase over third quarter of fiscal year 2007. Accuray
16 experienced its fifth consecutive quarter of record revenue.
17 However, Accuray also reduced its backlog by \$58 million, from \$660
18 million to \$602 million. It claimed that this decrease was "a net
19 result of cancellations of existing contracts of \$54 million,
20 combined with unfavorable contract movement out of backlog based on
21 our specific assessment. All of these cancellations were
22 associated with contingent contracts" Id. ¶ 111. (Comp.,
23 Ex. 33 at 8). On April 29, 2008, Accuray's stock dropped from
24 \$8.06 per share to \$7.83 per share, but on May 1, 2008, it
25 increased to \$8.56 per share and by May 5, it was well above \$9.00
26 per share.

27 On August 19, 2008, Accuray issued its fourth quarter fiscal
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1 2008 press release, which stated its total revenue as \$50.9
2 million, a 16% increase over fourth quarter fiscal 2007. Accuray
3 also announced a backlog of \$647 million. It claimed that new
4 orders contributed \$68 million directly to its non-contingent
5 backlog. However, Accuray also removed \$39 million from backlog
6 because either eight CyberKnife orders were cancelled or their
7 future revenue recognition was in question. Id. ¶ 114. (Comp.
8 ¶ 120). On August 20, 2008, Accuray shares began trading at \$7.57
9 per share, at one point dropped to a low of \$6.90 per share, but
10 closed at \$7.70 per share.

11 On September 11, 2008, McNamara and Christopher Mitchell
12 resigned from Accuray. Mitchell was Accuray's General Counsel.

13 In November, 2009, the first of several derivative actions was
14 filed in this Court. In March, 2010, the cases were consolidated
15 and an amended complaint was filed in April, 2010. In the
16 controlling complaint, Plaintiffs assert twelve causes of action
17 for alleged breaches of fiduciary duties, waste, unjust enrichment,
18 insider selling and violations of Sections 10(b) and 20(a) of the
19 Securities Exchange Act of 1934.

20 DISCUSSION

21 I. Standing

22 Federal Rule of Civil Procedure 23.1(b)(1) requires a
23 derivative plaintiff to plead that he "was a shareholder . . . at
24 the time of the transaction complained of" Rule "23.1
25 requires that a derivative plaintiff be a shareholder at the time
26 of the alleged wrongful acts and that the plaintiff retain
27 ownership of the stock for the duration of the lawsuit." Lewis v.

1 Chiles, 719 F.2d 1044, 1047 (9th Cir. 1983). A derivative
2 plaintiff has no standing to challenge transactions that occurred
3 prior to the time that plaintiff owned company stock. In re
4 VeriSign, Inc., Deriv. Litig., 531 F. Supp. 2d 1173, 1202 (N.D.
5 Cal. 2007) ("plaintiffs must unambiguously indicate in any amended
6 complaint the dates they purchased Verisign stock, and whether they
7 have continuously owned VeriSign stock from the time of purchase up
8 to the present.").

9 Plaintiffs generally allege that they were shareholders of
10 "Accuray at the time of the continuing wrongs complained of
11 herein." Comp. ¶ 26-29. This vague allegation does not satisfy
12 the strict standard of Rule 23.1. Plaintiffs do not identify when
13 they purchased Accuray shares. Plaintiffs attempt to remedy their
14 complaint by attaching declarations to their opposition which state
15 the date each Plaintiff purchased Accuray stock. However, on a
16 motion to dismiss, the Court reviews the adequacy of Plaintiffs'
17 claims asserted in the complaint, not the claims they assert in
18 their brief. Schneider v. Cal. Dept. of Corrections, 151 F.3d
19 1194, 1197 n. 1 (9th Cir. 1998) ("In determining the propriety of a
20 Rule 12(b)(6) dismissal, a court may not look beyond the complaint
21 to a plaintiff's moving papers, such as a memorandum in opposition
22 to a defendant's motion to dismiss.") (emphasis in original).

23 Even if the Court were to consider these declarations, they
24 would not support the allegation that all Plaintiffs continuously
25 owned shares of Accuray throughout the entire period of Defendants'
26 alleged wrongdoing, February, 2007 to January, 2009. The
27 declarations show that Christopher Borrelli has owned shares since
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1 August 9, 2007; Thomas Beebe has owned shares since August 17,
2 2007; and Eric Bachinski has owned shares since January 31, 2008.²
3 Because Plaintiffs fail to satisfy this aspect of Rule 23.1, the
4 Court concludes that Plaintiffs do not have standing to pursue
5 shareholder derivative claims.

6 II. Demand Futility

7 Under the substantive law of Delaware,³ "the right of a
8 stockholder to prosecute a derivative suit is limited to situations
9 where the stockholder has demanded that the directors pursue the
10 corporate claim and they have wrongfully refused to do so or where
11 demand is excused because the directors are incapable of making an
12 impartial decision regarding such litigation." Rales v. Blasband,
13 634 A.2d 927, 932 (Del. 1993).

14 When challenging the propriety of decisions made by directors,
15 the shareholder must overcome the powerful presumption of the
16 business judgment rule. Id. at 933. The shareholder must show
17 that, "under the particularized facts alleged, a reasonable doubt
18 is created that: (1) the directors are disinterested and
19 independent [or] (2) the challenged transaction was otherwise the
20 product of a valid exercise of business judgment." Aronson v.
21 Lewis, 473 A.2d 805, 814 (Del. 1984). The only claims in
22 Plaintiffs' complaint that address an affirmative Board decision

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24 ²Sanjay Israni is arguably the only Plaintiff to declare that
25 he has owned shares throughout the entire period of Defendants'
alleged wrongdoing, as he states that he has owned shares since
February 7, 2007.

26 ³ The substantive law of Delaware applies because Accuray is
27 a Delaware corporation. In re Silicon Graphics, 183 F.3d 970, 990
(9th Cir. 1999).

1 relate to the authorization of a \$25 million share repurchase.

2 When a shareholder plaintiff challenges something other than a
3 board decision, "the business judgment rule has no application" and
4 the test for demand futility is simply whether the plaintiff has
5 plead particularized facts that "create a reasonable doubt that, as
6 of the time the complaint is filed, the board of directors could
7 have properly exercised its independent and disinterested business
8 judgment in responding to a demand." Rales, 634 A.2d at 933-34.
9 Under federal procedural law, the facts necessary to demonstrate
10 that demand would be futile must be plead with particularity. Fed.
11 R. Civ. P. 23.1; In re Silicon Graphics, 183 F.3d at 989.

12 Prior to filing this lawsuit, Plaintiffs did not present their
13 allegations to the Accuray Board of Directors and demand that
14 Accuray pursue this litigation on its own behalf. Instead,
15 Plaintiffs allege that it would have been futile to make such a
16 demand because a reasonable doubt has been raised as to individual
17 Defendants' disinterest and independence.

18 At the time the complaint was filed, Accuray's Board of
19 Directors consisted of seven individuals: Euan Thomson, Louis
20 Lavigne, Jr., Dennis Winger, Elizabeth Dávila, Wayne Wu, Li Yu and
21 Robert Weiss. All of the Board members were outside directors
22 except Thomson. Plaintiffs must plead particularized facts showing
23 that four directors (a majority) were not sufficiently
24 disinterested and independent to have considered a pre-suit demand.
25 Plaintiffs do not allege that demand is futile with respect to
26 Lavigne or Winger. However, Defendants do not argue that Thomson
27 is not disinterested and independent. In a footnote, they state,
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1 "Because all of the outside directors are clearly disinterested and
2 independent, this Motion does not address Dr. Thomson, the sole
3 inside director, in the demand analysis." Motion at 7 n.5.

4 Defendants move to dismiss the complaint on the basis that it
5 does not sufficiently allege that Plaintiffs either demanded that
6 Accuray proceed with these claims before filing suit on its behalf
7 or that such a demand would have been futile. As described below,
8 the Court concludes that Plaintiffs have not alleged particularized
9 facts showing that there is a reasonable doubt that a majority of
10 the board is disinterested or independent.

11 A. Disinterest

12 To plead a disqualifying interest, Plaintiffs must allege that
13 a director "will receive a personal financial benefit from a
14 transaction that is not equally shared by the stockholders," or
15 that "a corporate decision will have a materially detrimental
16 impact on a director, but not the corporation and the
17 stockholders." Id. at 936.

18 Plaintiffs first argue that the directors are "interested"
19 because they face a likelihood of personal liability for breaches
20 of fiduciary duty and violations of the securities laws based on
21 their misstatements regarding the backlog and they caused Accuray
22 to disseminate false and misleading information. For allegations
23 of personal liability to create an interest which would make a
24 demand futile, Plaintiffs must set forth facts establishing that
25 personal liability is not "a mere threat" but instead that the
26 director's actions were "so egregious that a substantial likelihood
27 of director liability exists." In re Silicon Graphics, Inc. Sec.

1 Litig., 183 F.3d 970, 990 (9th Cir. 1999) (quoting Aronson, 473
2 A.3d at 805); see Rales, 634 A.2d at 936. Plaintiffs must include
3 particularized factual allegations "detailing the precise roles
4 that these directors played at the company, the information that
5 would have come to their attention in these roles, and any
6 indication as to why they would have perceived the [wrongdoing]." Guttman v. Huang, 823 A.2d 492, 502 (Del. Ch. 2003).

8 Section 102(b)(7) of the Delaware General Corporation Law
9 authorizes Delaware corporations, by a provision in the certificate
10 of incorporation, to exculpate their directors from monetary damage
11 liability for a breach of the duty of care, but not "[f]or any
12 breach of the director's duty of loyalty" or "for acts or omissions
13 not in good faith" Del. Code Ann. tit. 8, § 102(b)(7).
14 The exculpatory clause limits directors' liability to actions that
15 are made in bad faith or constitute intentional misconduct.
16 Guttman, 823 A.2d at 501. Accuray's certificate of incorporation
17 contains such an exculpatory provision. Therefore, Plaintiffs must
18 a plead a non-exculpated claim based on particularized facts.
19 Guttman, 823 A.2d at 501.

20 Plaintiffs challenge the applicability of the exculpatory
21 clause. However, even if the exculpatory clause is not considered,
22 Plaintiffs' generalized allegations are insufficient to demonstrate
23 that Director Defendants face a substantial likelihood of personal
24 liability. Plaintiffs' substantive claims will be addressed in
25 more detail below. Before addressing the substantive claims,
26 however, the Court considers Plaintiffs' other allegations of
27 demand futility.

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1 fact that the backlog and revenues were discussed at board meetings
2 and touted in press releases and conference calls cannot imply that
3 any Accuray directors knew of the alleged accounting problems.
4 Moreover, there are no allegations that internal company metrics or
5 information discussed at the Board level contradicted any of
6 Defendants' statements.

7 2. Reliable Financial Controls

8 Plaintiffs allege that Defendants' failure to ensure reliable
9 systems of financial controls, along with their other allegations,
10 establish demand futility. Such a "failure to monitor" claim is
11 "possibly the most difficult theory in corporation law upon which a
12 plaintiff might hope to win a judgment." In re Caremark Int'l Inc.
13 Deriv. Litig., 698 A.2d 959, 967 (Del. Ch. 1996). Demand is not
14 excused where plaintiffs fail to plead facts showing either that
15 "the directors utterly failed to implement" any controls or "having
16 implemented such . . . controls, consciously failed to monitor or
17 oversee [their] operation" Stone v. Ruter, 911 A.2d 362,
18 370 (Del. 2006). Plaintiffs have not alleged any specific
19 information that each director knew and ignored concerning the
20 backlog. Moreover, Defendants did undertake efforts to improve
21 internal controls and Plaintiffs acknowledge this in their
22 complaint.

23 3. Audit Committee Membership

24 Plaintiffs allege that, as "members of the Audit Committee,"
25 Defendants Wu, Yu, Weiss and Dávila "were responsible for
26 overseeing and directly participating in" the allegedly false press
27 releases, conference calls and filings. Comp. ¶ 105. However,
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1 Plaintiffs have not alleged particularized facts to support this
2 allegation.

3 Pleading that the director defendants . . . "caused or
4 allowed" the Company to issue certain statements is not
5 sufficient particularized pleading to excuse demand under
6 Rule 23.1. It is unclear from such allegations how the
board was actually involved in creating or approving the
statements, factual details that are crucial to determining
whether demand . . . would have been excused as futile.

7 In re Citigroup Inc. Shareholder Deriv. Litig., 964 A.2d 106, 133
8 n.88 (Del. Ch. 2009). According to Accuray's Audit Committee
9 Charter, "the Committee's responsibilities are limited to
10 oversight" and it "is not the responsibility of the Committee . . .
11 to determine that the Company's financial statements and
12 disclosures are complete and accurate" Walters Decl.,
13 Ex. D, Appdx. A, § I. The Charter requires the Audit Committee to
14 "review[] and discuss[] information presented in the Company's
15 earnings press releases and other information provided to analysts
16 and rating agencies." Id. § IV.8. The Charter also notes that
17 such discussions "may be general in nature" and "need not take
18 place in advance of each earnings release or each instance in which
19 the Company provides earnings guidance." Id. However, it is
20 important to note that "liability is not measured by the
21 aspirational standards established by the internal documents
22 detailing a company's oversight system." In re Citigroup, 964 A.2d
23 at 135. Even putting aside the text of the Audit Committee's
24 Charter, Plaintiffs fail to allege any particularized facts
25 concerning the Audit Committee's role in the decision to change the
26 definition of backlog or that the Committee knew of inaccuracies in
27 the challenged statements. Guttman, 823 A.2d at 498 ("The

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1 complaint is entirely devoid of particularized allegations of fact
2 demonstrating that the outside directors had actual or constructive
3 notice of the accounting improprieties.").

4 4. Compensation Committee Membership

5 Plaintiffs allege that Defendants Wu, Yu and Weiss committed
6 "corporate waste" because they approved compensation plans for
7 Thomson and Hampton that based 14% and 6.5%, respectively, of
8 fiscal year 2008 compensation on backlog. Comp. ¶¶ 94, 152.
9 Plaintiffs argue that tying compensation to backlog was wasteful
10 because the committee knew that the "reported backlog numbers were
11 grossly inaccurate." Opp. at 19. Plaintiffs also argue that the
12 Compensation Committee improperly provided McNamara with a
13 severance package valued at \$934,464 knowing that he breached his
14 fiduciary duties to Accuray and its shareholders.

15 To establish waste, Plaintiffs must allege that "what the
16 corporation has received is so inadequate in value that no person
17 of ordinary, sound business judgment would deem it worth that which
18 the corporation has paid." Grobow v. Perot, 539 A.2d 180, 189
19 (Del. 1988). "[D]irectors have the power, authority and wide
20 discretion to make decisions on executive compensation." Brehm v.
21 Eisner, 746 A.2d 244, 262 n.56 (Del. 2000); See Del. Code Ann. tit
22 8, § 122(5).

23 Plaintiffs have not adequately alleged that the Compensation
24 Committee committed waste. Plaintiffs fail to show that relying on
25 the backlog component increased compensation or was wasteful in any
26 way. In fact, reliance on backlog actually decreased compensation
27 for Thomson and Hampton because once the Committee realized that
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1 Accuray was not going to meet a particular goal of backlog for
2 fiscal year 2008, it decreased these executives' compensation to
3 only 40% of the target payment.

4 As to the severance package, Plaintiffs ignore the fact that
5 the amount was dictated by McNamara's publicly filed employment
6 agreement. "A corporate board's decision to honor the
7 corporation's contractual obligations certainly is not a business
8 decision so egregious or irrational that it could not have been
9 based on a valid assessment of the corporation's best interest."

10 In re Am. Int'l. Group, Inc. Deriv. Litig., 2010 WL 1245000, at *18
11 (S.D.N.Y.).

12 5. Repurchase of Shares

13 Plaintiffs argue that the Board authorized the \$25 million
14 repurchase of Accuray shares at artificially inflated prices to
15 mask Accuray's declining revenues. They claim that, ultimately,
16 the repurchase of stock led to a waste of millions of dollars.
17 Plaintiffs argue that there is reasonable doubt that the decision
18 to repurchase shares "was otherwise the product of a valid exercise
19 of business judgment." Aronson, 473 A.2d at 814. The decision to
20 repurchase stock was made, in part, by Defendants Wu, Weiss and Yu.

21 Plaintiffs face "a substantial burden, as the second prong of
22 the Aronson test is directed to extreme cases in which despite the
23 appearance of independence and disinterest a decision is so extreme
24 or curious as to itself raise a legitimate ground to justify
25 further inquiry and judicial review." Highland Legacy Ltd. v.
26 Singeru, 2006 WL 741939, at *7 (Del. Ch.) (internal citation and
27 quotation marks omitted). Plaintiffs have not alleged

1 particularized facts to suggest that Defendants had any knowledge
2 that the stock price was artificially inflated at the time of the
3 repurchase authorization or that the repurchase was a waste of
4 Accuray's money. In the absence of such facts, the Court must
5 presume that the Board had a legitimate business purpose. In re
6 Silicon Graphics, 183 F.3d at 990 (holding that plaintiff "has not
7 stated facts that demonstrate that the Board intended for the stock
8 repurchase plan to inflate artificially the value of SGI stock in
9 order to facilitate insider trading. In the absence of such facts,
10 we must presume that the Board had a legitimate business purpose
11 when it repurchased SGI stock.").

12 B. Independence

13 To plead a lack of independence, Plaintiffs must "show that
14 the directors are beholden to the [other directors] or so under
15 their influence that their discretion would be sterilized." Rales,
16 634 A.2d at 936 (internal quotation marks omitted). Plaintiffs
17 allege that certain "long term relationships" rendered three of the
18 outside directors dependent. Plaintiffs claim that Yu and Wu are
19 dependent on each other because of their prior employment with
20 Preferred Bank and that Dávila is dependent on Adler due to their
21 affiliations with Stanford University. Both of these arguments
22 fail because Plaintiffs have not shown that these Director
23 Defendants were dominated or controlled by these relationships.
24 Grobow, 539 A.2d at 189. Yu and Wu's working relationship at
25 Preferred Bank is not problematic because allegations of "a mere
26 outside business relationship, standing alone, are insufficient to
27 raise a reasonable doubt about a director's independence." Beam v.

1 Stewart, 845 A.2d 1040, 1050 (Del. 2004). For the same reason, the
2 claim that Dávila lacked independence because she and Adler were
3 both affiliated with Stanford University also fails. Plaintiffs do
4 not even allege that Dávila and Adler knew each other at Stanford.
5 That they were both on the same campus at the same time is not
6 enough to overcome the presumption of a director's independence.
7 Lastly, Plaintiffs have not alleged that these relationships
8 constitute a disinterested Director's dependence on an interested
9 one.

10 In sum, when viewing the totality of Plaintiffs allegations,
11 they have not plead demand futility with sufficient particularity.
12 Therefore, the Court grants Defendants' motion to dismiss and
13 grants leave to amend. Because Plaintiffs may amend their
14 complaint, the Court addresses whether any of Plaintiffs'
15 substantive claims present valid legal theories.

16 III. Federal Law Claims

17 A. Violations of Section 10(b) of the Exchange Act (Counts
18 One and Two)

19 In Counts one and two of the complaint, Plaintiffs allege that
20 Defendants Thomson and McNamara violated Section 10(b) of the
21 Exchange Act.

22 Section 10(b) of the Exchange Act makes it unlawful for any
23 person to "use or employ, in connection with the purchase or sale
24 of any security . . . any manipulative or deceptive device or
25 contrivance in contravention of such rules and regulations as the
26 [SEC] may prescribe." 15 U.S.C. § 78j(b); see also 17 C.F.R.
27 § 240.10b-5 (Rule 10b-5). To state a claim under § 10(b), a
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1 plaintiff must allege: "(1) a misrepresentation or omission of
2 material fact, (2) scienter, (3) a connection with the purchase or
3 sale of a security, (4) transaction and loss causation, and
4 (5) economic loss." In re Gilead Sciences Securities Litig., 536
5 F.3d 1049, 1055 (9th Cir. 2008).

6 Defendants argue that Plaintiffs have not adequately plead
7 scienter. Some forms of recklessness are sufficient to satisfy the
8 element of scienter in a § 10(b) action. See Nelson v. Serwold,
9 576 F.2d 1332, 1337 (9th Cir. 1978). Within the context of § 10(b)
10 claims, the Ninth Circuit defines "recklessness" as

11 a highly unreasonable omission [or misrepresentation],
12 involving not merely simple, or even inexcusable
13 negligence, but an extreme departure from the standards
14 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.

15 Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1569 (9th Cir.
16 1990) (en banc) (quoting Sundstrand Corp. v. Sun Chem. Corp., 553
17 F.2d 1033, 1045 (7th Cir. 1977)). As explained by the Ninth
18 Circuit in Silicon Graphics, recklessness, as defined by Hollinger,
19 is a form of intentional conduct, not merely an extreme form of
20 negligence. See Silicon Graphics, 183 F.3d at 976-77. Thus,
21 although § 10(b) claims can be based on reckless conduct, the
22 recklessness must "reflect[] some degree of intentional or
23 conscious misconduct." See id. at 977. The Silicon Graphics court
24 refers to this subspecies of recklessness as "deliberate
25 recklessness." See id. at 977.

26 Pursuant to the requirements of the PSLRA, a complaint must
27 "state with particularity facts giving rise to a strong inference
28

1 that the defendant acted with the required state of mind." 15
2 U.S.C. § 78u-4(b)(2). The PSLRA thus requires that a plaintiff
3 plead with particularity "facts giving rise to a strong inference
4 that the defendant acted with," at a minimum, deliberate
5 recklessness. See 15 U.S.C. § 78u-4(b)(2); Silicon Graphics, 183
6 F.3d at 977. Facts that establish a motive and opportunity, or
7 circumstantial evidence of "simple recklessness," are not
8 sufficient to create a strong inference of deliberate recklessness.
9 See Silicon Graphics, 183 F.3d at 979. To satisfy the heightened
10 pleading requirement of the PSLRA for scienter, plaintiffs "must
11 state specific facts indicating no less than a degree of
12 recklessness that strongly suggests actual intent." Id.

13 When evaluating the strength of an inference, "the court's job
14 is not to scrutinize each allegation in isolation but to assess all
15 the allegations holistically." Tellabs, Inc. v. Makor Issues &
16 Rights, Ltd., 551 U.S. 308, 325 (2007). "The inference of scienter
17 must be more than merely 'reasonable' or 'permissible' -- it must
18 be cogent and compelling, thus strong in light of other
19 explanations." Id. at 324. A complaint will survive "only if a
20 reasonable person would deem the inference of scienter cogent and
21 at least as compelling as any opposing inference one could draw
22 from the facts alleged." Id. However, "the inference that the
23 defendant acted with scienter need not be irrefutable, i.e., of the
24 'smoking-gun' genre, or even the 'most plausible of competing
25 inferences.'" Id.

26 Plaintiffs have not plead particularized facts that either
27 Thomson or McNamara was aware of, or actively concealed, allegedly
28

1 inflated sales or backlog figures. Plaintiffs rely on the
2 speculation of four confidential witnesses: a Regional Sales
3 Director from 2004 to 2007; a Regional Sales Director from 2005 to
4 2007; a Sales Operations Specialist from 2006 to 2009; and a
5 database analyst during 2008. However, the allegations based on
6 the knowledge and opinions of these CWs do not add anything
7 meaningful to the complaint because they do not purport to have had
8 any contact with Thomson or McNamara; therefore, they have no
9 knowledge of what either Defendant knew at the time each of the
10 challenged statements was made. Although the CWs challenge the
11 accuracy of certain comments made by Thomson and McNamara, the CWs'
12 opinion as to the accuracy of these comments are not a substitute
13 for evidence of Defendants' scienter.

14 Plaintiffs also claim that McNamara's resignation is evidence
15 of scienter. However, there is nothing suspicious about the timing
16 of his resignation, even though it occurred weeks after Accuray's
17 August, 2008 backlog revision. See Zucco Partners, LLC v. Digimarc
18 Corp., 552 F.3d 981, 1002 (9th Cir. 2009) ("Where a resignation
19 occurs slightly before or after the defendant corporation issues a
20 restatement, a plaintiff must plead facts refuting the reasonable
21 assumption that the resignation occurred as a result of
22 restatement's issuance itself.").

23 Plaintiffs contend that, because Thomson and McNamara
24 "repeatedly touted the Company's record backlog and promoted market
25 reliance on the Revised Backlog Definition as a window into
26 revenues," there is a strong inference that they knew or were
27 deliberately reckless in not knowing that they acted illegally by
28

1 not accurately reporting the backlog to the public and the SEC. In
2 essence, Plaintiffs argue that understanding how the backlog was
3 configured was critical to Accuray's "core operations." South
4 Ferry LP v. Killinger, 542 F.3d 776, 785 (9th Cir. 2008) ("Where a
5 complaint relies on allegations that management had an important
6 role in the company but does not contain additional detailed
7 allegations about the defendants' actual exposure to information,
8 it will usually fall short of the PSLRA standard. . . However, in
9 some unusual circumstances, the core operations inference, without
10 more, may raise the strong inference required by the PSLRA").
11 Here, while Defendants no doubt knew how important the backlog was
12 to investors, not enough facts have been alleged to support a
13 strong inference that, simply because of the importance of the
14 backlog and Defendants' position in the company, they knew, or were
15 deliberately reckless in not knowing, that accounting errors were
16 made.

17 Plaintiffs also allege that Thomson's bonus compensation and
18 stock sale provided a motive to inflate backlog. However, the fact
19 that Thomson's bonus compensation was tied to the backlog does not
20 necessarily raise a strong inference of scienter, especially
21 because the amount that was tied to the backlog accounted for only
22 20% of a potential bonus.

23 As to Thomson's lone stock sale, he sold only 10.5% of his
24 stock and he did so during the IPO. Insider stock sales become
25 suspicious "only when the level of trading is dramatically out of
26 line with prior trading practices at times calculated to maximize
27 the personal benefit from undisclosed inside information." In re

1 Vantive Corporation Securities Litig., 283 F.3d 1079, 1092 (9th
2 Cir. 2002). "Among the relevant factors to consider are: (1) the
3 amount and percentage of shares sold by insiders; (2) the timing of
4 the sales; and (3) whether the sales were consistent with the
5 insider's prior trading history." Silicon Graphics, 183 F.3d at
6 986. Thomson's relatively small sale during a time when
7 shareholders traditionally trade stock is not suspicious behavior.

8 In sum, the Court concludes that Plaintiffs' allegations do
9 not support a strong inference of scienter. Therefore, Plaintiffs'
10 Section 10(b) claims against Thomson and McNamara are dismissed.

11 B. Section 20(a) (Counts Three and Four)

12 Counts three and four of the complaint allege control person
13 liability against Defendants Wu, Yu, Weiss, Dávila and Wareham
14 based on Section 20(a) of the Exchange Act, which states,

15 Every person who, directly or indirectly, controls any
16 person liable under any provision of this chapter or of any
17 rule or regulation thereunder shall also be liable jointly
18 and severally with and to the same extent as such controlled
19 person to any person to whom such controlled person is
20 liable, unless the controlling person acted in good faith
21 and did not directly or indirectly induce the act or acts
22 constituting the violation or cause of action.

23 17 U.S.C. § 78t(a).

24 To prove a prima facie case under Section 20(a), a plaintiff
25 must prove: (1) "a primary violation of federal securities law" and
26 (2) "that the defendant exercised actual power or control over the
27 primary violator." Howard v. Everex Sys., Inc., 228 F.3d 1057,
28 1065 (9th Cir. 2000). "[I]n order to make out a prima facie case,
it is not necessary to show actual participation or the exercise of
power; however, a defendant is entitled to a good faith defense if

1 he can show no scienter and an effective lack of participation."
2 Id. "Whether [the defendant] is a controlling person is an
3 intensely factual question, involving scrutiny of the defendant's
4 participation in the day-to-day affairs of the corporation and the
5 defendant's power to control corporate actions." Id.

6 Plaintiffs allege that, by virtue of Defendants' high-level
7 positions in Accuray, they influenced and controlled the content
8 and dissemination of the myriad statements that Plaintiffs contend
9 were false and misleading. Because Plaintiffs failed to plead a
10 primary securities violation, Plaintiffs have also failed to plead
11 a violation of Section 20(a). Moreover, Plaintiffs failed to plead
12 that these Defendants' "participation in the day-to-day affairs" of
13 Accuray was such that they "exercised actual power or control over"
14 other individuals who were involved in the issuance of any
15 accounting decisions or financial statements.

16 IV. State Law Claims

17 Seven out of Plaintiffs' eight state law claims sound in fraud
18 and thus are subject to the heightened pleading requirements of
19 Federal Rule of Civil Procedure 9(b). The only claim not subject
20 to Rule 9(b) is Plaintiffs' unjust enrichment claim. The
21 allegations for the other seven state causes of action must be
22 "specific enough to give defendants notice of the particular
23 misconduct which is alleged to constitute the fraud charged so that
24 they can defend against the charge and not just deny that they have
25 done anything wrong." Semegen v. Weidner, 780 F.2d 727, 731 (9th
26 Cir. 1985). Statements of the time, place and nature of the
27 alleged fraudulent activities are sufficient, id. at 735, provided

28

1 the plaintiff sets forth "what is false or misleading about a
2 statement, and why it is false." In re GlenFed, Inc., Secs.
3 Litig., 42 F.3d 1541, 1548 (9th Cir. 1994). Scierter may be
4 averred generally, simply by saying that it existed. Id. at 1547;
5 see Fed. R. Civ. P. 9(b) ("Malice, intent, knowledge, and other
6 condition of mind of a person may be averred generally.").
7 Allegations of fraud based on information and belief usually do not
8 satisfy the particularity requirements of Rule 9(b); however, as to
9 matters peculiarly within the opposing party's knowledge,
10 allegations based on information and belief may satisfy Rule 9(b)
11 if they also state the facts upon which the belief is founded.
12 Wool v. Tandem Computers, Inc., 818 F.2d 1433, 1439 (9th Cir.
13 1987).

14 A. Breach of Fiduciary Duty Regarding Dissemination of
15 Alleged False and Misleading Statements (Counts Six and
16 Seven)

16 Fiduciaries owe Accuray and its shareholders the duties of due
17 care, loyalty and good faith. Emerald Partners v. Berlin, 787 A.2d
18 85, 90 (Del. 2001). Plaintiffs claim that the Audit Committee
19 Defendants -- Tu, Wu and Weiss -- breached their fiduciary duties
20 by disseminating false and misleading financial statements in
21 Accuray's Registration Statement and Forms 10-K filed with the SEC.
22 However, Plaintiffs do not allege that any member of the Audit
23 Committee prepared these financial statements or that they were
24 directly responsible for the misstatements. Further, even if these
25 Defendants were involved in preparing the statements, Plaintiffs
26 have not alleged that they were made with knowledge of alleged
27 inaccuracies or in bad faith.

1 Plaintiffs' breach of fiduciary duty claims against Defendants
2 Thomson and McNamara are predicated on the same alleged
3 misrepresentations as the Section 10(b) claims and therefore they
4 suffer from the same lack of specificity. Although Plaintiffs need
5 only prove gross negligence to establish a breach of fiduciary
6 claim in this context, the standard for gross negligence is
7 "stringent" and not readily satisfied. In re Lear Corp. S'holder
8 Litig., 967 A.2d 640, 652 (Del. Ch. 2008). Gross negligence is "a
9 reckless indifference to or a deliberate disregard of the whole
10 body of stockholders' or actions which are without the bounds of
11 reason." In re Walt Disney Co. Deriv. Litig., 907 A.2d 693, 750
12 (Del. Ch. 2005) (internal citations and quotation marks omitted).
13 Plaintiffs have not alleged that Thomson and McNamara deliberately
14 disregarded or were recklessly indifferent to alleged inaccuracies
15 in their statements about the backlog at the time they made those
16 statements.

17 Therefore, the Court grants Defendants' motion to dismiss
18 these misrepresentation claims.

19 B. Repurchase Claims (Counts Five and Eight)

20 Plaintiffs allege that "Director Defendants" breached their
21 fiduciary duties by "authorizing Accuray's stock repurchase plan
22 and failing to halt the Company's purchase under the stock
23 repurchase plan while Accuray's share price was artificially
24 inflated" Comp. ¶ 205. Plaintiffs have not shown that
25 "the directors acted in bad faith when they approved the stock
26 repurchases." In re Citigroup, Inc. S'holder Deriv. Litig., 2009
27 WL 2610746, at *9 (S.D.N.Y.). Here, at most, Plaintiffs'

1 allegations show that the stock repurchases were "bad business
2 decisions in light of the subsequent decline in the price" of
3 Accuray's stock. Id. Thus, Plaintiffs' claim against the Director
4 Defendants fails.

5 Plaintiffs similarly allege that Thomson and McNamara breached
6 their fiduciary duty because they "caused" Accuray to purchase its
7 own stock while the share price was artificially inflated.
8 However, as noted above, Plaintiffs have not alleged that Thomson,
9 as a Board member, made the decision to authorize the share
10 repurchase in bad faith. The claim against McNamara is equally
11 unavailing because he was not a member of the Board and there are
12 no allegations to suggest that he was involved in the decisions to
13 repurchase shares. Therefore, Plaintiffs' claim against Thomson
14 and McNamara also fail.

15 C. Waste Claim (Count Nine)

16 Plaintiffs allege that Defendants wasted corporate assets in
17 several ways: (1) directing Accuray to purchase over \$23.9 million
18 of its own stock at artificially inflated prices; (2) paying
19 bonuses and compensation to certain of its executive officers;
20 (3) paying McNamara a lucrative severance package; and
21 (4) incurring potentially hundreds of millions of dollars of legal
22 liability and legal costs.

23 All but the last allegation were addressed in the above demand
24 futility analysis. To summarize from that analysis, Plaintiffs
25 fail (1) to rebut the presumption that the repurchases were a valid
26 exercise of business judgment; (2) to allege that the bonuses and
27 compensation packages were devoid of a legitimate corporate

1 purpose; and (3) to allege that McNamara's severance package was an
2 unconscionable waste of corporate assets. Plaintiffs' legal
3 liability and costs allegation is too vague and speculative to
4 satisfy the requirements of a waste claim. Plaintiffs have not
5 satisfied the rigorous test for waste.

6 D. Unjust Enrichment (Count Ten)

7 To state a claim for unjust enrichment, Plaintiffs must allege
8 (1) an enrichment, (2) an impoverishment, (3) a relation between
9 the enrichment and the impoverishment, (4) the absence of
10 justification and (5) the absence of a remedy provided by law. See
11 Jackson Nat'l Life Ins. Co. v. Kennedy, 741 A.2d 377, 393 (Del. Ch.
12 1999). Plaintiffs alleged that Defendants "were unjustly enriched
13 as a result of the compensation and director remuneration they
14 received while breaching fiduciary duties owed to Accuray." Comp.
15 ¶ 215. However, Plaintiffs fail to allege how each Defendant was
16 unjustly enriched at the expense of Accuray. See Flee Corp. v.
17 Topps Chewing Gum, Inc., 539 A.2d 1060, 1062 (Del. 1988) ("Before
18 the court may properly order restitution, it must find that the
19 defendant was unjustly enriched at the expense of the plaintiff.").
20 Therefore, the Court grants, with leave to amend, Defendants'
21 motion to dismiss the unjust enrichment claim.

22 E. Insider Trading (Counts Eleven and Twelve)

23 Plaintiffs allege that Defendants violated California and
24 Delaware law proscribing insider trading. To state a claim under
25 Delaware law, Plaintiffs must allege that Defendants possessed
26 material, non-public information and used that information
27 improperly by making stock trades while motivated by the substance
28

1 of such information. In re Oracle Derivative Litig., 867 A.2d 904,
2 934 (Del. Ch. 2004). Similarly, California Corporations Code
3 Section 25402 makes it unlawful for officers or directors to sell
4 shares with knowledge of material non-public information.
5 Plaintiffs allege that the timing and amounts of Defendants' trades
6 give rise to an inference of insider trading. However, the fact
7 that officers and directors sold shares during the IPO is far from
8 unusual or suspicious. Further, the amounts sold were not
9 outrageously high enough to raise any suspicions. Moreover,
10 Plaintiffs have not plead what inside information each Defendant
11 possessed, how and when that information was acquired and how that
12 information was used in trading Accuray stock. For all of these
13 reasons, Plaintiffs' insider trading claims fail.⁴

14 CONCLUSION

15 For the foregoing reasons, the Court GRANTS Defendants' motion
16 to dismiss. Docket No. 35. The complaint is dismissed with leave
17 to amend, although the Court is doubtful that Plaintiffs will be
18 able to plead sufficient particularized facts to establish demand

19
20 ⁴Defendants argue that Plaintiffs' claim under California
21 Corporations Code section 25402 is barred by the two-year statute
22 of limitations. The operative complaint in this case was filed on
23 April 8, 2010. Defendants argue that Plaintiffs discovered facts
24 constituting the alleged violation on January 30, 2008, when
25 Accuray issued a press release which announced a reduction in their
26 revenue projection from \$250-270 million to \$210-230 million.
27 Comp. ¶ 105. In the complaint, Plaintiffs discuss this press
28 release under the heading, "The Truth Comes to Light: The Write-
Downs Begin." Plaintiffs argue that they did not learn of the
violation until January 29, 2009, when Accuray's new CFO admitted
the "imprecision" of the revised backlog definition. Comp. ¶ 118.
Plaintiffs' allegations suffice to bring their § 25402 claim within
the statute of limitations. Accordingly, the Court denies
Defendants' motion to dismiss Plaintiffs' claim on statute of
limitations grounds.

1 futility in any amended complaint. Any amended complaint shall be
2 filed no later than September 20, 2010. Defendants shall respond
3 by October 7, 2010. If Defendants file a motion to dismiss,
4 Plaintiffs shall file an opposition by October 21, 2010 and
5 Defendants shall file a reply by October 28, 2010. The motion will
6 be heard on November 11, 2010 at 2:00 p.m. If Defendants answer
7 the amended complaint and no motion to dismiss is filed, a case
8 management conference will be held on October 19, 2010 at 2:00 p.m.

9
10 IT IS SO ORDERED.

11
12 Dated: 08/31/10

Claudia Wilken

CLAUDIA WILKEN
United States District Judge