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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA, WESTERN DIVISION

GALAXIA ELECTRONICS CO., LTD., a Korean corporation,

Plaintiff,

vs.

LUXMAX, U.S.A., a Nevada corporation; RWS MANAGEMENT, INC., a Nevada company; DANIEL MURPHY, an individual; ROBERT SCARNECHIA, an individual; and FULL THROTTLE FILMS, INC., a California company,

Defendants.

LUXMAX, U.S.A., a Nevada corporation; RWS MANAGEMENT, INC., a Nevada company; and ROBERT SCARNECHIA. an individual,

Counter-Claimants,

vs.

GALAXIA ELECTRONICS CO., LTD., a Korean corporation,

Counter-Defendant.

CASE NO. 2:16-cv-05144-JAK-GJS

PLAINTIFF'S REPLY IN SUPPORT OF MOTION TO DISMISS COUNTERCLAIMS

Date: January 22, 2018
Time: 8:30 a.m.
Crtrm.: 10B

Assigned to Hon. John A. Kronstadt

ROBERT SCARNECHIA. an individual,

Third Party Plaintiff,

vs.

SUP YOON, an individual,

Third Party Defendant.

I. INTRODUCTION

The Luxmax Defendants' Opposition underscores that their Counterclaims are both factually and legally deficient. Indeed, the purpose of notice pleading is to ensure that a defendant is properly apprised of the claims against it, and the attendant factual bases for those claims, so that it can prepare a defense. Yet the Counterclaims do not come close to meeting that standard, much less the more stringent particularity standard required for fraud claims.

For example, for their various interference claims, Defendants have not alleged in their Counterclaims any specific wrongdoing beyond the rote parroting of claim elements (e.g., "Galaxia intentionally interfered with economic relationships"). Defendants could have simply pled that "Galaxia committed various intentional and negligent torts" with the same effectiveness. In fact, after reading the Counterclaims, Galaxia is left to try to divine what it purportedly did wrong, if anything. For instance, what type of economic relationships were disrupted? With which third parties? And, most importantly, how? The Counterclaims do not address those questions and should therefore be dismissed.

Beyond the factual infirmities, however, Defendants' Counterclaims are also not supported legally. For instance, as the Ninth Circuit has recognized, manufacturers like Galaxia, who have a continuing direct economic interest in the goods they manufacture, cannot be held liable for intentionally interfering with contracts for the sale of those goods. This is fatal to the interference claims.

Likewise, the balance of the Luxmax Defendants' Counterclaims lack factual support, legal support, or in most instances, both. For those reasons, and for the reasons set forth in Galaxia's opening brief, the Counterclaims should be dismissed.

II. ARGUMENT

A. The Luxmax Defendants Do Not (And Cannot) Plead Fraud and Negligent Misrepresentation with Particularity.

Fraud and negligent misrepresentation claims "are subject to strict

requirements of particularity in pleading." *Committee on Children's Television, Inc. v. General Foods Corp.*, 35 Cal. 3d 197, 216 (1983). The Counterclaims lack such particularity, and must be dismissed. For instance, Defendants claim that the parties executed "similar documents" after the Payment Agreement without specifying which documents they refer to. Defendants also do not specify their injury,[1] stating only that they have sustained damages in an amount to be proven at trial. This lack of particularity is fatal to these claims, which may not be pled by "vague and artful pleading of fraud simply to get a foot in the courtroom door." *Wilhem v. Pray, Price, Williams & Russell*, 186 Cal. App. 3d. 1324, 1331 (1986).

Further, Galaxia's alleged promise not to use the acknowledgments cannot be actionable as *fraud* or shown to have been false at the time it was made, given that performance of the promise necessarily depended on whether Defendants paid the outstanding amounts. *See, e.g., Magpali v. Farmers Group Inc.*, 48 Cal. App. 4th 471, 481 (1996) ("[a] promise of future conduct is actionable as fraud only if made without a present intent to perform. . . . something more than nonperformance is required to prove the defendant's intent not to perform the promise") (internal citations and quotations omitted).

For the foregoing reasons, the misrepresentation claims must be dismissed.

B. The Luxmax Defendants' Claim of Negligent Misrepresentation Further Fails For Lack of Pleading A Necessary Element of Negligence: A Duty.

In addition to lack of particularity, Defendants' claim of negligent misrepresentation must also be dismissed because Defendants failed to plead a necessary element of the claim: the existence of a duty. *See, e.g., Nymark v. Heart*

[1] To the extent that the Opposition suggests that the unarticulated injury is having to defend against Galaxia's suit, such a claim would be barred by the litigation privilege. *See, e.g., Action Apt. Ass'n., Inc. v. City of Santa Monica*, 41 Cal. 4th 1232 (2007) ("no communication . . . is more clearly protected by the litigation privilege than the filing of a legal action"). If so, any attempts to amend the claim would be futile since Defendants have not suffered a cognizable injury.

Fed. Savings & Loan Assn., 231 Cal.App.3d 1089, 1095 (1991) ("[t]he existence of a duty of care owed by a defendant to a plaintiff is a prerequisite to establishing a claim for negligence"). In their Opposition, while Defendants concede that "any negligence cause of action must be founded on a duty of care," they attempt to suggest that the Counterclaims actually pled such a duty. (Opp. at 8-9 ("even if Counter-Claimants were required to plead some legal duty aside from the general duty of care set forth in *Civil Code* 1714 . . . simply being a party to a business transaction . . . imposes a duty.[2]").) In fact, the negligent misrepresentation claim is devoid of a reference to any duty at all, and thus, fails to plead even in a conclusory manner a necessary element of negligent misrepresentation.[3] Failing to plead a necessary element is fatal to the claim.

C. Defendants Do Not Dispute The Absence of A Provision Giving Rise to a Breach of Implied Covenant Claim And Have Not Alleged Custom or Usage Contrary to the Parties' Written Intent.

Defendants do not deny that to state a claim for breach of the implied covenant of good faith and fair dealing they must "identify the specific contractual provision that was frustrated." *Plastino v. Wells Fargo Bank*, 873 F. Supp. 2d 1179, 1191 (N.D. Cal. 2012). Nor do they deny that there is no written provision in the contract between the parties to support their counterclaim. Instead, Defendants

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[2] Moreover, Defendants are incorrect in claiming that simply being party to a business transaction gives rise to a duty of care. *See, e.g., Nymark*, 231 Cal. App. 3d at 1095-96 (financial institutions owe no duty of care to a borrower).

[3] Defendants did, however, casually allege Galaxia was a fiduciary in a separate section, without explaining how two entities in an arms-length transaction are fiduciaries of each other. Simply labeling a party a fiduciary in the face of clear law to the contrary cannot defeat a motion to dismiss. *See, e.g., Kabushiki Kaisha Megahouse v. Anjar Co. LLC, et al.* No. 2:14–cv–00598–CAS(CWx), 2014 WL 5456523, at *10 (C.D. Cal. Oct. 20, 2014) ("The general rule is that fiduciary obligations do not exist between commercial parties operating at arm's length") (internal quotations and citations omitted).

argue that they have alleged frustration of implied provisions that were supplemented through the parties' "course of conduct" in four paragraphs of their Counterclaims. (Opp. at 9 (citing Counterclaims ¶¶ 16-17, 39, 51).) This is both legally incorrect and unsupported by the pleadings.

As an initial matter, the Exclusive Agreement between the parties contained an integration clause stating that it could not be modified "except by an instrument in writing." (Dkt. No. 16-1 at Exhibit A at ¶ 8.4.) And as Defendants themselves recognized, before terms modifying a written contract can be implied, the conduct of the parties "must be inconsistent with the written contract so as to warrant the conclusion that the parties intended to modify the written contract." *Garrison v. Edward Brown & Sons*, 25 Cal. 2d 473, 479 (1944). But Defendants have not alleged any such conduct between the parties.

In the four paragraphs of the Counterclaims that Defendants cite in their Opposition, nowhere do they allege any custom developed whereby Galaxia reimbursed expenses. Rather, they allege only that there was a "custom and practice" that Luxmax would "distribute products" and "forward monies" to Galaxia. (*See, e.g.* Counterclaims ¶¶ 16-17, 39.) Furthermore, undercutting their own claim, Defendants allege that Galaxia "consistently" "[f]orc[ed] Counterclaimants to bear the burden of expenses and costs." (*Id.* ¶ 51.) Nowhere do Defendants allege that the parties *actually developed a practice* of reimbursing marketing and other costs, and in fact, they appear to allege that Galaxia did the opposite, in consistently requiring them to bear those expenses. Thus, even if the written agreement between the parties could be modified by custom and practice, which they could not, this newly asserted custom is not stated within the Counterclaims.[4] Hence, Defendants' counterclaim should be dismissed.

[4] Defendants' assertions that they need not "plead every factual and evidentiary detail" is an inaccurate representation of their burden. Defendants *are* required to

D. Defendants Do Not Allege Facts About The Timing of Alleged Non-Conformities Or Facts to Support a Plausible Breach of Warranty Claim.

The breach of warranty counterclaim should also be dismissed because Defendants do not dispute that such a claim requires that a defect must exist at the time of sale and delivery. *See, e.g.*, Cal. Com. Code § 2725. "[T]he product is either merchantable or not . . . only at the time of delivery." *Mexia v. Rinker Boat Co.*, 174 Cal. App. 4th 1297, 1304-05 (2009). Nor do Defendants deny that they have *failed* to specify when any alleged non-conformities arose; in fact, they do not address the issue at all. For this reason, this counterclaim must be dismissed.[5]

E. The Counterclaim for Unfair Competition Fails Due to a Fundamental Misunderstanding of California Unfair Competition Law.

A plaintiff's failure to distinguish between the unlawful, unfair, and fraudulent prongs of a UCL claim requires dismissal of the claim because the law is "written in the disjunctive," establishing three varieties of unfair competition, each with separate elements and pleading requirements. *See Cel-Tech Comms., Inc. v. Los Angeles Cellular Telephone Co.*, 20 Cal. 4th 163, 180 (1999); *see also Kearns v Ford Motor Co.*, 567 F.3d 1120, 1127 (9th Cir. 2009). Defendants argue that the Counterclaim "clearly identif[ies] fraudulent conduct which is also unfair and unlawful. Other conduct described in the Counterclaim is merely unlawful or simply unfair, and importantly, relief is sought under all three provisions." (Opp. at. 12.) In short, Defendants concede that the Counterclaim fails to differentiate

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do more than recite elements and must allege *facts* supporting a plausible claim. *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (citations omitted). While they need not make an exhaustive evidentiary showing, a failure to allege basic facts should result in dismissal. *Asmussen v. PNC Bank, N.A.*, No. 5:14-CV-01948-SVW-KK, 2014 WL 12591628, at *3 (C.D. Cal. Oct. 22, 2014).

[5] Defendants again mischaracterize their burden by arguing that they need not plead "all their evidence." (Opp. at 11:19-25.) Defendants fail to allege any basic facts about the nature of alleged non-conformities supporting a plausible claim, let alone, most critically, when they arose. *Mexia*, 174 Cal. App. 4th at 1304-05.

between the three distinct prongs of the UCL, even when certain conduct falls only under one of the three prongs.

Defendants' UCL claim also fundamentally misunderstands the law. The UCL is a statute that prohibits unfair competition primarily in order to protect the public. For that reason, a UCL claim of fraudulent business practices must allege that "'members of the public are likely to be deceived' by the challenged conduct."[6] *Bardin v. Daimlerchrysler Corp.*, 136 Cal. App. 4th 1255, 1261 (2006). Therefore, any portion of the UCL claim that was brought under the fraudulent business practices prong fails because Defendants failed to allege that the public would be deceived by the allegedly fraudulent conduct. *See, e.g.*, *Bardin*, 136 Cal. App. 4th at 1261; *Access Holdings Corp. v. Ball*, No.: CV 10–04329 SJO (DTBx), 2010 WL 11552872 (C.D. Cal. Dec. 14, 2010) ("putting aside the issue of whether [Plaintiff] is a 'consumer' and is permitted to even bring a UCL claim, Plaintiff did not allege that members of the public would likely be deceived by Defendant's conduct").

Rather than pleading the UCL claim in a manner that would allow Galaxia to determine how the UCL was violated, Defendants list a few general allegations that are circumspect in detail, and purport to argue that they have met the requirements of pleading a UCL claim.[7] For these reasons, the claim must be dismissed.

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[6] Similarly, the unfairness prong of the UCL covers conduct that "offends an established public policy . . . or is immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers." *See People v. Duz-Mor Diagnostic Lab., Inc.*, 68 Cal. App. 4th 654, 658 (1998).

[7] For instance, Defendants claim that Galaxia "[m]isappropriat[ed] proprietary, commercially sensitive information belonging to [Defendants] and sharing said information with customers in order to compete unfairly against [Defendants] . . . ." (Counterclaims ¶ 51.) This allegation is not explained further anywhere in the Counterclaims. Defendants attempt to cure the deficient pleading by arguing that the quoted sentence "provides adequate context for Galaxia to know what information is being addressed without requiring the information actually be revealed in the Counterclaim." (Opp. at. 13.) This only underscores the fact that the

F. The Counterclaims for Negligent and Intentional Interference With Prospective Economic Relations Are Also Deficient.

Defendants also fail to allege facts supporting a plausible claim for negligent or intentional interference with prospective economic relations for similar reasons. Defendants' main argument is that, buried in a sub-paragraph in their UCL claim, there is an allegation that Galaxia misappropriated commercially sensitive information. (Opp. at 14 (citing Counterclaims ¶ 51).) Thus, Defendants contend that they have identified independent, wrongful conduct and alleged facts supporting their interference claims. Again, this misstates the law.

To plead interference with prospective economic relationships, the independent, wrongful conduct alleged must not merely appear wrongful on its face, but must be in contravention of some specific "constitutional, statutory, regulatory, common law, or other determinable legal standard." *See Korea Supply Co. v. Lockheed Martin Corp.*, 29 Cal. 4th 1134, 1159 (2003). Here, Defendants make the conclusory assertion that alleged misappropriation is "obviously" wrongful, as is other conduct alleged in paragraph 51. But the point made repeatedly in the prior briefing and above is that the UCL claim is devoid of basic facts even beginning to describe the conduct at issue, let alone what law that conduct allegedly contravened.

Likewise, Defendants do not dispute that the Counterclaims fail to expressly allege the element of duty in support of a negligent interference claim. Instead, Defendants argue that they have implicitly alleged a duty because of the "closeness

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Counterclaims failed to even generally describe the category of information that was allegedly misappropriated. In fact, the lack of factual basis underlying this pseudo-misappropriation claim is likely for good reason, as it seems there is *no proprietary information Defendants can actually identify*. The parties agree that Galaxia manufactured LED products, and Defendants distributed them. So this begs the direct question, what "proprietary" information related to Galaxia's products do Defendants contend belonged to them, as opposed to Galaxia? It is Defendants' burden to plead the basic details regarding their cause of action, not Galaxia's burden to divine the conduct at issue so that it may defend itself.

of the connection or nexus between the defendant's conduct and risk of injury to the plaintiff." (Opp. at 14:25-15:7 (citing *LiMandri v. Judkins*, 52 Cal. App. 4th 326, 348-349 (1997).) This again misstates their burden and restates the problem with all of the Counterclaims. To assess the nexus between the risk of injury to Defendants and the conduct at issue, Defendants must allege basic facts *about that conduct*. *See LiMandri*, 52 Cal. App. 4th at 349 (analyzing party's specific alleged conduct and concluding that the "nexus between the conduct and the risk of injury to [plaintiff] was too tenuous to support the imposition of a duty of care"). But Defendants have not alleged the most rudimentary facts about the conduct at issue, as stated above, or how that conduct relates to an alleged duty of care. For these reasons, both the intentional and negligent interference with contract claims must be dismissed.

G. Defendants Agree that An Intentional Interference Claim Is Likely Precluded Due To Galaxia's Direct Economic Interest.

Defendants agree that it is "true that a defendant's direct economic interest in the performance of a contract would *likely preclude* a finding it was a 'stranger' to the relationship between the contracting parties," (Opp. at 16:6-8 (emphasis added)), but contest that this "necessarily" precludes an interference claim. Relying primarily on a California Court of Appeal decision, *Woods*, Defendants argue that the Ninth Circuit in *Marin Tug & Barge, Inc. v. Westport Petroleum, Inc.*, 271 F.3d 825, 834 (9th Cir. 2001) was "not extending immunity from contract interference claims to an even broader, more attenuated class of persons." *Woods v. Fox Broad. Sub., Inc.*, 129 Cal. App. 4th 344, 356 (2005).

Once again, however, Defendants misstate applicable law. As recognized by the District Court of the Central District of California, federal courts are bound by the Ninth Circuit's interpretation of this issue as set forth in *Marin Tug*, and not by *Woods*. *See Citizens of Humanity, LLC v. LAB sarl*, No. CV1210627MMMJEMX, 2013 WL 12129393, at *17 (C.D. Cal. Apr. 22, 2013) (observing that *Woods'* interpretation of strangers to contract was non-binding in light of absence of

California Supreme Court authority). *Citizens* is particularly instructive, as the Central District determined that counterclaims against a manufacturer for alleged interference should be dismissed, since the manufacturer was clearly not a stranger to the contractual relationship. There, the court noted various factors in finding that Citizens was not a stranger because the contractual relationships at issue "necessarily depended on Citizens' participation," such as the fact that Citizens had ongoing involvement in the approval of sales, development of customer base and promotional activities. *Id.*

Likewise, here, Galaxia's direct participation with customers was both contractually required and asserted by Defendants themselves. (*See*, *e.g.*, Dkt. No. 16-1 at Exhibit A, ¶ 2.5 (requiring discussion with manufacturer regarding development of new types of products); ¶ 4.3 (requiring manufacturer to make and supply parts and components).) Defendants, in fact, allege that Galaxia was obligated to actively engage with customers in an ongoing manner in the form of repairs and to "address technical issues raised by customers." (*See* Counterclaims ¶ 51(E).) Thus, as in *Citizens*, Galaxia, as a manufacturer, not only had a direct economic interest in the distribution of its goods, but an ongoing requirement to participate in those contractual relationships.

In an attempt to avoid addressing Galaxia's direct economic interest, Defendants argue, in the alternative, that Galaxia's interest is irrelevant because Galaxia was acting as a competitor. (Opp. at 15:25-27.) This is incorrect as a legal matter for the reasons stated above, but also because it is unsupported by the pleadings. Here, again, Defendants rely on their conclusory statements that Galaxia acted as a "competitor" and "interfered" with contractual relationships. But Defendants again in no way specify what conduct was meant to give rise to the interference.[8] Describing the basic facts of the supposed interference is the

[8] If Defendants are falling back on assertions of misappropriation, this fails for the

minimum standard for basic pleading under Rule 8(a), as well as under *Iqbal* and *Twombly*. Defendants fall well below that bar, and thus, their intentional interference counterclaim should also be dismissed.

H. The Counterclaim for Violation of Penal Code Section 632 Fails to Plead Facts That Establish Confidentiality, a Necessary Element of the Claim.

Simply alleging that the communications at issue are confidential, as the Luxmax Defendants have done, is insufficient to plead a claim under Section 632. Courts routinely dismiss such claims when plaintiffs fail to plead facts demonstrating that the communication falls within the scope of Section 632, which expressly requires more than a subjective expectation of confidentiality. *See, e.g.*, *Faulkner v. ADT Sec. Services Inc.*, 706 F.3d 1017, 1019-20 (9th Cir. 2013) ("[t]o prevail against the Rule 12(b)(6) motion, then, [plaintiff] would have to allege facts that would lead to the plausible inference that his was a confidential communication—that is, a communication that he had an objectively reasonable expectation was not being recorded"). This is because section 632 ***expressly excludes*** communications made in a public gathering or in "any other circumstance in which the parties to the communication may reasonably expect that the communication may be overheard or recorded." Cal. Penal Code § 632. Because the Counterclaim has not pled any allegations that would allow the Court to evaluate whether the communications were made in a location and under circumstances that would make section 632 applicable, this claim must be dismissed.

III. CONCLUSION

For the reasons stated here and in the opening brief, and any argument at the hearing on the Motion, the Court should dismiss the Luxmax Defendants' counterclaims in their entirety.

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reasons stated above. If Defendants allege Galaxia engaged in competition because of contacts with customers, it is all the more critical that the conduct be defined, given that Galaxia had contractual duties to those users.

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Respectfully submitted,

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