

UNITED STATES DISTRICT COURT  
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No.	CV 09-2487 PA (PLAx)	Date	September 14, 2009
Title	WPP Luxemburg Gamma Three Sarl v. Spot Runner Inc., et al.		

Present: The Honorable	PERCY ANDERSON, UNITED STATES DISTRICT JUDGE		
	Paul Songco	Not Reported	N/A
	Deputy Clerk	Court Reporter	Tape No.
	Attorneys Present for Plaintiffs:	Attorneys Present for Defendants:	
	None	None	

**Proceedings: IN CHAMBERS - MOTION TO DISMISS**

Before the Court are four Motions to Dismiss the Complaint. The first is filed by defendant Spot Runner Inc. (“the Company”) (Docket No. 29.) The second is filed by Nick Grouf, David Waxman (collectively “the Founders”) and Peter Huie. (Docket No. 36.) The third is filed by Robert Pittman (Docket No. 26), and the fourth is filed by defendants Battery Ventures VI, L.P, Battery Investment Partners VI, LLC, Battery Ventures VII, L.P, Battery Investment Partners VII, LLC (collectively “Battery”), Index Ventures III (Jersey) L.P., Index Ventures III (Delware) L.P., Index Ventures III Parallel Entrepreneur Fund (Jersey) L.P. (collectively “Index”), Danny Rimer, and Roger Lee (Docket No. 32.) The Court refers to all defendants collectively as “Defendants.” Plaintiff WPP Luxemburg Gamma Three Sarl (“Plaintiff”) has filed an Opposition. Pursuant to Rule 78 of the Federal Rules of Civil Procedure and Local Rule 7-15, the Court finds that this matter is appropriate for decision without oral argument. The hearing calendared for September 14, 2009, is vacated, and the matter taken off calendar.

**I. Factual Background**

The Company was founded in 2004 by Nick Grouf, David Waxman, and Adam Shaw (who is not a party to this action). The Company’s board of directors consists of Grouf, Waxman, Danny Rimer, Roger Lee, and Robert Pittman. Battery and Index are preferred stockholders in the Company. The Company agreed with Battery and Index that each would have the right to appoint one director. Rimer is the Index board representative and Lee is the Battery board representative.

In August 2006, Plaintiff made an initial investment in the Company for approximately ten million dollars. Shortly thereafter, Plaintiff entered into an agreement with the Company in which it was granted a seat on the board as a non-voting observer. That same month Plaintiff also entered into the Second Amended and Restated Rights of First Refusal and Co-Sale Agreement (“ROFR”). The parties to the ROFR were the Company, the Founders, and the holders of Series A, Series B, and Series C preferred stock (collectively “the Investors”), which included Plaintiff, Battery and Index. Under the ROFR, a Founder who wishes to sell or transfer his shares must first provide the Company and the Investors with notice of the potential sale. The Company has a right of first refusal for any shares that a

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Founder wishes to sell or transfer. If the Company chooses not to exercise its right of first refusal, then each Investor has the right to purchase a pro rata share of the shares to be sold. The ROFR also contains a provision stating that “the holders of sixty percent (60%) of the Shares held by the Investors voting together may waive, discharge, terminate, modify or amend, on behalf of all Investors, any provisions hereof.” (Compl. ¶ 44.)

In May 2007 the Company engaged in a new issuance of common stock. On May 21, 2007 Plaintiff’s counsel e-mailed Peter Huie, general counsel for the Company, to ask whether any existing shareholders or founders were selling their shares. Huie replied the same day, stating “This offering does not involve the sale of any existing shares. It is an entirely new issuance by the Company.” (*Id.*, ¶71.) Based on Huie’s reply, Plaintiff purchased an additional 383,111 shares of Company stock on May 24, 2007 for approximately \$1.7 million.

Plaintiff later discovered that the Founders had sold shares during May 2007 without notifying it. Notice was not given because Battery and Index, who together comprised 60% of the shares held by the Investors, had purportedly waived the notice provision of the ROFR. Battery and Index’s vote to waive notice did not occur during a shareholder meeting.

Plaintiff filed its Complaint on April 9, 2009, claiming that Defendants have committed violations of the Securities Exchange Act § 10(b), as well as several state laws.

## II. Legal Standard

Federal Rule of Civil Procedure 12(b)(6) allows dismissal of a complaint for “failure to state a claim upon which relief can be granted.” In order to survive a Rule 12(b)(6) motion, typically a complaint need only give “a short and plain statement of the claim showing that the pleader is entitled to relief.” Fed. R. Civ. P. 8(a)(2). “All allegations of material fact are taken as true and construed in the light most favorable to the plaintiff.” *In re Stac Elecs. Sec. Litig.*, 89 F.3d 1399, 1403 (9th Cir. 1996)(quoting *In re Wells Fargo Sec. Litig.*, 12 F.3d 922, 925 (9th Cir. 1993)). “[A] plaintiff’s obligation to provide the ‘grounds’ of his ‘entitle[ment] to relief’ requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do.” *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555, 127 S. Ct. 1955, 1964-65, 167 L. Ed. 2d 929 (2007). “Factual allegations must be enough to raise a right to relief above the speculative level, on the assumption that all the allegations in the complaint are true (even if doubtful in fact)” *Id.* (citations omitted). “To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to ‘state a claim to relief that is plausible on its face.’” *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949, 173 L. Ed. 2d 868 (2009)(quoting *Bell Atlantic*, 550 U.S. at 570, 127 S. Ct. at 1974). “A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.” *Id.* “Where a complaint pleads facts that are ‘merely consistent with’ a defendant’s liability, it ‘stops short of the line between possibility and plausibility of ‘entitlement to relief.’” *Id.*

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In addition, under Federal Rule of Civil Procedure 9(b), claims for fraud are subject to heightened pleading requirements: “In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake.” Fed. R. Civ. P. 9(b). In a private action for securities fraud under § 10(b), the complaint must also satisfy the heightened pleading requirements of the Private Securities Litigation Reform Act of 1995 (“PSLRA”), 15 U.S.C. § 78u-4. See Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 321, 127 S. Ct. 2499, 2508, 168 L. Ed. 2d 179 (2007).

The PSLRA requires a plaintiff to plead the existence of any material false statement or omission with particularity:

the complaint shall specify each statement alleged to have been misleading, 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).

Moreover, the PSLRA provides that the complaint shall “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 a § 10(b) claim, that state of mind is scienter, meaning “the defendant’s intention ‘to deceive, manipulate, or defraud.’” Tellabs, 551 U.S. at 313, 127 S. Ct. at 2504. To qualify as a “strong inference” of scienter, “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, 127 S. Ct. at 2404-05. When measuring a complaint against the PSLRA’s pleading requirements, “courts 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 . . . . The inquiry . . . 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, 127 S. Ct. 2509.

### III. Discussion

Section 10(b) of the Securities Exchange Act “provides that it is unlawful ‘to use or employ in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance . . . .’” In re Read-Rite Corp., 335 F.3d 843, 845 (9th Cir. 2003) (quoting 15 U.S.C. § 78j(b)). In a § 10(b) action, the plaintiff must plead the following elements:

- (1) . . . use or employ[ment of] any manipulative or deceptive device or contrivance; (2) scienter, i.e. wrongful state of mind; (3) a connection with the purchase or sale of a

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security; (4) reliance, often referred to . . . as “transaction causation;” (5) economic loss; and (6) loss causation, i.e. a causal connection between the manipulative or deceptive device or contrivance and the loss.

Desai v. Deutsche Bank Sec. Ltd., 573 F.3d 931, 939 (9th Cir. 2009)(quoting Simpson v. AOL Time Warner Inc., 452 F.3d 1040, 1047 (9th Cir. 2006)).

SEC Rule 10b-5 defines three categories of manipulative or deceptive devices that constitute a violation of Section 10(b):

- (a) [t]o employ any device, scheme, or artifice to defraud[;]
- (b) [t]o make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading[;] or
- (c) [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

Under Rule 10b-5(b), a defendant can be liable for making material misrepresentations or omissions when there is a duty to disclose. See Desai, 573 F.3d at 938. However, liability under § 10(b) need not be based on a statement. A defendant who uses a “device, scheme, or artifice to defraud,” or engages in “any act, practice, or course of business which operates or would operate as a fraud or deceit,” as mentioned in Rule 10b-5(a) and 10b-5(c) can be liable by virtue of his conduct alone. See Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, 552 U.S. 148, 128 S. Ct. 761, 769, 169 L. Ed. 2d 627 (2008) (“[t]o suggest there must be a specific oral or written statement before there could be liability under § 10(b) or Rule 10b-5 . . . would be erroneous. Conduct itself can be deceptive . . .”). Courts have often called liability arising under Rule 10b-5(a) or (c) “scheme liability.” Id. at \_\_\_, 128 S. Ct. at 770. Scheme liability consists of acts that have “the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme.” Burnett v. Rowzee, 561 F. Supp. 2d 1120, 1125 (C.D. Cal. 2008). A defendant cannot be liable for “aiding and abetting” a violation of Section 10(b). Central Bank of Denver, N.A. v. First Interstate Bank, 511 U.S. 164, 177, 114 S. Ct. 1439, 1448, 128 L. Ed. 2d 119 (1994). Thus, to be liable for participating in a scheme, a defendant “must satisfy each of the elements or preconditions for liability.” Stoneridge, 552 U.S. at \_\_\_, 128 S. Ct. at 729.

A. Misrepresentation

The Complaint states that the basis for Plaintiff’s § 10(b) claim is that Defendant engaged in a

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“scheme or artifice to defraud,” where the only conduct alleged to be part of the scheme is a misrepresentation:

89. As alleged in more detail, *supra*, in connection with [the Spring 2007] securities sale, Defendants engaged in a scheme or artifice to defraud. Defendants caused Spot Runner to falsely represent to WPP that neither the Founders nor the existing stockholders of Spot Runner were selling shares of Spot Runner stock in May 2007, when in truth and in fact, they knew that Grouf, Waxman, Battery and Index were selling substantial quantities of Company stock at the time.

90. In purchasing an additional 383,111 shares of Spot Runner stock in May 2007, WPP reasonably relied on Defendants’ representations that Grouf, Waxman, Battery, and Index were not selling their shares of the Company, and WPP would not have acquired the additional Company stock had they known of those sales.

91. By misrepresenting that Grouf, Waxman, Battery and Index were not selling stock, Defendants have engaged in acts of fraud and deceit in the sale of Spot Runner shares to WPP.

(Compl., p. 16-17)(emphasis added).

The only misrepresentation alleged in the Complaint are the statements in Huie’s May 21, 2007 e-mail. The facts alleged in the Complaint are as follows: The Company engaged in a round of common stock financing in the spring of 2007. On May 10, 2007, the Company wrote Plaintiff a letter stating that the Company was notifying all existing shareholders, including the Founders, of a new investor who had recently purchased shares from the Company and desired to purchase additional shares from existing shareholders. Plaintiff wanted to know if any of the other shareholders or Founders had responded to the new investor’s request, and wrote an e-mail to Huie on May 21, 2007 asking, “Is there an existing investor and/or founder selling existing shares related to this offering?” (Compl. ¶ 70)(emphasis added). Huie responded, “This offering does not involve the sale of any existing shares.” (Id. ¶ 71) (emphasis added). Plaintiff interpreted Huie’s statement to be a “representation that no existing Investors or Founders were selling shares.” (Id. at ¶ 72).

However, contrary to Plaintiff’s interpretation, Huie’s statement was literally true. Huie’s statement that “this offering” was a new issuance by the Company was not false, since the Company was at the time holding an offering where it was issuing new shares. Plaintiff’s interpretation of Huie’s statement would require the Court to read Huie’s reference to “this offering” as a reference to the May 10, 2007 letter. The May 10, 2007 letter did not describe any offering; rather, it was a solicitation to see whether any of the existing shareholders wished to sell their shares. The only plausible reading of “this offering” is a reference to the round of common stock financing that was then ongoing. Apparently, when Plaintiff’s counsel asked about sales “related to” this offering, he was asking whether any existing

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shareholders or Founders had responded to the May 10, 2007 letter. Huie's response about who was selling in "this offering" did not answer the question that Plaintiff's counsel theoretically posed, but it did not state a falsehood. Plaintiff may have misread Huie's e-mail, but such a misunderstanding cannot form the basis for a § 10(b) claim, absent any facts indicating that Plaintiff was likely to misinterpret Huie's truthful statements. Because Plaintiff does not allege any facts which support its interpretation of Huie's email, the Court finds that the Complaint does not adequately allege any misrepresentation which would constitute a violation of § 10(b).

B. Scheme Liability

Plaintiff's Opposition argues that the Complaint adequately states a § 10(b) claim against Defendants based on scheme liability. Although not specified in the Complaint, the Opposition alleges there was a scheme consisting of five actions: (1) the Founders' failure to provide notice of their sales pursuant to the ROFR; (2) Battery and Index's attempted waiver of the Investors' rights under the ROFR; (3) the directors' vote to waive the Company's rights under the ROFR and their failure to mention the Founders' sales during board meetings; (4) misrepresentations made by Huie in his May 21, 2007 e-mail; and (5) the Company's sale of its shares to Plaintiff. According to Plaintiff, the purpose of this scheme was to mislead Plaintiff into believing that the Company was being managed as a profitable business venture, when in fact Defendants were only interested in using the Company as a vehicle for personal profit by making secondary sales to new investors at high prices.

On a motion to dismiss under Rule 12(b)(6) a court must consider the allegations in the complaint, not the opposition. As discussed, the Complaint states that the only basis for the § 10(b) claim is a scheme consisting solely of Huie's May 21, 2007 e-mail. Arguments in Plaintiff's Opposition cannot cure deficiencies in the Complaint. See, e.g., Intri-Plex Techs., Inc. v. Crest Group, Inc., 499 F.3d 1048, 1052 (9th Cir. 2007) ("Generally, a court may not consider material beyond the complaint in ruling on a Fed. R. Civ. P. 12(b)(6) motion."); Harrell v. U.S., 13 F.3d 232, 236 (7th Cir. 1993) ("[A] plaintiff cannot amend his complaint by a brief that he files in the district court or the court of appeals."). Nevertheless, even assuming that the scheme mentioned in the Complaint encompasses all five actions above and not just the statements in Huie's e-mail, the Complaint must still be dismissed because it does not adequately plead facts giving rise to a strong inference of scienter for each defendant.<sup>1</sup> See Tellabs, 551 U.S. at 322-23, 127 S. Ct. at 2509; In re Silicon Graphics Inc. Sec. Litig., 183 F.3d 970, 986 (9th Cir. 1999) (outlining the relevant factors to consider when determining whether "unusual" or "suspicious" stock sales by corporate insiders may constitute circumstantial evidence of scienter).

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<sup>1/</sup> Plaintiff's Opposition also argues that the Complaint has adequately stated a § 10(b) claim based on material omissions by several of the defendants. Since the Complaint does not even mention omissions as a basis for liability under §10(b), the Court does not consider whether § 10(b) liability for any omissions was adequately pled. See Harrell, 13 F.3d at 236.

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C. Loss Causation

Defendants argue that another reason the Complaint also fails to state a § 10(b) claim because it has not adequately pled loss causation. Moreover, Defendants claim that Plaintiff could never plead loss causation because the Complaint shows that the Company's stock price rose over time and never fell. The mere fact that there was no decline in stock price does not prevent Plaintiff from successfully pleading loss causation. See Livid Holdings, Ltd. v. Salomon Smith Barney, Inc., 416 F.3d 940 (9th Cir. 2005); EP Medsys., Inc. v. EchoCath, Inc., 235 F.3d 865, 884 (3d Cir. 2000). However, the Court finds no need to decide at this time whether loss causation was adequately pled, since Plaintiff has failed to allege other essential elements of its § 10(b) claim.

D. State Claims

In addition to Plaintiff's claim under the Securities and Exchange Act § 10(b), the Complaint also states eight causes of action under state law. Plaintiff's Complaint asserts federal question jurisdiction based on Defendants' violations of the Securities Exchange Act §10(b). As this Court finds that Plaintiff has not sufficiently pled its federal securities law claim, we decline to reach the state claims until the Court's jurisdiction over the case has been established.

Conclusion

Accordingly, for the reasons stated above, the Court grants Defendants' motions to dismiss the Complaint, and grants Plaintiff leave to amend. Plaintiff shall file its amended complaint no later than October 12, 2009. Failure to file an amended complaint by this date will result in dismissal without prejudice.

IT IS SO ORDERED.

Initials of Preparer

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: N/A  
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