UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No.	CV 14-1153-GW(JEMx)	Date	March 12, 2015
Title	*Motorcar Parts of America, Inc. v. FAPL Holdings, Inc., et al.*		

Present: The Honorable	GEORGE H. WU, UNITED STATES DISTRICT JUDGE	
Javier Gonzalez	Katie Thibodeaux	
Deputy Clerk	Court Reporter / Recorder	Tape No.

Attorneys Present for Plaintiffs:	Attorneys Present for Defendants:
Franz Phillip Hosp Michael F. Perlis Wrenn E. Chais	Seth A. Aronson Michelle C. Leu

PROCEEDINGS: **DEFENDANTS' MOTION TO DISMISS PLAINTIFF MOTORCAR PARTS OF AMERICA, INC.'S FOURTH AND FIFTH CAUSES OF ACTION FOR VIOLATIONS OF SECTIONS 10(b) AND 20(a) OF THE SECURITIES EXCHANGE ACT OF 1934 [15]**

The Court's Tentative Ruling is circulated and attached hereto. Court hears oral argument. Parties will have until March 19, 2015 to file additional citations in support of their side. Responses, if any will be filed by March 26, 2015. Briefs will not exceed five pages. Defendants' motion is continued to April 2, 2015 at 8:30 a.m.

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Initials of Preparer JG

Motorcar Parts of Am., Inc. v. FAPL Holdings Inc., et al., Case No. CV 14-01153
Tentative Ruling on Motion to Dismiss Fourth and Fifth Causes of Action for Violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934

I. Background

Motorcar Parts of America, Inc. ("Plaintiff") sued FAPL Holdings Inc. ("FAPL") and four individuals – Jack Shuster, Gordon Fenwick, Paul Fenwick and Joel Fenwick (collectively with FAPL, "Defendants") – acting as FAPL's principals, based on the sale of capital stock of Fenwick Automotive Products Ltd., its affiliate Introcan, Inc., and their subsidiaries (collectively, "Fenco") to Plaintiff. *See* Complaint ¶¶ 1, 5-9. All four individuals were also officers and/or directors of Fenwick Auto. *See id.* ¶¶ 6, 8-9.

Plaintiff's claims are for breach of contract, negligent misrepresentation, common law fraud, and violations of Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j, and Section 10b-5 of the Exchange Act Rule, 17 C.F.R. § 240.10b-5. As to the individual defendants, Plaintiff also brings a claim for violation of Section 20(a) of the Securities Exchange Act, 15 U.S.C. § 78t.

Defendants move to dismiss the federal securities claims under Federal Rules of Civil Procedure 12(b)(6) and 9(b).

II. Analysis

A. Applicable Standard

Under Rule 12(b)(6), a court must (1) construe the complaint in the light most favorable to the plaintiff, and (2) accept all well-pleaded factual allegations as true, as well as all reasonable inferences to be drawn from them. *See Sprewell v. Golden State Warriors*, 266 F.3d 979, 988 (9th Cir.), *amended on denial of reh'g*, 275 F.3d 1187 (9th Cir. 2001); *Pareto v. F.D.I.C.*, 139 F.3d 696, 699 (9th Cir. 1998). In its consideration of the motion, the court is limited to the allegations on the face of the complaint (including documents attached thereto), matters which are properly judicially noticeable and "documents whose contents are alleged in a complaint and whose authenticity no party questions, but which are not physically attached to the pleading." *Branch v. Tunnell*, 14 F.3d 449, 453-54 (9th Cir. 1994), *overruling on other grounds recognized in Galbraith v. County of Santa Clara*, 307 F.3d 1119 (9th Cir. 2002); *Lee v. City of Los Angeles*, 250

F.3d 668, 688-89 (9th Cir. 2001). Dismissal pursuant to Rule 12(b)(6) is proper only where there is either a "lack of a cognizable legal theory or the absence of sufficient facts alleged under a cognizable legal theory." *Balistreri v. Pacifica Police Dep't*, 901 F.2d 696, 699 (9th Cir. 1990); *Johnson v. Riverside Healthcare Sys., LP*, 534 F.3d 1116, 1121-22 (9th Cir. 2008); *see also Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 561-63 (2007) (dismissal for failure to state a claim does not require the appearance, beyond a doubt, that the plaintiff can prove "no set of facts" in support of its claim that would entitle it to relief).

B. Application of the Supreme Court's *Morrison* Decision

Defendants argue that, under the Supreme Court's 2010 decision in *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010), Plaintiff may not advance the federal securities claims it has here. Defendants – in part, based on an understandable misconception of what Plaintiff would actually argue in order to avoid *Morrison* – assert that U.S. securities laws apply only if the transaction in question occurred on a domestic exchange or if title to the security was transferred in the United States or irrevocable liability was incurred here. *See, e.g.*, *United States v. Georgiou*, 777 F.3d 125, 135-37 (3d Cir. 2015); *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 69 (2d Cir. 2012). Plaintiff does not attempt to argue that either of those scenarios is in play here.[1] Instead, it hews more closely to the language actually used in *Morrison*, emphasizing that its *own* stock is *listed* on NASDAQ. Thus, Plaintiff does not attempt to argue that the stock of FAPL – one of the securities fraud *defendants* – or of Fenco enables Plaintiff's federal securities fraud claims here, but that *its* stock – the securities fraud *plaintiff's* – does. In particular, Plaintiff emphasizes that it paid for Fenco with 360,000 shares of its own common stock. *See* Complaint ¶¶ 2, 29, 78.

In *Morrison*, the Supreme Court considered "whether § 10(b) of the Securities Exchange Act of 1934 provides a cause of action to foreign plaintiffs suing foreign and American defendants for misconduct in connection with securities traded on foreign

[1] This is a Rule 12(b)(6) motion and it is true that Plaintiff alleged in its Complaint that title to Plaintiff's stock was transferred within the United States, *see* Complaint ¶¶ 11, 85, an assertion that the Court would normally credit on a Rule 12(b)(6) motion. However, Defendants have relied here on exhibits attached to Plaintiff's Complaint to contest that allegation and to demonstrate that the transfer actually occurred in Canada. Plaintiff does not attempt to refute Defendants' ability to rely upon these materials or the factual conclusion Defendants draw from them.

exchanges." *Id.* at 250.[2] In that case, the common stock of an Australian bank, listed only on non-U.S. exchanges, was the only stock at issue in the case (though the bank also had American Depositary Receipts – representing "the right to receive a specified number of [the bank's common stock]" – which were listed on the New York Stock Exchange). *See id.* at 251-52. Consequently, it is relatively clear that the facts of *Morrison* are somewhat distinct from the allegations present here, where the transaction was for the non-exchange-listed stock of a privately-held Canadian company, involving, as consideration, common stock of an exchange-listed American company.[3]

In addressing an argument that the transaction in *Morrison* was domestic because certain of the deceptive conduct occurred in the United States, the Supreme Court explained its position as follows:

> [W]e think that the focus of the Exchange Act is not upon the place where the deception originated, but upon purchases and sales of securities in the United States. Section 10(b) does not punish deceptive conduct, but only deceptive conduct "in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered." Those purchase-and-sale transactions are the objects of the statute's solicitude. It is those transactions that the statute seeks to "regulate"; it is parties or prospective parties to those transactions that the statute seeks to "protect[t]." And it is in our view only transactions in securities listed on domestic exchanges, and domestic transactions in other securities, to which § 10(b) applies.

Id. at 266-67 (omitting internal citations) (quoting 15 U.S.C. § 78j(b) and *Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 10, 12 (1971)); *see also id.* at 269-70 (describing "[t]he transactional test we have adopted" as "whether the purchase or sale is made in the United States, or involves a security listed on a domestic exchange"); *id.* at 273 ("Section 10(b) reaches the use of a manipulative or deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States."). Under

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[2] The plaintiffs in *Morrison* also sued under Section 20(a) of the Exchange Act and SEC Rule 10b-5. *See Morrison*, 561 U.S. at 252-53; *see also id.* at 262 ("[I]f § 10(b) is not extraterritorial, neither is Rule 10b-5.").

[3] As Plaintiff notes, *Morrison* considered a "foreign cubed action…in which (1) foreign plaintiffs [were] suing (2) a foreign issuer in an American court for violations of American securities laws based on securities transactions in (3) foreign countries." *United States v. Georgiou*, 777 F.3d 125, 135 (3d Cir. 2015) (quoting *Morrison*, 561 U.S. at 283 n.11 (Stevens, J., concurring in the judgment)).

the plain language of *Morrison*, it would appear that the involvement of Plaintiff's stock in the purchase of Fenco would implicate U.S. securities laws, at least if the transaction could be characterized as the "purchase or sale" of Plaintiff's stock.

Ordinarily, and writing on a blank slate, the Court would likely find it a stretch to consider what happened here to be the purchase or sale of *Plaintiff's* stock. Among other reasons for this tentative, uninformed-by-case-law, approach, as Defendants note, under the parties' Purchase Agreement – the very agreement that led to all of Plaintiff's claims – FAPL is defined as the "Vendor," Plaintiff is the "Purchaser," and the "Purchase and Sale" is the Vendor agreeing "to sell, assign and transfer to the Purchaser" and the Purchaser agreeing "to purchase from the Vendor" the *Fenco* shares. *See* Complaint, Exh. A, at 1. As Defendants further note, if U.S. securities laws were to apply here, American companies could force application of such laws in connection with any transaction anywhere in the world simply by having any part of the consideration consist of their domestic exchange-listed stock.

The problem with the latter of these two observations is that the Supreme Court would likely consider it to be a matter better left to Congress (especially considering that *Morrison* itself was a rumination on Congressional silence concerning the extraterritoriality of the nation's securities laws). The problem with the former is that case law instructs that courts are to look to the substance of transactions, not their form, in determining whether a purchase or sale has occurred, as addressed further below. As to that issue, Plaintiff has directed the Court to pre-*Morrison* Supreme Court and Ninth Circuit authority supporting the proposition that the purchase-and-sale requirement is satisfied where a transaction involves an exchange of securities during a merger or consolidation of corporations. *See SEC v. Nat'l Secs., Inc.*, 393 U.S. 453 (1969); *In re Am. Cont'l Corp./Lincoln Sav. & Loan Secs. Litig.*, 49 F.3d 541, 543 (9th Cir. 1995).[4]

In *National Securities*, the Supreme Court determined that a "purchase or sale" of a security was involved because one company's shareholders "were misled in various material respects prior to their approval of a merger…which resulted in their losing their status as shareholders in [the original insurance company] and becoming shareholders in a new company." *Nat'l Secs.*, 393 U.S. at 467. Concluding that the "alleged deception

[4] In their Reply, Defendants do not address these cases.

ha[d] affected individual shareholders' decisions in a way not at all unlike that involved in a typical cash sale or share exchange," the Supreme Court determined that "[t]he broad antifraud purposes of [Section 10(b) and Rule 10b-5] would clearly be furthered by their application to this type of situation." *Id.*

In *American Continental*, the Ninth Circuit concluded that "a corporation's transfer of stock to a trust in partial satisfaction of the corporation's obligation to fund the trust constitutes a 'purchase' and a 'sale' under the securities laws." *Am. Cont'l*, 49 F.3d at 542. In reaching that conclusion, the Ninth Circuit observed that "[c]ourts have generally recognized that this 'purchase and sale' requirement should be read flexibly in order to effect the securities laws' remedial purposes." *Id.* at 543. Moreover, it summed up the jurisprudence in this area by noting that "courts have generally looked to the substance of the transaction rather than to its form in determining whether a purchase and sale has occurred," and (though it did not involve a merger itself) further observed that "the purchase and sale requirement has been held satisfied in a transaction involving an exchange of securities during a merger or consolidation of corporations." *Id.* (citing *Nat'l Secs.*). Finally, the *American Continental* court commented that "[t]he transfer of securities in exchange for a contractual obligation would seem to fit the prototypical definitions of purchase and sale." *Id.* at 544.

Notwithstanding the language of the test set forth in *Morrison* and the assessments of the "purchase or sale" requirement made in *National Securities* and *American Continental*, Defendants argue that the very stock that was the subject of the transaction must have been transferred *on or by way of* a domestic exchange – it is not sufficient if stock of the same type is merely listed on such an exchange. Because the transaction in Plaintiff's stock here did not occur by way of an exchange, they feel that this situation is distinct.

In truth, the *Morrison* decision is not without *some* support for Defendant's emphasis on exchange-based transactions. In further explaining "[t]he primacy of the domestic exchange" under the nation's securities laws (and why the mere fact of alleged U.S.-based fraudulent conduct was insufficient to invoke them), the Supreme Court quoted from "the very prologue of the Exchange Act, which sets forth as its object '[t]o provide for the regulation of securities *exchanges*...operating in interstate and foreign

commerce and through the mails, to prevent inequitable and unfair practices *on such exchanges*....'" *Morrison*, 561 U.S. at 267 (quoting 48 Stat. 881) (emphasis added).

The Court might also perceive some wiggle room in this area as a result of several recent Second Circuit decisions. Last year, in *Parkcentral Global Hub Ltd. v. Porsche Auto. Holdings SE*, 763 F.3d 198 (2d Cir. 2014), the Second Circuit concluded "[o]n careful consideration of *Morrison*'s words and arguments," that while *Morrison* "unmistakably made a domestic securities transaction (or transaction in a domestically listed security) *necessary* to a properly domestic invocation of § 10(b), such a transaction is not alone *sufficient* to state a properly domestic claim under the statute."[5] *Id.* at 215 (emphasis added); *see also id.* ("[A] rule making the statute applicable whenever the plaintiff's suit is predicated on a domestic transaction, regardless of the foreignness of the facts constituting the defendant's alleged violation, would seriously undermine *Morrison*'s insistence that § 10(b) has no extraterritorial application."). One day prior, the Second Circuit also concluded, in case based upon anti-retaliation provision of Dodd-Frank Wall Street Reform and Consumer Protection Act, that "*Morrison*...decisively refutes [the plaintiff's] contention that the United States securities laws apply extraterritorially to the actions abroad of any company that has issued United States-listed securities" because in *Morrison* itself the Australian bank had listed ADRs on the New York Stock Exchange. *Meng-Lin v. Siemens AG*, 763 F.3d 175, 180 (2d Cir. 2014); *see also id.* ("Far from helping Liu, *Morrison* establishes that where a plaintiff can point only to the fact that a defendant has listed securities on a U.S. exchange, and the complaint alleges no further meaningful relationship between the harm and those domestically listed securities, the listing of securities alone is the sort of 'fleeting' connection that 'cannot overcome the presumption against extraterritoriality.'") (quoting *Morrison*, 561 U.S. at 263). In addition, earlier in 2014 the Second Circuit rejected an argument that U.S.

[5] Justice Scalia's criticism in *Morrison* of Second Circuit precedent on extraterritorial application of U.S. securities laws might be said to have been lost on that same Circuit considering the resulting – and self-predicted – uncertainty from the decision in *Parkcentral*. *See Parkcentral*, 763 F.3d at 217 ("We do not purport to proffer a test that will reliably determine when a particular invocation of § 10(b) will be deemed appropriately domestic or impermissibly extraterritorial. We believe courts must carefully make their way with careful attention to the facts of each case and to combinations of facts that have proved determinative in prior cases, so as eventually to develop a reasonable and consistent governing body of law on this elusive question."); *see also Morrison*, 561 U.S. at 255-61.

securities laws apply to transactions of foreign-issued shares on a foreign exchange merely because those shares were cross-listed on the New York Stock Exchange, explaining that *Morrison*'s "securities listed on domestic exchanges" language, while "taken in isolation, supports plaintiffs' view, the 'listing theory' is irreconcilable with *Morrison* read as a whole." *City of Pontiac Policemen's & Firemen's Retirement Sys. v. UBS AG*, 752 F.3d 173, 179-80 (2d Cir. 2014).[6]

Nevertheless, the *Morrison* test, as enunciated, actually reaches "transactions *in* securities *listed on* domestic exchanges."[7] *Id.* Moreover, this case arises in the Ninth Circuit, not the Second Circuit, and none of the Second Circuit's decisions cited in the foregoing paragraph share facts similar to those involved here. While Defendants also direct the Court to several district court decisions (including In re UBS, *see* Footnote 7, *supra*) that reject the mere listing of securities on United States exchanges as a basis for application of U.S. securities laws, those cases – in addition to departing from the seemingly-straightforward language in *Morrison* – are likewise factually dissimilar (not involving the merger/corporate buyout scenario involved here) and/or involved ADRs (which were similarly present in, and of no moment to the majority in, *Morrison*). *See In re Royal Bank of Scotland Grp. PLC, Secs. Litig.*, 765 F. Supp. 2d 327, 336 (S.D.N.Y. 2011); *In re Alstom SA Secs. Litig.*, 741 F.Supp.2d 469, 472 (S.D.N.Y. 2010) ("Though isolated clauses of [Morrison] may be read as requiring only that a security be 'listed' on a domestic exchange for its purchase anywhere in the world to be cognizable under the federal securities laws, those excerpts read in total context compel the opposite result."); *id.* at 473 ("That the transactions themselves must occur on a domestic exchange to trigger application of § 10(b) reflects the most natural and elementary reading of Morrison."). The Court would be within reason, therefore, in rejecting Defendants' reliance upon them.

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[6] Both *Parkcentral* and *Meng-Lin* were decided after the briefing on this motion was complete. The Second Circuit decided *City of Pontiac* during the briefing on this motion. Though Defendants did not cite *City of Pontiac* in their Reply brief, Defendants did rely on the Southern District of New York's decision in that case, which (in considering "foreign-cubed" claims) reached the same conclusion regarding the effect of mere cross-listing. *See In re UBS Secs. Litig.*, No. 07 Civ. 11225 (RJS), 2011 U.S. Dist. LEXIS 106274, *11-22 (S.D.N.Y. Sept. 13, 2011).

[7] Indeed, Section 10(b) itself applies to "the purchase or sale of any security registered on a national securities exchange." 15 U.S.C. § 78j(b).

As a result, unless either side believes supplemental briefing is warranted to assist in a decision of this issue, it would appear that Defendants should not prevail upon their *Morrison*-based arguments.

C. Sufficiency of Plaintiff's Allegations

If the Court concludes that U.S. securities laws can be invoked here, Defendants also argue that Plaintiff's claims must be dismissed because they do not approach the level of pleading detail and plausibility required under the Private Securities Litigation Reform Act ("PSLRA") and case law construing that legislation's requirements. To make out a claim for securities fraud, Plaintiff must allege a material misrepresentation or omission, scienter, in connection with the purchase or sale of a security, reliance, economic loss and loss causation. *See Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 341-42 (2005). Specifically, Defendants argue that the "who, what, when, where, and how" of the alleged misrepresentations set forth in paragraphs 48-55 and 83 of the Complaint is missing. They also assert that Plaintiff has merely grouped the various defendants together, and have not identified specific financial statements or the specific alleged misrepresentations therein. Moreover, Defendants argue that Plaintiff has not specified what is false about the alleged misstatements, or how they were false, and argues that vague references to GAAP or unspecified aspects of Defendants' accounting methodology is insufficient.

In short, the Court agrees with Defendants on this point, and Plaintiff will have to amend. Each statement alleged to have been misleading must be specified, along with "the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed." 15 U.S.C. § 78u-4(b)(1); *see also Rubke*, 551 F.3d at 1161 ("[T]he complaint must 'set forth what is false or misleading about a statement, and why it is false.'") (quoting *Yourish v. Cal. Amplifier*, 191 F.3d 983, 993 (9th Cir. 1999)); *id.* at 1164. Like falsity, scienter must also be pled with particularity under the PSLRA. *See* 15 U.S.C. § 78u-4(b)(2); *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 321 (2007); *Rubke*, 551 F.3d at 1164; *In re Silicon Graphics Sec. Litig.*, 183 F.3d 970, 974 (9th Cir.), *reh'g & reh'g en banc denied*, 195 F.3d 521 (1999). In the Ninth Circuit that requires deliberate recklessness or conscious

misconduct, and deliberate recklessness itself means "some degree of intentional or conscious misconduct." *Silicon Graphics*, 183 F.3d at 974, 979; *see also SEC v. Rubera*, 350 F.3d 1084, 1094 (9th Cir. 2003) (defining recklessness 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").

The scienter requirement obligates securities fraud plaintiffs to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2). In *Tellabs*, the Supreme Court took on the "task…to prescribe a workable construction of the 'strong inference' standard" required by section 78u-4(b)(2). *See* 551 U.S. at 322. In so doing, it laid out the following analytical roadmap.

As with any motion to dismiss for failure to plead a claim on which relief can be granted, the Court must accept all factual allegations in the complaint as true. *See id.* The Court must consider the complaint in its entirety, "as well as other sources courts ordinarily examine when ruling on Rule 12(b)(6) motions to dismiss, in particular, documents incorporated into the complaint by reference, and matters of which a court may take judicial notice." *Id.* The question "is whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard." *Id.* at 322-23 (emphasis in original).

In determining whether a "strong" inference of scienter exists, "the court must take into account plausible opposing inferences." *Id.* at 323. This includes both "plausible nonculpable explanations for the defendant's conduct, as well as inferences favoring the plaintiff." *Id.* at 324. However, "[t]he inference that the defendant acted with scienter need not be irrefutable, i.e., of the 'smoking-gun' genre, or even the 'most plausible of competing inferences." *Id.* But the inference of scienter must be more than merely "reasonable" or "permissible" – "it must be cogent and compelling." *Id.* A complaint survives "only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the

facts alleged." *Id.* Elsewhere, the Court summarized this "strong inference" analysis as follows:

> It does not suffice that a reasonable factfinder plausibly could infer from the complaint's allegations the requisite state of mind. Rather, to determine whether a complaint's scienter allegations can survive threshold inspection for sufficiency, a court governed by § 21D(b)(2) must engage in a comparative evaluation; it must consider, not only inferences urged by the plaintiff...but also competing inferences rationally drawn from the facts alleged. An inference of fraudulent intent may be plausible, yet less cogent than other, nonculpable explanations for the defendant's conduct. To qualify as 'strong' within the intendment of § 21D(b)(2)...an inference of scienter must be more than merely plausible or reasonable – it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent.

Id. at 314; *see also id.* at 328 ("A plaintiff alleging fraud in a § 10(b) action...must plead facts rendering an inference of scienter at least as likely as any plausible opposing inference."). In making this determination, the Ninth Circuit indicates that the Court is obligated to take a "holistic" approach. *See Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 992 (9th Cir. 2009); *see also In re VeriFone Holdings, Inc. Secs. Litig.*, 704 F.3d 694, 72 (9th Cir. 2012).

Though the Ninth Circuit has demarcated certain strict exceptions, so-called "group pleading" is generally not permissible under either the Private Securities Litigation Reform Act or 9(b), and is arguably impermissible even under Rule 8, given the Supreme Court's opinion in *Ashcroft v. Iqbal*, 556 U.S. 662 (2009). *See, e.g., Redondo Waste Sys., Inc. v. Lopez-Freytes*, 659 F.3d 136, 140 (1st Cir. 2011) (indicating that, in order to draw plausibility inference, as required by *Iqbal*, the complaint "must allege facts linking each defendant to the grounds on which that particular defendant is potentially liable"). This is equally true with respect to both alleged responsibility for alleged misrepresentations and for scienter. *See Or. Pub. Employees Retirement Fund v. Apollo Group Inc.*, 774 F.3d 598, 607 (9th Cir. 2014) ("Where, as here, the Plaintiffs seek to hold individuals and a company liable on a securities fraud theory, we require that the Plaintiffs allege scienter with respect to each of the individual defendants."). In *Tellabs*, the Supreme Court noted that the Seventh Circuit, in that same case, had concluded that "allegations of scienter made against one defendant cannot be imputed to all other individual defendants." 551 U.S. at 326 n.6. The Court then noted the disagreement

among the Circuits on that point and that the plaintiffs in that case did not "contest" that determination in arguing the case to the Court, before announcing that it would not "disturb" the Seventh Circuit's conclusion. *Id.*

In the years since *Tellabs*, the Ninth Circuit has repeatedly indicated that Rule 9(b) plainly does not allow "lumping" of defendants, but instead "requires plaintiffs to differentiate their allegations when suing more than one defendant and inform each defendant separately of the allegations surrounding his alleged participation in the fraud." *Lee*, 655 F.3d at 997-98 (quoting *Swartz v. KPMG LLP*, 476 F.3d 756, 764-65 (9th Cir. 2007)). "'In the context of a fraud suit involving multiple defendants, a plaintiff must, at a minimum identify the role of each defendant in the alleged fraudulent scheme.'" *Id.* (quoting *Swartz*, 476 F.3d at 764-65). "Everyone did everything" allegations are – in most cases at least – simply insufficient. *Destfino v. Reiswig*, 630 F.3d 952, 958 (9th Cir. 2011). While the Ninth Circuit has instructed that scienter may be "impute[d]…to individual defendants in some situations, for example, where 'a company's public statements [are] so important and so dramatically false that they would create a strong inference that at least some corporate officials knew of the falsity upon publication,'" *Oregon Public*, 774 F.3d at 607-08 (quoting *Glazer*, 549 F.3d at 743-44),[8] this case – at least on the current allegations – does not meet that standard.

Plaintiff responds to Defendants' arguments under Rule 9(b) and the PSLRA, in part, by taking the position that paragraphs 47[9] and 83[10] of the Complaint supply some of

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[8] In *Glazer*, the Ninth Circuit had indicated that its earlier precedent did not "foreclose the possibility that, in certain circumstances, some form of collective scienter pleading might be appropriate." 549 F.3d at 744. Of course, *Glazer* – which ultimately concluded that the Ninth Circuit did not have to definitively decide the viability of the "group pleading" doctrine in the Circuit, *see id.* at 745 – was decided *before* the Supreme Court's opinion in *Iqbal*. Apart from a brief citation for purposes of identifying the general pleading standard under Fed. R. Civ. P. 8(a)(2), *see* 774 F.3d at 603-04, *Oregon Public* does not discuss *Iqbal* at all. The same limited citation to *Iqbal* is true of *In re NVIDIA Corp. Secs. Litig.*, 768 F.3d 1046, 1051 (9th Cir. 2014), another case in which the Ninth Circuit reiterated the possible exception for "collective scienter," *id.* at 1063.

[9] "Specifically, [Plaintiff] discovered that the [individual defendants] (1) inflated Fenco's revenue by using a full core valuation method without properly recording the full extent of future core returns, (2) directed customers not to return cores until after the acquisition so that liabilities would not be reflected in the financial statements, and (3) failed to account for numerous customer rebates and allowances that had not been posted to the customers' accounts receivable sub-ledger or the accruals for contractual rebates and allowances due to the customers." Complaint ¶ 47.

[10] "Specifically, the Defendants misrepresented and omitted facts material to Fenco's financial position, including but not limited to (i) that the Pre-Acquisition Financial Statements did not conform with

the necessary specified information. Even as to these allegations, however, Defendants point out that Plaintiff has not identified what exactly Defendants represented about these subjects that was false or where the alleged misrepresentations were made.

In its Opposition brief, Plaintiff also identifies at least one specific accounting policy which it asserts is directly tied to the alleged misrepresentation. *See* Docket No. 24, at 13:9-12. But that does not change that the misrepresentation itself is missing the necessary detail to satisfy Rule 9(b) and the PSLRA. Moreover, Defendants respond that even in its Opposition, Plaintiff only generally refers to a description of Fenco's accounting policies, which spans four pages of material. *See* Docket No. 24, at 13:6-8; *see also* Docket No. 23-8, Exh. N, at 237-40.

Plaintiff also argues that it may rely on group pleading in certain circumstances, under authority of *Wool v. Tandem Computers Inc.*, 818 F.2d 1433, 1440 (9th Cir. 1987). As Defendants point out, however, *Wool* is a pre-PSLRA (and pre-*Iqbal*) case (and Plaintiff has cited no post-PSLRA or post-*Iqbal* case in support of its position on group pleading with respect to responsibility for statements/representations). *See In re Amgen Inc. Secs. Litig.*, 544 F.Supp.2d 1009, 1035-36 (C.D. Cal. 2008); *Lapiner v. Camtek, Ltd.*, No. C 08-01327 MMC, 2011 U.S. Dist. LEXIS 9985, *10-12 (N.D. Cal. Feb. 2, 2011). In addition, as noted above, the Ninth Circuit has recently strictly limited the availability of such a pleading tactic in at least the scienter context. Moreover, insofar as Plaintiff has relied – as discussed further below – just on supplying the Court with the individual defendants' job titles, it has not plausibly alleged how they were involved in the financial statements in question, as even *Wool* would require. *See Wool*, 818 F.2d at 1440.

As to scienter, Plaintiff argues that Defendants had a *motive* to commit fraud because Fenco was experiencing serious liquidity issues and they knew that Plaintiff would be relying on the financial statements. Plaintiff also identifies one specific email regarding fill rates that Gordon Fenwick authored. It relies further on what it characterizes in its brief as "extensive" GAAP violations, which it asserts supports a proper scienter allegation. Finally, it also relies on the individual defendants' positions

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Canadian or U.S. GAAP, (ii) the extent of Fenco's outstanding core liabilities, including the fact that it instructed various customers not to return cores until after the Purchase Agreement's execution date, (iii) the terms of various side agreements with major customers, (iv) substantial inventory and other payable amounts due to vendors for pre-acquisition transactions and/or penalties, and (v) reasonable sales forecasts based on realistic fill rates." Complaint ¶ 83.

within Fenco.

In response (on the issue of scienter), Defendants argue that Plaintiff has nothing more than group pleading and the fact that the individual defendants held certain job titles or positions. *See In re Netflix, Inc. Secs. Litig.*, No. C04-2978 FMS, 2005 U.S. Dist. LEXIS 18765, *23 (N.D. Cal. June 28, 2005) ("The court observes that general allegations of defendants' positions within a company, their 'hands-on' style of management, or access to internal reports do not give rise to a strong inference of scienter."). Even as to Gordon Fenwick – the only individual Defendants admit is the subject of some measure of specificity in Plaintiff's allegations – Plaintiff has not pled that he knew the specified practices in question were fraudulent. Defendants also argue that motive, even combined with job title, is not sufficient to sufficiently allege scienter. *See Police Retirement Sys. of St. Louis v. Intuitive Surgical, Inc.*, 759 F.3d 1051, 1062 (9th Cir. 2014) ("Read as a whole, the allegations in the complaint at best establish 'mere recklessness or a motive to commit fraud and opportunity to do so,' and are 'not independently sufficient.'"); *Reese v. Malone*, 747 F.3d 557, 569 (9th Cir. 2014); *Glazer Capital Mgmt., LP v. Magistri*, 549 F.3d 736, 748 (9th Cir. 2008); *Rubke v. Capitol Bancorp Ltd.*, 551 F.3d 1156, 1166 (9th Cir. 2009). Further, to counter the allegation of scienter under Tellabs, Defendants note that FAPL's financials were audited by BDO Canada LLP, and the individual defendants relied upon that process. Plaintiff discounts that fact, asserting that auditors rely on information provided by the company and its executives.

With a minor possible exception (related to Gordon Fenwick), Plaintiff has only alleged what falsities Defendants conveyed (or what information was concealed) in general terms, and only by lumping all Defendants together. *See* Complaint ¶¶ 2-3, 12, 25, 30-35, 44, 46. Indeed, even where specifics are provided, Plaintiff has almost never – with the exception of Gordon Fenwick – identified which of the individual defendants would be implicated thereby. *See, e.g., id.* ¶ 52. If paragraphs 47 and 83 are as close to specificity as Plaintiff can get, they are plainly insufficient, given their lack of details. Even as to Gordon Fenwick, it is not entirely clear that Plaintiff has linked up information he allegedly knew about with any specific falsehoods conveyed to Plaintiff. *See id.* ¶¶ 47, 49-50, 55, 83. At a minimum, Plaintiff must amend to make that linkage clearer.

With respect to scienter, Plaintiff has alleged that Defendants "had a pecuniary interest in the acquisition" and that the misrepresentations were in aid of "secur[ing] releases for pre-existing security interests against the Defendants' property." *Id.* ¶¶ 76, 80. Otherwise, the scienter allegations are completely conclusory, *see id.* ¶ 84, or simply rely on the positions the individual defendants held and/or their job titles (with a variety of entities whose connection to FAPL, Fenwick Auto and/or Fenco is often less than clear, making it difficult to determine whether any "core operations" inference might be in play).

In that last regard, Plaintiff alleges that Shuster was acting as president and CEO of Fenwick Auto, Introcan Inc., Rafko Holdings Inc., LH Distribution Inc., Rafko Enterprises Inc., and Flo-Pro Inc. *See id.* ¶ 6. Gordon Fenwick was acted as president and CEO of Autocat Catalogue Services Inc., 778355 Ontario Inc., and FAPCO, S.A. de C.V. *See id.* ¶ 7. Paul Fenwick acted as a director, vice-president and treasurer of Fenwick Auto. *See id.* ¶ 8. Joel Fenwick acted as a director, vice-president and secretary of Fenwick Auto. *See id.* ¶ 9. All individual defendants were also allegedly "controlling principals" of FAPL. *See id.* ¶¶ 6-9. Other than providing their titles, Plaintiff simply argues conclusorily – in connection with its control person claim – that the individual defendants "participat[ed] in and [were] aware[] of Fenco's operations, and [had] intimate knowledge of the false statements made by Fenco and disseminated to the investing public." *Id.* ¶ 89. It also summarily alleges that they each "had a direct and supervisory involvement in the day-to-day operations of Fenco before the acquisition." *Id.* ¶ 90.

The only possible allegation where Plaintiff may have matched up a specific misrepresentation with a sufficient allegation of scienter is in paragraph 55, where it alleges the following: "[T]he [individual defendants] misrepresented Fenco's financial condition by using a target fill rate of 95% to calculate Fenco's net sales. The [individual defendants] knew that Fenco's actual fill rates were much lower. For example, in an email to the [individual defendants] dated October 7, 2010, Gordon Fenwick stated 'I stand behind my statement made at the management meeting 3 weeks ago, where I stated we are losing $5MM per month in Sales Revenue due to Fill Rate issues.'" *Id.* ¶ 55. One still might ask where the misrepresentation related to this knowledge occurred, and why

this would exhibit scienter with respect to anyone other than Gordon Fenwick. Even as to him, it is not entirely clear that $5MM lost per month (a dollar figure) does not match up with a 95% fill rate (a percentage).

Beyond that paragraph, only Gordon Fenwick is subject to any measure of specific allegation (including specific date, subject matter and customer involved) arguably supporting a finding of scienter. *See id.* ¶¶ 49-50. Even as to him, however, Plaintiff comes up short with respect to the specificity necessary in relation to the alleged misrepresentations.

In sum, both in holistic and individual terms, Plaintiff's Complaint requires improvement in order to satisfactorily plead scienter, especially with respect to defendants other than Gordon Fenwick. In addition, for the reasons set forth above, Plaintiff must also improve the particularity and specificity of its allegations of misrepresentations. For these reasons, the Court would dismiss Plaintiff's fourth claim with leave to amend.

D. Section 20(a) Claim

Finally, Defendants argue that if Plaintiff does not have a viable anchor securities fraud claim, its Section 20(a) claim withers on the vine. Plaintiff does not contend otherwise, but it does request the opportunity to amend if the Court finds a basis to dismiss. Because Plaintiff's Section 10(b)/Rule 10b-5 claim requires amendment if it is to survive, the Court will also dismiss its Section 20(a) claim with leave to amend.