UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA

Nowakowski v. AXT, Inc.

No. 24-cv-02778-MMC (N.D. Cal. May 28, 2025) · No. 24-cv-02778-MMC · Decided May 28, 2025

SUMMARY

The United States District Court for the Northern District of California granted defendants' motion to dismiss an amended securities-fraud class action complaint against AXT, Inc. and individual defendants. The court held that plaintiffs failed to plead falsity with the particularity required by the PSLRA, including by failing to identify the sources supporting allegations concerning alleged trade-secret misappropriation and a short-seller report. The dismissal was granted with leave to amend by June 27, 2025.

OPINION

1 2 3 4 IN THE UNITED STATES DISTRICT COURT 5 FOR THE NORTHERN DISTRICT OF CALIFORNIA 6 7 CRAIG NOWAKOWSKI, et al., Case No. 24-cv-02778-MMC 8 Plaintiffs, ORDER GRANTING DEFENDANTS' 9 v. MOTION TO DISMISS; DISMISSING AMENDED COMPLAINT WITH LEAVE 10 AXT INC., et al., TO AMEND 11 Defendants. 12 13 Before the Court is defendants AXT, Inc. ("AXT"), Morris Young ("Young"), and 14 Gary L Fischer's ("Fischer") Motion, filed November 8, 2024, "to Dismiss Plaintiffs' 15 Amended Class Action Complaint."

Plaintiffs Craig Nowakowski and Charles Grubb have 16 filed opposition, to which defendants have replied. Having read and considered the 17 papers filed in support of and in opposition to the motion,1 the Court rules as follows.2 18 BACKGROUND 19 In the operative complaint, the Amended Class Action Complaint ("AC"), plaintiffs, 20 who state they have purchased stock in defendant AXT (see AC ¶¶ 10-11), allege that 21 AXT, a "materials science company," obtains "almost all of [its] revenue" from the 22 operations of Tongmei, its "subsidiary based in China" (see AC ¶¶ 21-22, 24).

According 23 to plaintiffs, AXT announced in November 2020 that it planned "to list Tongmei on 24 China's STAR Market, an exchange established by the Chinese government" (see AC 25 1 In support of its motion, defendants request the Court take judicial notice of 26 fifteen documents.

As the Court does not find it necessary to consider those documents to address the instant motion, said request is hereby DENIED. 27 1 ¶ 26), and that it thereafter raised $49.6 million from "private equity firms in China" in 2 exchange for "a 7.28% non-controlling interest in Tongmei" and gave those firms the right to redeem their shares if "Tongmei's IPO application" was "rejected" or Tongmei "withdrew" it (see AC ¶¶ 29-30).

Plaintiffs also allege that, in December 2021, Tongmei submitted its IPO application to the Shanghai Stock Exchange, which entity, in August 2022, "gave preliminary approval and forwarded an amended version of [the IPO application] to the CSRC [China Securities Regulatory Commission]." (See AC ¶ 32.) Plaintiffs further allege that AXT filed reports with the Securities and Exchange Commission ("SEC") on, respectively, March 23, 2021, January 10, 2022, March 15, 2022, August 2, 2022, March 16, 2023, and March 14, 2024, containing, according to plaintiffs, "materially false and misleading statements."

(See AC at 15:1-2, ¶¶ 59-90.) In that regard, plaintiffs contend, AXT failed to disclose in those reports that "there were specific, known material risks that Tongmei's IPO attempt would fail, requiring AXT to refund the $49 million investment to the pre-IPO Chinese corporate investors and that AXT's financial condition, and business operations would be adversely impacted."

(See AC ¶¶ 63, 65, 68, 70, 72, 75, 77, 79, 81, 84, 86, 88, 90; see also AC ¶ 61.) Plaintiffs' allegations include an acknowledgment that the above-referenced reports AXT filed with the SEC contained what plaintiffs refer to as "risk disclosures" (see AC ¶¶ 60, 67, 69, 76, 78, 80, 85, 87, 89), for example, that "[t]he proposed Tongmei IPO on the STAR market in China could fail to be completed" (see AC ¶ 67), and that "[t]he terms of the private equity raised by Tongmei in China grant each investor a right of redemption if the IPO fails to pass the audit of the Shanghai Stock Exchange, is not approved by the CSRC or Tongmei cancels the IPO application[,] [which] could result in disgorging the cash [Tongmei] raised from the [i]nvestors" (see AC ¶ 78).

Plaintiffs allege, however, that the risk disclosures were "incomplete and materially false and misleading" (see AC ¶¶ 63, 65, 68, 72, 75, 77, 79, 81, 84, 86, 88, 90; see also AC ¶¶ 61, 70) for the asserted reason that AXT did not disclose that "Tongmei had stolen trade in China" (see AC ¶ 3). In light of the above, plaintiffs assert two causes of action on their own behalf and on behalf of a putative class, namely, "Violations of Section 10(b) and Rule 10b-5 Promulgated Thereunder" (Count I) and "Violations of Section 20(a) of the Exchange Act" (Count II).

DISCUSSION

The elements of a private securities fraud action under § 10b, Rule 10b-5, and § 20(a) are "(1) a material misrepresentation or omission of fact, (2) scienter, (3) a connection with the purchase or sale of a security, (4) transaction and loss causation, and (5) economic loss." See Metzler Inv. GMBH v. Corinthian Colleges, Inc., 540 F.3d 1049, 1055, 1061 (9th Cir. 2008) (internal quotation and citation omitted). In their motion, defendants argue the AC is subject to dismissal for failure to allege, as is required by the Private Securities Litigation

Reform Act ("PSLRA"), sufficient facts to meet what the Ninth Circuit has described as the "formidable pleading requirements" applicable in "private securities fraud class actions," see id. at 1054-55, and, in particular, facts sufficient to support a finding of "falsity," see id. at 1070.[3] "To plead falsity adequately under the PSLRA[,] 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."

Glazer Capital Mgmt., L.P. v. Forescout Technologies, Inc., 63 F.4th 747, 765 (9th Cir. 2023) (internal quotation and citation omitted; emphasis omitted). "In doing so, the plaintiff must reveal the sources of his information." Id. (internal quotation, alteration, and citation omitted). In the instant action, plaintiffs allege that Tongmei, in 2019, hired a former 3 In light of the Court's findings stated herein with respect to falsity, the Court has not addressed defendants' additional arguments that the AC fails to sufficiently plead employee of a competitor known as Sinocryst who "brought with him trade secrets" of Sinocryst (see AC ¶ 38), that Tongmei "used" Sinocryst's trade secrets to "quickly develop" products (see id.), that Sinocryst, in 2021, "reported the violation" to the Yucheng City Public Security Bureau, which agency "obtained evidence of Tongmei's IP infringement" and "launched a criminal investigation" (see AC ¶¶ 39-40), and that said agency, in 2023, "completed its investigation and transferred the case records to the People's Procuratorate, or public prosecutor's office, pending criminal prosecution" (see AC ¶ 41).

Plaintiffs fail to expressly allege, however, "the sources of [their] information," see Glazer Capital Mgmt., 63 F.4th at 765, and, to the extent plaintiffs implicitly allege the source was a "report" issued in April 2024 by "J Capital Research" (see AC ¶ 93 (alleging J Capital Research report "revealed the criminal investigation against Tongmei due to the IP infringement as stated above [in the AC]")), plaintiffs' reliance is unavailing.

Although courts have found that a plaintiff, to "allege falsity at the pleading stage," can "rely on a short seller report"[4] that contains "indicia of reliability," such as where the report "relies on publicly filed documents," see Hershewe v. Joyy Inc., 2021 WL 6536670, at *4 (C.D. Cal. November 5, 2021) (citing cases), here, the AC does not allege the source or sources on which J Capital Research relied, much less a source that is of the type on which a securities fraud claim can be based, see id. at *5 (finding short seller report insufficient to plead falsity, where short seller "did not corroborate its core conclusions" and cited only to "unverified and unverifiable information").

Accordingly, the AC will be dismissed for failure to sufficiently allege falsity. As it appears plaintiffs may be able to cure the deficiency identified,[5] the Court will afford 4 Although not alleged in the AC, the parties agree that J. Capital Research is a "short seller." (See Defs.' Mot.

at 1:16-17; Pls.' Opp. at 23:15-16.) 26 5 In support of their opposition, plaintiffs have offered five exhibits, and, although, as defendants note, a plaintiff cannot amend a pleading by citing to information not 27 contained therein, the Court has considered the exhibits in determining whether leave to 1 plaintiffs leave to amend.°® 2 CONCLUSION 3 For the reasons stated above, the motion to dismiss is hereby GRANTED, and the 4 || Amended Class Action Complaint is DISMISSED, with leave to amend.

Any Second 5 || Amended Class Action Complaint shall be filed no later than June 27, 2025. 6 IT IS SO ORDERED. 7 8 || Dated: May 28, 2025 INE M. CHESNEY 9 United States District Judge 10 11 12 13 16 17 18 19 20 21 22 23 24 25 26 27 ° In any further pleading, plaintiffs are not limited to amending their falsity 2g || allegations, and may choose to amend other allegations as well.