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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

In re OBALON THERAPEUTICS, INC.
SECURITIES ACTION,

Case No.: 3:18-cv-0352-AJB-WVG

ORDER:

This Document Relates to:
ALL ACTIONS

(1) GRANTING IN PART AND DENYING IN PART OBALON DEFENDANTS’ MOTION TO DISMISS THE CONSOLIDATED COMPLAINT (Doc. No. 41);

(2) GRANTING UNDERWRITER DEFENDANTS’ MOTION TO DISMISS THE CONSOLIDATED COMPLAINT (Doc. No. 42); AND

(3) GRANTING IN PART AND DENYING IN PART DEFENDANTS’ REQUEST FOR INCORPORATION BY REFERENCE AND JUDICIAL NOTICE (Doc. No. 41-2.)

Presently before the Court are: (1) Defendants Obalon Therapeutics, Inc. (“Obalon” or “the Company”), Andrew P. Rasdal, William J. Plovanic, Nooshin Hussainy, Kim Kamdar, Raymond Dittamore, Douglas Fisher, Les Howe, and Sharon Stevenson’s

1 (collectively, the “Obalon Defendants”) motion to dismiss the Consolidated Complaint
2 (“Complaint”) (Doc. No. 41); and (2) Defendants UBS Securities LLC, Canaccord Genuity
3 Inc., Stifel, Nicolaus & Co., Inc., and BTIG, LLC’s (the “Underwriter Defendants” and
4 collectively with the Obalon Defendants, “Defendants”) motion to dismiss the Complaint
5 (Doc. No. 42.) Concurrently with the motions to dismiss, Defendants filed a request for
6 incorporation by reference and judicial notice. (Doc. No. 41-2.) Lead Plaintiff Inter-Local
7 Pension Fund GCC/IBT (“Lead Plaintiff”) and Plaintiff Teamster Affiliates Pension Plan
8 (“Plaintiff TAPP” collectively with Lead Plaintiff, “Plaintiffs”) oppose the motions to
9 dismiss (Doc. Nos. 48, 49), and oppose the request for incorporation by reference and
10 judicial notice. (Doc. No. 50.) For the reasons set forth below: (1) the Obalon Defendants’
11 motion to dismiss is **GRANTED IN PART AND DENIED IN PART**; (2) the Underwriter
12 Defendants’ motion to dismiss is **GRANTED**, without leave to amend; and (3)
13 Defendants’ request for incorporation by reference and judicial notice is **GRANTED IN**
14 **PART AND DENIED IN PART**.

15 **RELEVANT BACKGROUND**

16 The instant action is a securities class action brought by Lead Plaintiff and Plaintiff
17 TAPP, alleging false and misleading statements in connection with the sales of securities.
18 Lead Plaintiff seeks relief against Defendants Obalon, Rasdal, and Plovanic pursuant to
19 §§ 10(b) and 20(a) of the Securities Exchange Act of 1934 (“Exchange Act”), and Rule
20 10b-5 promulgated thereunder, on behalf of itself and all persons or entities that purchased
21 or acquired publicly traded securities of Obalon between October 6, 2016 and May 11,
22 2018. (Complaint “Compl.” ¶ 14.) Plaintiff TAPP seeks relief against all Defendants
23 pursuant to §§ 11 and 15 of the Securities Act of 1933 (“Securities Act”). (Compl. ¶ 14.)

24 **I. The Company and the Obalon Balloon**

25 Obalon is a medical device company based in Carlsbad, California. (Doc. No. 41-1
26 at 9.) Obalon’s sole product is the Obalon balloon system (“the Obalon Balloon”), an
27 intragastric balloon device that is placed in a patient’s stomach to simulate a feeling of
28 fullness. (Compl. ¶ 1.) The Obalon Balloon was created to help patients achieve weight

1 loss. (*Id.*) To use the Obalon Balloon, a patient must first swallow one or more capsules
2 containing the inflatable balloon. (*Id.*) The Obalon Balloon is attached to a long catheter,
3 and once the capsule is swallowed, an x-ray is taken to check the placement of the balloon.
4 (*Id.*) After the capsule dissolves, the balloon is inflated with gas through the catheter. (*Id.*)
5 The catheter is then detached, and pulled out from the stomach through the patient’s throat.
6 (*Id.*) After six months, a doctor will perform an endoscopic procedure to pop and remove
7 the balloon from the patient’s stomach. (*Id.*) Obalon is not the only maker of intragastric
8 balloons. (*Id.* ¶ 2.) But unlike the Obalon Balloon’s competitors, the Obalon Balloon does
9 not require an endoscopic procedure to initially place the device into a patient’s stomach.
10 (*Id.*) As such, the Obalon Balloon is the only balloon device on the market that is swallowed
11 by the patient, and then filled with gas. (*Id.*)

12 **II. Factual Allegations Underlying the Complaint**

13 **A. Obalon’s Initial Public Offering**

14 Obalon went public on October 12, 2016. (Doc. No. 41-1 at 14.) In connection with
15 its initial public offering (“IPO”), Obalon disclosed in its registration statement, amended
16 registration statement, and prospectus (“the Offering Materials”) information about the
17 Obalon Balloon and the Six-Month Adjunctive Weight Reduction Therapy (“SMART”)
18 trial, a clinical trial conducted to evaluate the safety and efficacy of the Obalon Balloon.
19 (*Id.* at 9.) In its Offering Materials, Obalon explained the advantages of the Obalon Balloon
20 as compared to its competitors, and discussed the balloon’s “ease of placement,” “favorable
21 safety profile,” and “simple and convenient placement.” (*Id.* at 13–14.) Obalon further
22 disclosed that “90.8% of patients who received the Obalon balloon system experienced an
23 event that the FDA classifies as an adverse device event”; that Obalon patients lost an
24 average of 15.1 pounds during the six-month treatment period; and that “7.6% of the
25 combined treatment and control group patients failed to swallow a capsule with the
26 microcatheter attached despite success swallowing a placebo that did not have a catheter
27 attached.” (*Id.* at 14.)
28

1 **B. The Northland Report**

2 The following year, on June 21, 2017, a securities analyst with Northland Securities,
3 Inc. published a report (“the Northland Report”) that provided a third-party critique of
4 Obalon’s representations about the Obalon Balloon’s characteristics. (Compl. ¶¶ 169–75.)
5 The Northland Report was based on the SMART study results, Obalon’s public filings, and
6 “other scientific papers, journals, and blogs.” (*Id.* ¶¶ 170–71, 174.) The Northland Report
7 expressed concerns over the performance of the device, specifically, the ease of placement,
8 safety, and efficacy of the Obalon Balloon. (*Id.* ¶¶ 169–75.) Based on these findings, the
9 Northland Report ultimately concluded the Obalon stock price was overvalued. (*Id.*
10 ¶¶ 170–71.) Following the Northland Report, the Obalon stock price dropped from \$10.96
11 per share to \$10.12 per share. (*Id.* ¶ 176.)

12 **C. The New Year Promotion, the Secondary Offering, and the**
13 **Whistleblower Allegations**

14 Between October 1 and December 29, 2017, Obalon launched a year-end promotion
15 just in time for New Year weight loss resolutions. (Doc. No. 41-1 at 15.) The promotion
16 offered patient leads to doctors who purchased the device in the promotional period, and
17 also offered rebates to patients participating in the weight-loss challenge. (*Id.*) As a result
18 of this promotion, Obalon announced strong Q4 2017 results. (*Id.*)

19 After the announcement of its strong Q4 2017, on January 16, 2018, Obalon
20 announced a secondary offering of \$35 million in Obalon stock as a way to raise more
21 capital for the Company. (Compl. ¶ 179.) Following this announcement of the Company’s
22 need for public financing, Obalon’s stock price dropped from \$7.93 per share on January
23 16, 2018 to \$5.24 per share on January 19, 2018. (*Id.* ¶ 180.)

24 Then, on January 23, 2018, Obalon disclosed that a whistleblower had submitted a
25 complaint to the Company’s independent auditors at KPMG. (*Id.* ¶ 181.) The complaint
26 purportedly described “improper revenue recognition during the Company’s fourth fiscal
27 quarter of 2017,” and alleged that management “misled investors” as to the Company’s
28 financial condition. (*Id.* ¶ 183.) Obalon cancelled its secondary offering in order to

1 investigate the claims. (*Id.* ¶ 181.) After the revelation of the whistleblower allegations,
2 Obalon’s stock price dropped again from \$5.19 per share to \$3.46 per share. (*Id.* ¶ 182.)
3 On February 20, 2018, the Company announced that it had completed its investigation, and
4 concluded that the whistleblower allegations were without merit. (*Id.* ¶ 183.)

5 On March 5, 2018, Obalon filed its 2017 Form 10-K, and released audited financials,
6 making a correction that deferred \$147,000 of revenue from Q4 2017 to 2018. (*Id.* ¶ 162.)
7 On May 10, 2018, Obalon announced its Q1 2018 earnings, which revealed that Q1 2018
8 brought in the lowest amount of total revenue for any quarter. (*Id.* ¶ 186.) Following this
9 news, Obalon’s stock price fell from \$4.32 per share to \$2.85 per share. (*Id.* ¶ 189.)

10 PROCEDURAL BACKGROUND

11 On February 14, 2018, Plaintiff Michael Hustig filed a Class Action Complaint
12 against Defendants Obalon, Rasdal, and Plovanic. (Doc. No. 1.) On April 16, 2018, lead
13 plaintiff motions were filed (Doc. Nos. 3–4), and Inter-Local Pension Fund GCC/IBT was
14 appointed as Lead Plaintiff. (Doc. No. 10.) Lead Plaintiff and Plaintiff TAPP then filed a
15 Consolidated Complaint on October 5, 2018. (Doc. No. 17.) Defendants filed motions to
16 dismiss the Consolidated Complaint, and Lead Plaintiff and Plaintiff TAPP objected. (Doc.
17 Nos. 41–42, 48–49.) These motions were fully briefed by both parties on February 19,
18 2019. (Doc. Nos. 58–59.)

19 LEGAL STANDARDS

20 I. Federal Rule of Civil Procedure 12(b)(6)

21 A Rule 12(b)(6) motion tests the legal sufficiency of the claims made in the
22 complaint. Accordingly, dismissal under Rule 12(b)(6) is proper where the complaint fails
23 to set forth a “cognizable legal theory,” or where there is “an absence of sufficient facts
24 alleged to support a cognizable legal theory.” *Navarro v. Block*, 250 F.3d 729, 732 (9th
25 Cir. 2001) (citing *Ballistreri v. Pacifica Police Dept.*, 901 F.2d 696, 699). Although a
26 complaint need only contain “a short and plain statement of the claim showing that the
27 pleader is entitled to relief” under Rule 8(a)(2), “a plaintiff’s obligation to provide the
28 grounds of his entitlement to relief requires more than labels and conclusions, and a

1 formulaic recitation of the elements of a cause of action will not do. Factual allegations
2 must be enough to raise a right to relief above the speculative level.” *Bell Atl. Corp. v.*
3 *Twombly*, 550 U.S. 544, 555 (2007) (internal quotations, brackets, and citations omitted).
4 In reviewing a motion to dismiss under Rule 12(b)(6), the court must assume the truth of
5 all “allegations of material fact,” and construe them “in the light most favorable to the
6 nonmoving party.” *Cahill v. Liberty Mut. Ins. Co.*, 80 F.3d 336, 337–38 (9th Cir. 1996).

7 **II. Rule 9(b)**

8 A complaint alleging fraud must also comply with Rule 9(b). Under Rule 9(b), when
9 the complaint includes allegations of fraud, a party must “state with particularity the
10 circumstances constituting fraud or mistake,” even though “[m]alice, intent, knowledge,
11 and other conditions of a person’s mind may be alleged generally.” Fed. R. Civ. P. 9(b).
12 “In other words, the complaint must set forth what is false or misleading about a statement,
13 and why it is false.” *Rubke v. Capitol Bancorp Ltd.*, 551 F.3d 1156, 1161 (9th Cir. 2009)
14 (internal quotation marks omitted). Additionally, fraud claims made pursuant to the
15 Securities Exchange Act must “plead with particularity both falsity and scienter.” *Zucco*
16 *Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 990 (9th Cir. 2009), as amended (Feb. 10,
17 2009).

18 **III. Private Securities Litigation Reform Act of 1995 (“PSLRA”)**

19 Finally, claims brought under the Exchange Act are also subject to the requirements
20 of the PSLRA regarding scienter. The PSLRA “requires that a complaint alleging
21 misleading statements or omissions ‘specify each statement alleged to have been
22 misleading, the reason or reasons why the statement is misleading, and, if an allegation
23 regarding the statement or omission is made on information and belief, . . . all facts on
24 which that belief is formed.’” *Reese v. BP Exploration (Alaska) Inc.*, 643 F.3d 681, 690
25 (9th Cir. 2011) (quoting 15 U.S.C. § 78u–4(b)(1)).

26 “Thus, the misrepresentation claims pled [under the Exchange Act] must satisfy the
27 ‘particularity’ requirement of Rule 9(b) of the Federal Rules of Civil Procedure, the
28 ‘plausibility’ requirement of *Iqbal*, and the scienter requirement of the PSLRA.” *Id.* at 690–

1 91.

2 **REQUEST FOR INCORPORATION BY REFERENCE**
3 **AND JUDICIAL NOTICE**

4 Defendants request the Court to take judicial notice and consider under the
5 incorporation by reference doctrine, several documents, including SEC filings, analyst call
6 transcripts, and reports filed in support of their motions to dismiss. (Doc. No. 41-2.) As set
7 forth below, the Court **GRANTS IN PART AND DENIES IN PART** Defendants'
8 request.

9 While the scope of review on a motion to dismiss for failure to state a claim is limited
10 to the complaint, a court may consider evidence on which the complaint necessarily relies
11 if: “(1) the complaint refers to the document; (2) the document is central to the plaintiff[’s]
12 claim; and (3) no party questions the authenticity of the copy attached to the 12(b)(6)
13 motion.” *Daniels–Hall v. Nat’l Educ. Ass’n*, 629 F.3d 992, 998 (9th Cir. 2010) (internal
14 quotation marks and citations omitted). Furthermore, Federal Rule of Evidence 201(b)
15 permits judicial notice of a fact when it is “not subject to reasonable dispute because it: (1)
16 is generally known within the trial court’s territorial jurisdiction; or (2) can be accurately
17 and readily determined from sources whose accuracy cannot reasonably be questioned.”
18 *Welk v. Beam Suntory Imp. Co.*, 124 F. Supp. 3d 1039, 1041–42 (S.D. Cal. 2015).
19 Additionally, courts can consider documents under the “incorporation by reference”
20 doctrine when a plaintiff “refers extensively to the document or the document forms the
21 basis of the plaintiff’s claim.” *Khoja v. Orexigen Therapeutics, Inc.*, 899 F.3d 988, 1002
22 (9th Cir. 2018) (quoting *U.S. v. Ritchie*, 342 F.3d 903, 907 (9th Cir. 2003)).

23 Here, Defendants request consideration of several exhibits filed in support of their
24 motions to dismiss. (*See* Doc. No. 41-2.) Defendants contend all the documents are
25 appropriate subjects for consideration under judicial notice or the doctrine of incorporation
26 by reference. (*Id.* at 11.) Plaintiffs object to some of Defendants’ requests, urging the Court
27 not to consider Exhibits 10-13, which are three FDA Summary of Safety and Effectiveness
28 Data (“SSED”) filings from Obalon, and its competitors, Orbera, and ReShape (Exhibits

1 10-12), and an October 31, 2016 analyst report published by Underwriter Defendant
2 Canaccord (Exhibit 13). (Doc. No. 50 at 4 n.4.) As Plaintiffs do not oppose Exhibits 1-9,
3 and the Court finds that these documents (SEC filings and analyst calls transcripts) are
4 proper for consideration, Defendants' request for incorporation by reference and judicial
5 notice is **GRANTED** as to Exhibits 1-9. The Court will now turn to Plaintiffs' objections.

6 First, Plaintiffs object to the consideration of Exhibits 10-13, arguing (1) Exhibit 10
7 is not referenced in the Complaint, (2) Exhibits 10-12 should not be judicially noticed
8 because its contents and effect are subject to reasonable dispute, and (3) Exhibit 13 should
9 not be judicially noticed because it is a biased report prepared by Underwriter Defendant
10 Canaccord. (Doc. No. 50 at 8–10.) The essence of Defendants' argument is that
11 consideration of Exhibits 10-13 is proper to demonstrate what was publicly available at the
12 time the Northland Report concluded Obalon's stock was overvalued, in efforts to show
13 that certain facts were actually disclosed, and thus not misleading under federal securities
14 laws. (Doc. No. 41-2 at 10.)

15 The Court ultimately agrees with Plaintiffs that Exhibits 10-13, should not be
16 considered by the Court at this stage of pleading because these extrinsic documents were
17 not incorporated by reference in the Complaint, and are not proper subjects for judicial
18 notice. While agency reports, such as Exhibits 10-12, are generally susceptible to judicial
19 notice, the inquiry does not stop there when "there is a reasonable dispute as to what the
20 report establishes." *Khoja*, 899 F.3d at 1001. Here, Plaintiffs have adequately disputed that
21 certain facts purportedly disclosed by these reports are "contrary to the well-pleaded factual
22 allegations of the Complaint." (Doc. No. 50 at 9.) Plaintiffs point out, as an example, that
23 Defendants contend that the Obalon SSED report adequately disclosed patients' difficulty
24 swallowing the Obalon capsule. But Plaintiffs also demonstrate that the SSED report
25 included a photograph of the capsule that created the impression that the capsule was
26 smaller than it really is. (*Id.* at 10.) As such, judicial notice would not be proper given the
27 existence of "reasonable dispute" as to what was established in these SSED reports, and
28 the effect of the SSED report on investors. *Khoja*, 899 F.3d at 1001.

1 Likewise, at this stage of the litigation, the Court will not consider Exhibit 13, an
2 analyst report published by an Underwriter Defendant, as it was not incorporated by
3 reference in the Complaint, and the Court finds that the report could potential reflect
4 inherent bias rendering the report inappropriate for judicial notice. *See Hsu v. Puma*
5 *Biotechnology, Inc.*, 213 F. Supp. 3d 1275, 1282 (C.D. Cal. 2016) (rejecting request to
6 judicially notice analyst reports because they “reflect an inherent bias favoring
7 [Defendant]”).

8 In essence, Defendants offer documents outside the four corners of the Complaint to
9 argue disputed facts to demonstrate Defendants did not violate federal securities laws.
10 Consideration of these documents would not be proper on a motion to dismiss. *See Tellabs,*
11 *Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322 (2007) (“The time for comparing
12 ‘evidence’ is after discovery, during summary judgement, or at trial—not now.”) (internal
13 citations omitted); *In re Immune Response Sec. Litig.*, 375 F. Supp. 2d 983, 995–96 (S.D.
14 Cal. 2005) (declining to incorporate numerous exhibits in SEC action where the complaint
15 did not mention or rely on them, but the defendants instead “offer[ed] the documents as
16 evidence that Defendants did not commit a securities violation”).

17 In sum, the Court **GRANTS** Defendants’ request as to Exhibits 1-9, but **DENIES**
18 the Defendants’ request as to Exhibits 10-13. Accordingly, the Court’s review “on [this]
19 motion to dismiss is limited to the contents of the [C]omplaint.” *Pelletier v. Fed. Home*
20 *Loan Bank of San Francisco*, 968 F.2d 865, 872 (9th Cir. 1992). Regarding the unopposed
21 documents, the Court will refer to them as it finds appropriate.

22 **DISCUSSION**

23 **I. Claims under the Securities Exchange Act of 1934 Section 10(b) & Rule** 24 **10b-5 Against Defendants Obalon, Rasdal, and Plovanic**

25 The Court first addresses Obalon Defendants’ motion to dismiss Count III of the
26 Complaint. Under Count III, Lead Plaintiff asserts claims under Section 10(b) of the
27 Exchange Act and Rule 10b–5 against Defendants Obalon, Rasdal, and Plovanic. Section
28 10(b) of the Exchange Act forbids: (1) the use or employment of any deceptive device, (2)

1 in connection with the purchase or sale of any security, and (3) in contravention of
2 Securities and Exchange Commission rules and regulations. 15 U.S.C. § 78j(b); *see Dura*
3 *Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 341 (2005). Additionally, Rule 10b–5,
4 promulgated by the SEC under Section 10(b), forbids the making of any “untrue statement
5 of a material fact” or the omission of any material fact “necessary in order to make the
6 statements made not misleading.” 17 C.F.R. § 240.10b–5; *see Dura*, 544 U.S. at 341. To
7 succeed in a private civil action under Section 10(b) and Rule 10b–5, a plaintiff must
8 establish “(1) a material misrepresentation (or omission); (2) scienter, *i.e.*, a wrongful state
9 of mind; (3) a connection with the purchase or sale of a security; (4) reliance. . .; (5)
10 economic loss; and (6) loss causation, *i.e.*, a causal connection between the material
11 misrepresentation and the loss.” *Dura*, 544 U.S. at 341–42.

12 Here, Obalon Defendants challenge three of the elements necessary to prove a
13 Section 10(b) and Rule 10b-5 claim: (1) Lead Plaintiff failed to allege a materially false or
14 misleading statement; (2) Lead Plaintiff failed to allege scienter; and (3) Lead Plaintiff
15 failed to establish loss causation. (Doc. No. 41-1.) For the reasons set forth below, the Court
16 **GRANTS IN PART AND DENIES IN PART** Obalon Defendants’ motion to dismiss
17 Count III of the Complaint.

18 **A. Materially False or Misleading Statements**

19 To allege an actionable false or misleading statement, a plaintiff must “specify each
20 statement alleged to have been misleading, the reason or reasons why the statement is
21 misleading, and, if an allegation regarding the statement or omission is made on
22 information and belief, . . . state with particularity all facts on which that belief is formed.”
23 *In re Rigel Pharms., Inc. Sec. Litig.*, 697 F.3d 869, 877 (9th Cir. 2012) (quoting 15 U.S.C.
24 § 78u-4(b)(1)). This is a demanding standard, requiring a plaintiff to allege with specificity
25 “contemporaneous statements or conditions,” *Ronconi v. Larkin*, 253 F.3d 423, 432 (9th
26 Cir. 2001), that demonstrate both “how and why the statements were false” when made,
27 *Metzler Inv. GMBH v. Corinthian Colleges, Inc.*, 540 F.3d 1049, 1071–72 (9th Cir. 2008).
28 Lead Plaintiff alleges, and Obalon Defendants challenge “three categories of misstatements

1 and omissions: (1) the Obalon Balloon’s performance; (2) the Company’s financials; and
2 (3) revenue recognition.” (Doc. No. 48 at 22.) The Court will address each category of
3 allegedly false and misleading statements.

4 **1. Statements Relating to Ease of Use, Safety, and Efficacy of the**
5 **Obalon Balloon**

6 In the Complaint, Lead Plaintiff alleges Obalon Defendants misrepresented the
7 Obalon Balloon’s superior ease of use, safety, and efficacy relative to its competitors’
8 products. (*Id.* at 22.) Obalon Defendants move to dismiss, arguing the statements were not
9 false because the facts purportedly concealed were disclosed and not inconsistent with
10 Obalon Defendants’ statements. (Doc. No. 41-1 at 19.) Additionally, Obalon Defendants
11 contend that many of the complained-of statements were principally statements of
12 corporate optimism. The Court agrees with Obalon Defendants.

13 As a preliminary note, the Court agrees that many of the statements Lead Plaintiff
14 protests as misleading are in fact statements of corporate optimism. It is well-established
15 that “[v]ague, generalized, and unspecific assertions” of “corporate optimism or statements
16 of mere puffing” cannot state actionable material misstatements of fact under federal
17 securities law.” *See Glen Holly Entm’t. Inc. v. Tektronix. Inc.*, 352 F.3d 367, 379 (9th Cir.
18 2003). Here, for example, the Complaint details several statements describing the Obalon
19 Balloon such as “easy to place,” “simple and convenient,” “about as easy. . . as it can [be]
20 to place” as false and misleading. (Compl. ¶¶ 127, 130, 132, 137.) However, these
21 statements amount to no more than generalized statements of corporate optimism as to the
22 convenience of the Obalon Balloon product, and puffery in its comparison to the
23 endoscopic procedure of Obalon’s competitors. *In re Cutera Sec. Litig.*, 610 F.3d 1103,
24 1111 (9th Cir. 2010) (“[M]ildly optimistic, subjective assessment hardly amounts to a
25 securities violation. Indeed, ‘professional investors, and most amateur investors as well,
26 know how to devalue the optimism of corporate executives.’”) (internal citations omitted).

27 Second, Lead Plaintiff’s theory that the Company omitted material information
28 regarding the performance of the Obalon Balloon also fails to state a claim because Obalon

1 Defendants in fact disclosed the allegedly omitted information in its SEC filings. *See Desai*
2 *v. Deutsche Bank Secs. Ltd.*, 573 F.3d 931, 939 (9th Cir. 2009) (“As for omissions, the term
3 generally refers to the failure to disclose material information about a company, as opposed
4 to affirmative manipulation.”) As an example, Lead Plaintiff alleges Obalon Defendants
5 failed to disclose that 90% of patients experienced adverse effects. (Compl. ¶ 138.) But as
6 Defendants highlight, this very fact was disclosed in the Company’s Form S-1/A, Form
7 424B, and Form 10-K for 2016 and 2017. (Doc. No. 41-1 at 20 (stating that the documents
8 disclosed “90.8% of patients who received the Obalon balloon system experienced an event
9 the FDA classifies as an adverse device event”).)

10 Lead Plaintiff counters Obalon Defendants essentially assert a “truth-on-the-market”
11 defense, which is generally inappropriate at the motion to dismiss stage. (Doc. No. 48 at
12 24); *In re Thoratec Corp. Sec. Litig.*, No. C-04-03168 RMW, 2006 WL 1305226, at *4
13 (N.D. Cal. May 11, 2006) (“A ‘truth-on-the-market’ defense is available in principle . . .
14 but not at the pleading stage.”) (internal quotations and citations omitted). Obalon
15 Defendants retort they are not raising a “truth-on-the-market” defense as to the *materiality*
16 of an allegedly false or misleading statement but are simply pointing out that the
17 purportedly omitted information was actually disclosed. (Doc. No. 59 at 9–10.) A “truth-
18 on-the-market” defense applies where “a defendant’s failure to disclose material
19 information may be excused where the information was made credibly available to the
20 market by *other sources*.” *Nguyen v. Radiant Pharm. Corp.*, No. SACV11–0406, 2011 WL
21 5041959, at *6 (C.D. Cal. Oct. 20, 2011) (citing *In re Amgen, Inc. Sec. Litig.*, 544 F. Supp.
22 2d 1009, 1025 (C.D. Cal. 2008)) (emphasis added). As such, Lead Plaintiff’s “truth-on-
23 the-market” argument is misplaced. Obalon Defendants here argue they disclosed all
24 required information in their Form S-1/A, Form 424B, and 2016 and 2017 Form 10-K to
25 the public. (Doc. No. 41-1 at 19–21.) Obalon Defendants *are not* contending they failed to
26 “make required disclosures but should be excused because other sources have already made
27 the same information available.” *See City of Royal Oak Ret. Sys. v. Juniper Networks, Inc.*,
28 880 F. Supp. 2d 1045, 1066 n.6 (N.D. Cal. 2012). As such, Obalon Defendants are not

1 raising an inappropriate “truth-on-the-market” defense. Because Obalon Defendants
2 disclosed the allegedly omitted facts regarding the Obalon Balloon’s performance, Lead
3 Plaintiff is unable to state a claim based on an omissions theory as to ease of use, safety,
4 and efficacy of the device.

5 Consequently, the Court concludes there was no Section 10(b) and Rule 10b-5
6 violation for statements relating to the Obalon Balloon’s performance.

7 **2. Statements Regarding Obalon’s Financial Condition**

8 Next, Lead Plaintiff asserts Obalon Defendants misrepresented the Company’s
9 financial condition. More specifically, Lead Plaintiff maintains Obalon Defendants touted
10 the strength of Obalon’s financials and interest from clients, when in actuality, sales had
11 stalled, and new client interested had declined. (Compl. ¶¶ 142, 140; Doc. No. 48 at 26.)
12 Obalon Defendants move to dismiss on the ground that there were no false or misleading
13 statements as to Obalon’s financial health. (Doc. No. 41-1 at 23.)

14 As an initial matter, several of the challenged statements relating to Obalon’s
15 financial condition are expressions of corporate optimism and puffery. Statements such as
16 client interest is “very, very high,” (Compl. ¶ 140), “I’m pleased that we had the percentage
17 of reorder we do” (*Id.*), and that market opportunities are “astounding” (*Id.* ¶ 144) are
18 statements of general corporate confidence routinely dismissed as inactionable puffery. *See*
19 *Police Ret. Sys. of St. Louis v. Intuitive Surgical, Inc.*, No. 10-CV-03451-LHK, 2012 WL
20 1868874, at *13 (N.D. Cal. May 22, 2012), *aff’d*, 759 F.3d 1051 (9th Cir. 2014) (statement
21 that market opportunity was “very, very large” was puffery); *Mazzaferro v. Aruba*
22 *Networks Inc.*, No. 13-CV-02342-VC, 2014 WL 12680773, at *1 (N.D. Cal. Aug. 1, 2014)
23 (holding statement of “[w]e are pleased with our continued momentum,” to be corporate
24 optimism); *In re iPhone 4S Consumer Litig.*, No. C 12-1127 CW, 2013 WL 3829653, at
25 *11 (N.D. Cal. July 23, 2013) (stating that statements such as “amazing” and “impressive”
26 are “generalized, vague and unspecific assertions, constituting mere ‘puffery’ upon which
27 a reasonable consumer could not rely.”) (internal citations omitted).

28 Statements of corporate optimism aside, Lead Plaintiff’s Complaint also alleges

1 Obalon Defendants “falsely touted reorders [of the Obalon Balloon] from existing clients,”
2 assuring investors, “it’s not as that these people make purchase and then sort of lose
3 interest. *I think all of them committed. . .*” (Compl. ¶ 140 (emphasis in original).) The
4 Court concludes Lead Plaintiff has adequately pled the existence of a false or misleading
5 statement. Here, Lead Plaintiff states with particularity the reasons why these statements
6 were misleading, given that the majority of the clients did not reorder Obalon Balloons,
7 and Obalon Defendants used a few committed clients to distract investors from the overall
8 lack of interest by a majority of clients. (*Id.* ¶ 106.) For example, despite flaunting the
9 apparent financial health of the Company and reorder sales from existing customers, Lead
10 Plaintiff points out Obalon Defendants admitted that a client who accounted for 36% of
11 reorders was not even “the company’s most active site.” (*Id.*) As such, Obalon Defendants’
12 statements regarding commitment of reorder sales “would give a reasonable investor the
13 ‘impression of a state of affairs that differs in a material way from one that actually exists.’”
14 *Brody v. Transitional Hosps. Corp.*, 280 F.3d 997, 1006 (9th Cir. 2002).

15 Lead Plaintiff also alleges that Obalon Defendants omitted material facts as to
16 Obalon’s financial state, rendering statements suggesting financial success misleading. For
17 instance, Lead Plaintiff challenges Obalon Defendants’ positive statements about the
18 Company’s 2017 increasing Obalon Balloon reorder sales without revealing that the starter
19 sales kits were decreasing, and the reorder sales were concentrated in a small number of
20 clients. (Compl. ¶ 145(a)-(b).) However, Obalon Defendants counter that the excerpts of
21 Obalon Defendants’ 1Q Earning Call transcript provided by Lead Plaintiff shows Obalon
22 Defendants disclosed that “the growth from quarter-to-quarter is driven by reorders, not
23 simply new stocking orders.” (Compl. ¶ 141.) But Lead Plaintiff succeeds in pleading that
24 the omission of decreasing starter sales kits, and that reorder sales were concentrated in a
25 small number of clients was misleading because it gave the impression of healthy and
26 equally distributed reorder accounts. Indeed, Obalon Defendants’ argument that they
27 disclosed that reorders was driving revenue is unavailing because statements that are
28 “literally true” can nevertheless be misleading in “their context and manner of

1 presentation.” *Miller v. Thane Int’l, Inc.*, 519 F.3d 879, 886 (9th Cir. 2008). Such is the
2 case here.

3 **3. Statements Concealing Obalon’s GAAP Violations**

4 The Court next turns to the allegations of Obalon Defendants’ Generally Accepted
5 Accounting Principles (“GAAP”) violations. Lead Plaintiff claims Obalon Defendants
6 “devised and executed a scheme to inflate 4Q17 revenues by prematurely recording future
7 revenues” in violation of GAAP while “touting 4Q17 as ‘[their] highest quarter ever.’”
8 (Compl. ¶ 148; Doc. No. 48 at 28.) The thrust of Obalon Defendants’ argument is that Lead
9 Plaintiff cannot survive the motion to dismiss because Lead Plaintiff does not explain what
10 Obalon’s accounting decision was, and why and how that decision was outside a zone of
11 reasonable accounting practices. (Doc. No. 41-1 at 29.)

12 As the Ninth Circuit has held, if properly pled, “overstating of revenues may state a
13 claim for securities fraud, as under GAAP, ‘revenue must be earned before it can be
14 recognized.’” *In re Daou Sys., Inc.*, 411 F.3d 1006, 1016 (9th Cir. 2005) (quoting *Hockey*
15 *v. Medhekar*, 30 F. Supp. 2d 1209, 1216 (N.D. Cal. 1998). “To properly state a claim for
16 accounting fraud, plaintiffs must ‘plead facts’ sufficient to support a conclusion that
17 [d]efendant[] prepared the fraudulent financial statements and that the alleged financial
18 fraud was material.” *In re Peerless Systems, Corp. Sec. Litig.*, 182 F. Supp. 2d 982, 991
19 (S.D. Cal. 2002) (citations omitted) (alterations in original). Additionally, when pleading
20 irregularities in revenue recognition, plaintiffs should allege “(1) ‘such basic details as the
21 approximate amount by which revenues and earnings were overstated’; (2) ‘the products
22 involved in the contingent transaction’; (3) ‘the dates of any of the transactions’; or (4) ‘the
23 identities of any of the customers or [company] employees involved in the transactions.’”
24 *In re McKesson*, 126 F. Supp. 2d 1248, 1273 (N.D. Cal. 2000) (quoting *Greebel v. FTP*
25 *Software, Inc.*, 194 F.3d 185, 204 (1st Cir. 1999). Plaintiffs need not allege each of those
26 particular details, but they must allege enough information so that “a court can discern
27 whether the alleged GAAP violations were minor or technical in nature, or whether they
28 constituted widespread and significant inflation of revenue.” *In re McKesson*, 126 F. Supp.

1 2d at 1273.

2 Here, the Court concludes that Lead Plaintiff has adequately alleged facts supporting
3 a plausible conclusion that Obalon Defendants concealed a revenue recognition scheme,
4 and that the alleged GAAP violation was material. First, in its Complaint, Lead Plaintiff
5 claims that the Company overstated its Q4 2017 revenue by 5%¹, acknowledged the
6 revenue recognition, and then corrected its Q4 2017 revenue after whistleblower
7 allegations. (Compl. ¶¶ 162, 165.) Specifically, Lead Plaintiff explains this revenue
8 overstatement resulted from Obalon’s failure to defer an appropriate amount of revenue
9 associated with certain patient lead lists offered to physicians as part of Obalon’s year-end
10 sales promotion. (*Id.* ¶¶ 157–162.) At the pleading stage for accounting fraud, Lead
11 Plaintiff’s allegations are sufficient to state a claim because it provides the “basic details”
12 such as the approximate amount by which revenues were overstated, and the transactions
13 involved that led to the purported overstatement. *See In re McKesson*, 126 F. Supp. 2d at
14 1273. Second, the Complaint also pleads that the overstatement was “quantitatively” material
15 as the amount was over 5%, and “qualitatively” material because the overstatement
16 “masked . . . expectations for the enterprise” and concerns a segment of the business that
17 “plays a significant role” in Obalon’s profitability. (Compl. ¶ 166.) Accordingly, Lead
18 Plaintiff has alleged with particularity misleading statements as to Obalon Defendants’
19 revenue recognition scheme.²

20 B. Scienter

21 The Court now turns to Obalon Defendants’ argument that Lead Plaintiff’s
22 Complaint should be dismissed for failure to plead scienter. (Doc. No. 41-1 at 30.)
23

24
25 ¹ Obalon Defendants argue that Lead Plaintiff’s Opposition is inconsistent with the Complaint on the
26 amount of revenue deferred. However, at this stage of litigation, Lead Plaintiff need only allege an
27 “approximate amount by which revenues and earnings were overstated,” not a precise amount. *See In re*
28 *McKesson*, 126 F. Supp. 2d at 1273.

² The Court, at this stage of the litigation, does not pass judgment on whether the Company’s own
investigation into the alleged GAAP violations resulted in proper findings. The Court, at this stage, only
holds that Lead Plaintiff has pled with enough specificity a plausible claim for account fraud.

1 “Scienter is [the] essential element of a § 10(b) claim.” *Lipton v. Pathogenesis Corp.*, 284
2 F.3d 1027, 1032 (9th Cir. 2002). The Supreme Court has explained that scienter for
3 purposes of Section 10(b) and Rule 10b–5 is “the defendant’s intention to deceive,
4 manipulate or defraud.” *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007).
5 The complaint must “state with particularity facts giving rise to a strong inference that the
6 defendant acted with the required state of mind.” *Id.* (quoting 15 U.S.C. § 78u–4(b)(2)).
7 This means a plaintiff “must provide, in great detail, all the relevant facts forming the basis
8 of her belief” that the defendant has acted with “deliberate recklessness or intent.” *In re*
9 *Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 985 (9th Cir. 1999), abrogated on other
10 grounds by *S. Ferry LP, No. 2 v. Killinger*, 542 F.3d 776 (9th Cir. 2008). A “strong
11 inference” is one that a reasonable person would deem “cogent and at least as compelling
12 as any opposing inference one could draw from the facts alleged.” *Tellabs*, 551 U.S. at 324.
13 When analyzing the sufficiency of a plaintiff’s scienter pleadings, the Court must
14 “determine whether any of the allegations, standing alone, are sufficient to create a strong
15 inference of scienter.” *N.M. State Inv. Council v. Ernst & Young LLP*, 641 F.3d 1089, 1095
16 (9th Cir. 2011). “[I]f no individual allegation is sufficient, we conduct a ‘holistic’ review
17 of the same allegations to determine whether the insufficient allegations combine to create
18 a strong inference of intentional conduct or deliberate recklessness.” *Id.*

19 **1. Scienter For Statements Relating to Obalon’s Financial Condition**

20 The Court holds that the Complaint alleges sufficient facts with particularity
21 demonstrating a strong inference of scienter.³ With regard to the statements relating to
22 Obalon’s financial condition, Lead Plaintiff adequately alleges the existence of scienter.
23 Lead Plaintiff invokes the “core operations doctrine,” arguing that because the Obalon
24 Balloon was the Company’s only product in a nascent business, it would be “absurd” to
25 suggest Obalon Defendants were not privy to the information about Obalon’s financial
26

27
28 ³ As the Court holds that there were no actionable statements with respect to the Obalon Balloon’s performance, the Court will not address the scienter arguments for that category of statements.

1 condition. (Doc. No. 48 at 33–34.) Obalon Defendants counter “corporate management’s
2 general awareness of the day-to-day workings of the company’s business does not establish
3 scienter” absent specific allegations of information conveyed to management. (Doc. No.
4 41-1 at 30–31 (quoting *Metzler*, 540 F.3d at 1068).) But here, Lead Plaintiff points out
5 Defendant Plovanic himself maintained “we work closely with our audit committee to
6 develop robust procedures for appropriately analyzing and recognizing revenue.” (Compl.
7 ¶ 194.) This fact provides a strong inference that Obalon Defendants closely monitored the
8 Company’s financials, and were aware of the state of Obalon’s financial condition. Indeed,
9 to suggest Obalon Defendants were not aware of the Company’s financial conditions as it
10 related to the revenue of the Company’s only product—while Obalon Defendants were
11 working closely with the audit committee—would strain credulity. *See Align Tech.*, 856
12 F.3d at 620 (“[P]articulized allegations that defendants had actual access to the disputed
13 information may raise a strong inference of scienter.”) (internal citations and quotations
14 omitted).

15 **2. Scienter For Statements Relating to GAAP Violations**

16 Lead Plaintiff’s Complaint also provides another independent basis for a finding of
17 scienter. Specifically, Lead Plaintiff emphasizes Obalon Defendants’ accounting
18 misconduct as evidence of scienter. (Doc. No. 48 at 31–33.) Obalon Defendants refutes
19 these allegations, arguing that Lead Plaintiff’s conclusory statements that “Defendants
20 knew or recklessly disregarded” that the statements were false does not meet Lead
21 Plaintiff’s burden of alleging particularized allegations. (Doc. No. 41-1 at 31–32.) The
22 Court agrees with Lead Plaintiff.

23 “[W]hen significant GAAP violations are described with particularity in the
24 complaint, they may provide powerful indirect evidence of scienter. After all, books do not
25 cook themselves.” *McKesson*, 126 F. Supp. 2d at 1273. Here, Lead Plaintiff provides
26 particularized facts suggesting Obalon Defendants were aware of the alleged revenue
27 recognition scheme. Lead Plaintiff does not simply conclude that Obalon Defendants
28 “knew or should have known” about the accounting errors but specifically points to: (1)

1 the Company’s rush to calculate financials for 4Q 2017, (2) the arrangement of a secondary
2 offering eleven days after the release of the 4Q 2017 financials, and (3) the allegations that
3 a whistleblower from within the Company alerted auditors Obalon Defendants had
4 incorrectly recognized revenue and management had “misled investors.” (Doc. No. 48 at
5 31–32; Compl. ¶ 183.) Taken together, these facts collectively paint a plausible picture that
6 Obalon Defendants were aware of the GAAP violations when touting their strong 4Q
7 performance. *See Tellabs*, 551 U.S. at 322–23 (“The inquiry . . . is whether all facts alleged,
8 taken collectively, give rise to a strong inference of scienter, not whether an individual
9 allegation, scrutinized in isolation, meets that standard.”). While Obalon Defendants
10 contend there was a non-culpable explanation for these allegations (namely, the Company
11 was optimistic about its future, attempted to raise capital, and investigated the purported
12 misconduct), the Court finds that at this stage of pleading, the facts presented by Lead
13 Plaintiff provide a reasonable inference of scienter, and one that is “at least as compelling
14 as any opposing inference of nonfraudulent intent.” *Tellabs*, 551 U.S. at 314.

15 C. Loss Causation

16 Even when deceptive conduct is properly pleaded, a securities fraud complaint must
17 also adequately plead “loss causation.” *Erica P. John Fund, Inc. v. Halliburton Co.*, 563
18 U.S. 804, 807 (2011). Loss causation is shorthand for the requirement that “investors must
19 demonstrate that the defendant’s deceptive conduct caused their claimed economic loss.”
20 *Id.* Thus, like a plaintiff claiming deceit at common law, the plaintiff in a securities fraud
21 action must demonstrate that an economic loss was caused by the defendant’s
22 misrepresentations, rather than some intervening event. *Dura*, 544 U.S. at 343–44. The
23 burden of pleading loss causation is typically satisfied by allegations that the defendant
24 revealed the truth through “corrective disclosures” which “caused the company’s stock
25 price to drop and investors to lose money.” *Halliburton*, 573 U.S. at 264.

26 Lead Plaintiff presents three disclosures to establish loss causation for the statements
27 relating to Obalon’s financial condition and revenue recognition scheme: (1) the disclosure
28 of the secondary offering, (2) the secondary offering’s sudden cancellation due to an

1 investigation of an Obalon whistleblower’s charge that the Company was improperly
2 recognizing revenue; and (3) the disclosure of inflated 4Q 2017 revenue and poor 1Q 2018
3 results. (Doc. No. 48 at 38.)

4 Specifically, the Complaint details the “cracks in the façade of the Company’s
5 financial condition appeared at the start of 2018” when on January 16, 2018, “Obalon
6 announced that it would return to the market to ask for an additional \$35 million in public
7 financing . . . just 15 months after the Company’s IPO raised \$67.4 million.” (Compl.
8 ¶ 179.) Lead Plaintiff alleges that the disclosure “resulted in a three-day slide of Obalon’s
9 stock price, which fell from \$7.93 on January 16, 2018, to \$5.24 on January 19, 2018, a
10 33.92% decline.” (*Id.* ¶ 180.) The Complaint also alleges that on January 23, 2018, Obalon
11 disclosed that a whistleblower had submitted a complaint to the Company’s independent
12 auditors for the Company’s improper revenue recognition, and that the Company would
13 investigate the alleged misconduct. (*Id.* ¶¶ 181, 183.) Following this announcement,
14 Obalon’s stock price dropped 33.33% from \$5.19 per share to \$3.46 per share. (*Id.* ¶ 182.)
15 Then, on May 10, 2018, Obalon revealed their disappointing 1Q 2018 earnings, and
16 disclosed that its strong 4Q 2017 results may have been attributed to its New Year
17 promotional scheme. (*Id.* ¶ 187.) Based on this news, Obalon’s stock dropped further from
18 \$4.32 per share to \$2.85 per share. (*Id.* ¶ 189.) In the face of these allegations, Obalon
19 Defendants’ main argument against a finding of loss causation is that “Plaintiff does not
20 allege, with particularity or at all, how these alleged investor reactions pertained to the
21 revelation of fraud” (Doc. No. 41-1.)

22 As the Ninth Circuit has recently held, “[d]isclosure of the fraud is not a sine qua
23 non of loss causation, which may be shown even where the alleged fraud is not necessarily
24 revealed prior to the economic loss.” *Mineworkers’ Pension Scheme v. First Solar Inc.*,
25 881 F.3d 750, 753 (9th Cir. 2018), cert. denied, 139 S. Ct. 2741 (2019). While the January
26 16, 2018 announcement of a secondary offering, standing alone, did not allege a corrective
27 disclosure, the additional allegations of the cancellation of the secondary offering, the
28 disclosure of an investigation into the purported accounting fraud, and the immediate drop

1 in stock prices thereafter following each announcement is enough to show “corrective
2 disclosures” which “caused the company’s stock price to drop and investors to lose
3 money.” *Halliburton*, 573 U.S. at 264.

4 Defendant cites to *Loos v. Immersion Corp.*, 762 F.3d 880, 883 (9th Cir. 2014), for
5 the proposition that “[t]he announcement of an investigation does not ‘reveal’ fraudulent
6 practices to the market.” Notwithstanding the Ninth Circuit’s recent articulation that the
7 disclosure of fraud is not necessary to establish loss causation, *First Solar Inc.*, 881 F.3d
8 at 753, as Ninth Circuit has also explained, “the announcement of an investigation can
9 ‘form the basis for a viable loss causation theory’ if the complaint also alleges a subsequent
10 corrective disclosure by the defendants.” *Lloyd v. CVB Fin. Corp.*, 811 F.3d 1200, 1210
11 (9th Cir. 2016).

12 Here, the Complaint does not only allege that an investigation was disclosed. Indeed,
13 the Complaint further contends: (1) Obalon’s disclosure of the accounting fraud
14 investigation caused its stock price to drop precipitously; (2) the secondary offering was
15 announced and cancelled, which caused the stock to drop; and (3) there was a corrective
16 disclosure by Obalon Defendants after the announcement of the investigation whereby
17 Obalon Defendants revealed their poor financial results for 1Q 2018. (Compl. ¶¶ 187–88).
18 Taken together, these allegations are sufficient to establish loss causation at the pleading
19 stage. *See, e.g., Mauss v. NuVasive, Inc.*, No. 13CV2005 JM (JLB), 2016 WL 3681831, at
20 *12 (S.D. Cal. July 12, 2016) (holding that the “the combination of partial disclosures” was
21 “sufficient to plead loss causation at this stage.”); *Pub. Employees Ret. Sys. of Mississippi,*
22 *Puerto Rico Teachers Ret. Sys. v. Amedisys, Inc.*, 769 F.3d 313, 324 (5th Cir. 2014)
23 (holding loss causation allegations “collectively constitute and culminate in a corrective
24 disclosure that adequately pleads loss causation for purposes of a Rule 12(b)(6) analysis.
25 This holding can best be understood by simply observing that the whole is greater than the
26
27
28

1 sum of its parts.”).⁴

2 * * *

3 Accordingly, the Court holds that Lead Plaintiff has adequately stated a claim for a
4 violation of Section 10(b) and Rule 10b-5 of the Exchange Act.

5 **I. Claims Under Section 20(a) of Securities Exchange Act of 1934**

6 The Court will now address Obalon Defendants’ motion to dismiss Count IV of
7 Lead Plaintiff’s Complaint for violation of Section 20(a) of the Exchange Act against
8 Defendants Rasdal and Plovanic. “[U]nder Section 20(a), plaintiff must prove: (1) a
9 primary violation of federal securities laws . . .; and (2) that the defendant exercised actual
10 power or control over the primary violator.” *Howard v. Everex Systems, Inc.*, 228 F.3d
11 1057, 1065 (9th Cir. 2000). “The statute is remedial and is to be construed liberally. It has
12 been interpreted as requiring only some indirect means of discipline or influence short of
13 actual direction to hold a ‘controlling person’ liable.” *Maher v. Durango Metals, Inc.*, 144
14 F.3d 1302, 1305 (10th Cir. 1998). “Plaintiff need not show that the defendant was a
15 culpable participant in the violation, but defendant may assert a ‘good faith’ defense.”
16 *Everex Systems*, 228 F.3d at 1065. Thus, “[t]o establish the liability of a controlling person,
17 the plaintiff does not have the burden of establishing that person’s scienter distinct from
18 the controlled corporation’s scienter.” *Arthur Children’s Trust v. Keim*, 994 F.2d 1390,
19 1398 (9th Cir. 1993).

20 Here, as discussed above, Lead Plaintiff has adequately pled a primary violation of
21 Section 10(b) and Rule 10b–5. Therefore, Lead Plaintiff prevails on the first prong of the
22 Section 20(a) requirements. Turning to the second prong, “[w]hether the defendant is a
23 controlling person is an intensely factual question, involving scrutiny of the defendant’s
24 participation in the day-to-day affairs of the corporation and the defendant’s power to
25 control corporate actions.” *Everex Systems*, 228 F.3d at 1065 (internal citations omitted).

26
27 ⁴ Lead Plaintiff cannot rely on the May 10, 2018 disclosure to establish loss causation because it sold its
28 shares of Obalon stock *before* the Company announced its disappointing quarter. See *Metzler*, 540 F.3d
at 1062.

1 Lead Plaintiff sufficiently alleges control liability under Section 20(a) against
2 Defendants Rasdal and Plovanic. To establish control, Plaintiffs must allege that
3 Defendants Rasdal and Plovanic were active in the day-to-day affairs of Obalon, or that
4 they exercised specific control over the preparation and release of the allegedly misleading
5 statements. *Id.* Lead Plaintiff has adequately done so. The Complaint contains numerous
6 allegations regarding Defendants Rasdal and Plovanic’s involvement in preparing the
7 alleged financial misstatements. (*See e.g.*, Compl. ¶ 183 (“[W]e work closely with our audit
8 committee to develop robust procedures for appropriately analyzing and recognizing
9 revenue.”) In addition, the Complaint alleges that both Defendants Rasdal and Plovanic
10 were involved in the day-to-day business of Obalon in their roles as Chief Executive
11 Officer, and Chief Financial Officer, respectively. (*Id.* ¶ 232.) Further, according to the
12 Complaint, Defendants Rasdal and Plovanic were provided with, or had unlimited access
13 to, “copies of the Company’s reports, press releases, public filings, and other statements
14 alleged by Lead Plaintiff to be misleading prior to and/or shortly after these statements
15 were issued and had the ability to prevent the issuance of the statements or cause the
16 statements to be corrected.” (*Id.* ¶ 231.)

17 Accordingly, Obalon Defendants’ motion to dismiss Count IV of the Complaint is
18 **DENIED.**

19 **II. Claims Under Section 11 of the Securities Act of 1933**

20 The Court now addresses all Defendants’ motion to dismiss Count I of the
21 Complaint. In Count I, Plaintiff TAPP asserts a violation of Section 11 of the Securities
22 Act against all Defendants. Section 11 establishes liability for false or misleading
23 statements or omissions contained within a registration statement. 15 U.S.C. § 77k(a).
24 Section 11 contains no scienter requirement and may be based on “innocent or negligent
25 material misstatements or omissions.” *Anderson v. Clow (In re Stac Elecs., Sec. Litig.)*, 89
26 F.3d 1399, 1404 (9th Cir. 1996) (quoting *Kaplan v. Rose*, 49 F.3d 1363, 1371 (9th Cir.
27 1994). In order to state a claim under Section 11, the plaintiff must prove: “(1) the
28 registration statement contained a material omission or misrepresentation, (2) the plaintiff

1 purchased a security that was part of a registered offering, and (3) the defendant falls into
2 one of the enumerated classes.” *In re Surebeam Corp. Sec. Litig.*, No. 03 CV
3 1721JM(POR), 2005 WL 5036360, at *6 (S.D. Cal. Jan. 3, 2005).

4 **A. Whether Plaintiff TAPP’s Claims are Time-Barred**

5 As a preliminary matter, Defendants contend Plaintiff TAPP’s Section 11 claim is
6 time-barred. (Doc. No. 42-1 at 16.) Section 11 claims must be brought “within one year
7 after the discovery of the untrue statement or the omission, or after such discovery should
8 have been made by the exercise of reasonable diligence.” 15 U.S.C. § 77m. This one-year
9 statute of limitations begins to run when the plaintiff discovered or should have discovered
10 the untrue statement or omission. *See F.D.I.C. v. Countrywide Fin. Corp.*, No. 12–cv–
11 04354, 2012 WL 5900973, at *3 (C.D. Cal. Nov. 21, 2012); *In re Bare Escentuals, Inc.*
12 *Sec. Litig.*, 745 F. Supp. 2d 1052, 1082 (N.D. Cal. 2010) (noting “discovery . . . occurs not
13 only once a plaintiff actually discovers the facts, but also when a hypothetical reasonably
14 diligent plaintiff would have discovered them”).

15 Defendants argue Plaintiff TAPP discovered or should have discovered the basis for
16 their Section 11 claim no later than June 21, 2017, the date on which the Northland Report
17 was released. (Doc. No. 42-1 at 16.) Defendants also assert that relation back under Federal
18 Rule of Civil Procedure 15(c) cannot save Plaintiff TAPP’s time-barred claims. (*Id.* at 16–
19 19.) Plaintiff TAPP maintains Defendants are wrong because: (1) the partial disclosures
20 did not disclose all “the facts constituting the violation”; (2) the statute was tolled; and (3)
21 the filing date relates back to the *Cook* Complaint. (Doc. No. 49 at 38.) The Court agrees
22 with Defendants.

23 First, Plaintiff TAPP “discovered or should have discovered” the facts surrounding
24 its Section 11 claim when the Northland Report was released. Here, Plaintiff TAPP alleges
25 the Northland Report, released on June 21, 2017, was the corrective disclosure for the
26 Section 11 claim, because it revealed for the first time the difficulties patients experienced
27 with the Obalon Balloon. (Compl. ¶¶ 170–73.) Indeed, the Complaint alleges, “[b]efore
28 June 21, 2017, investors had only heard positive reports from the analysts.” (Compl. ¶ 169.)

1 As such, Plaintiff TAPP, by June 21, 2017 “discovered or should have discovered” its
2 claims against Defendants. Thus, Plaintiff TAPP’s claims were time-barred by June 21,
3 2018. Because the Complaint was filed in October 5, 2018, the Complaint alleging a
4 Section 11 violation is untimely.⁵

5 Second, Plaintiff TAPP’s Section 11 claim did not relate back to the *Hustig* or *Cook*
6 Complaints. Federal Rule of Civil Procedure 15(c) provides “that an amendment adding a
7 new defendant will relate back to the original complaint” if three *separate* requirements
8 are met: (1) the claim brought against the new defendant “arose out of the conduct,
9 transaction, or occurrence set out—or attempted to be set out—in the original pleading”;
10 (2) within 120 days of the initial complaint, the new defendant received notice of the action;
11 and (3) within 120 days of the initial complaint, the new defendant “knew or should have
12 known that the action would have been brought against it, but for a mistake concerning the
13 proper party’s identity.” *Wilkins-Jones v. Cty. of Alameda*, 2012 WL 3116025, at *6 (N.D.
14 Cal. July 31, 2012) (quoting Fed. R. Civ. P. 15(c)).

15 Relation back is unavailable to Plaintiff TAPP because its Section 11 claim against
16 Defendants did not arise out of “the conduct, transaction, or occurrence” set out in the
17 original pleading. *Id.* at *6. The *Hustig* and *Cook* Complaints challenged statements
18 relating to Obalon’s accounting policies and GAAP compliance while the Consolidated
19 Complaint alleges for the first time misleading statements concerning the safety of use,
20 ease of placement, and efficacy of the Obalon Balloon. (Doc. No. 42-1.) The fact that the
21 Consolidated Complaint and the *Hustig* and *Cook* Complaints base their claims on the same
22

23
24 ⁵ Plaintiff TAPP’s argues that the statute of limitation to bring its Section 11 claims was equitably tolled
25 by the lead plaintiff appointment process. But Plaintiff TAPP does not provide any case law to support
26 this point. Plaintiff TAPP cites *In re Metro. Sec. Litig.*, 532 F. Supp. 2d 1260, 1282 (E.D. Wash. 2007)
27 for the proposition that Plaintiff TAPP did not have “control over when a court renders its decision” as to
28 the appointment of Lead Plaintiff. However, the Court does not find that Plaintiff TAPP has shown an
“extraordinary circumstance” to permit the Court to invoke equitable tolling. *See Barrett v. Forest Labs.,*
Inc., 2015 WL 4111827, at *3 (S.D.N.Y. July 8, 2015). The Court also notes that Plaintiff Cook was able
to timely file his complaint, which also asserted Section 11 claims. As such, Plaintiff TAPP’s Section 11
claims were not equitably tolled.

1 offering document does not change this analysis. *See Stichting Pensioenfonds ABP v.*
2 *Countrywide Fin. Corp.*, 802 F. Supp. 2d 1125, 1133 (C.D. Cal. 2011) (no relation back
3 where “the Original Complaint relates to the same offerings and the same offering materials
4 as the FAC. However, the complaints differ with respect to the specific facts alleged
5 regarding those offering materials.”); *In re Noah Educ. Holdings, Ltd. Sec. Litig.*, No. 08
6 CIV. 9203 (RJS), 2010 WL 1372709, at *9 (S.D.N.Y. Mar. 31, 2010) (holding that even
7 when both the Consolidated Complaint and original complaint arose from the same
8 offering documents, there was no relation back where original complaint focused on the
9 omission of information about the cost of raw materials while the new allegations involved
10 company’s regulatory requirements, labeling practices, or brand image).

11 Having found that Plaintiff TAPP fails the first requirement of relation back, the
12 Court need not address the other elements. Plaintiff TAPP’s Section 11 claim is time-
13 barred.

14 **B. False or Misleading Statements**

15 Even if Plaintiff TAPP’s Section 11 claim was timely, the Court would still find that
16 Plaintiff TAPP fails to state a claim under Section 11.⁶ A registration statement may violate
17 Section 11 in three ways by: (1) containing “an untrue statement of material fact”; (2)
18 omitting “a material fact required to be stated therein”; or (3) omitting a material fact
19 “necessary to make the statements therein not misleading.” 15 U.S.C. § 77k. Materiality is
20 ordinarily a factual question reserved for the jury. *Fecht v. Price Co.*, 70 F.3d 1078, 1081
21 (9th Cir. 1995).

22 First, as already explicated above, most of the statements Plaintiff TAPP challenges
23

24 ⁶ The Court also concludes that Defendants have presented an adequate affirmative defense to a Section
25 11 claim. Defendants argue “Section 11 defendants have an absolute ‘negative causation’ defense pursuant
26 to Section 11(e) for any [plaintiff] who disposed of their shares prior to the corrective disclosure.” *In re*
27 *McKesson*, 126 F. Supp. 2d at 1262. Here, Plaintiff TAPP contends that the corrective disclosure was the
28 June 21, 2017 Northland Report. (Compl. ¶¶ 169–78.) However, Plaintiff TAPP sold all its shares of
Obalon stock by March 2017, before the corrective disclosure occurred. Thus, Plaintiff TAPP cannot
attribute its losses to the Northland Report, which Plaintiff TAPP alleges revealed the false and misleading
statements.

1 as “an untrue statement of material fact” with regard to the safety of use, ease of placement,
2 and efficacy of the Obalon Balloon, were statements of non-actionable puffery. Statements
3 such as “overcome the limitations of traditional intragastric balloons” (Compl. ¶ 52),
4 “simple and convenient placement” (*Id.* ¶ 53), “favorable safety profile” (*Id.* ¶ 55) and
5 “durable” (*Id.* ¶ 57) are nothing more than expression of corporate optimism and puffing.
6 *See In re Dot Hill Sys. Corp. Sec. Litig.*, 594 F. Supp. 2d 1150, 1158 (S.D. Cal. 2008) (no
7 actionable statement when “statements that are so exaggerated or vague that no reasonable
8 investor would rely on the statement when considering the total mix of available
9 information.”) (internal citations and quotations omitted).

10 Second, most of the alleged omissions relating to the performance of the Obalon
11 Balloon Plaintiff TAPP complains were actually disclosed. As to the statements concerning
12 the Obalon Balloon’s efficacy, for example, Plaintiff TAPP alleges that Obalon “failed to
13 disclose that its product tested worse than its competitors” because “Orbera patients lost
14 22 pounds over the course of treatment, while Obalon patients lost only 15 pounds.”
15 (Compl. ¶ 58.) But as Defendants point out, Defendants disclosed these very facts in the
16 offering materials. (*See, e.g.*, Doc. No. 41-1, Ex. 1 at 87, 93 (disclosing both the weight
17 loss for the Orbera trial and SMART trial).) Additionally, as another example, with respect
18 to the statements concerning the Obalon Balloon’s ease of placement, Plaintiff TAPP
19 alleges Defendants did not disclose that “the Obalon treatment did not include a safety
20 gastrointestinal scan that is customary with the endoscopic placement of the Orbera and
21 ReShape balloons.” (Compl. ¶ 29.) However, as Defendants underscore, the offering
22 materials expressly explain the procedure to place the Obalon Balloon, and also explained
23 that the Obalon Balloon did not require the initial endoscopy. (Doc. No. 42-1 at 28.) The
24 Court finds that these disclosures are sufficient to demonstrate that Defendants disclosed
25 the allegedly omitted material facts. Indeed, federal securities laws only prohibit false or
26 misleading statements, it does not require Defendant to arrange disclosed information in a
27 way preferred by a plaintiff. *See Brody*, 280 F.3d at 1006 (“Rule 10b-5 . . . prohibit[s] only
28 misleading and untrue statements, not statements that are incomplete.”); *Lefter v. Yirendai*

1 *Ltd.*, No. CV1606437MWFAGR, 2017 WL 2857535, at *7 (C.D. Cal. June 20, 2017).

2 **III. Claims Under Section 15 of the Securities Act**

3 Lastly, in Count II of the Complaint, Plaintiff TAPP brings a claim under Section 15
4 of the Securities Act against the Obalon Defendants. Section 15 extends liability to so-
5 called “controlling persons”—persons who control those found liable under Section 11 are
6 also liable to plaintiffs. *See* 15 U.S.C. §§ 77o (requiring a primary violation of § 11 or
7 § 12(a)(2)). Liability under Section 15 is thus predicated on finding a violation of Section
8 11. *Anderson v. Clow*, No. 92-1120-R, 1994 WL 525256, at *12 (S.D. Cal. June 29, 1994).
9 Here, because Plaintiff TAPP does not state a claim under Section 11, Plaintiff TAPP’s
10 Section 15 claim also fails. Therefore, the motion to dismiss Count II of the Complaint is
11 **GRANTED.**


12 **CONCLUSION**

13 The Court concludes that Lead Plaintiff has sufficiently alleged a Section 10(b) and
14 Rule 10b-5 claim against Defendants Obalon, Rasdal, and Plovanic. Likewise, Lead
15 Plaintiff’s Section 20(a) claim against Defendants Rasdal and Plovanic survives
16 Defendants’ motions to dismiss. However, the Court holds that Plaintiff TAPP has failed
17 to plead a Section 11 and 15 claim against all Defendants.

18 Accordingly, the Court (1) **GRANTS IN PART AND DENIES IN PART** the
19 Obalon Defendants’ motion to dismiss; (2) **GRANTS** the Underwriter Defendants’ motion
20 to dismiss, without leave to amend; and (3) **GRANTS IN PART AND DENIES IN PART**
21 Defendants’ request for incorporation by reference and judicial notice.

22 **IT IS SO ORDERED.**

23 Dated: September 25, 2019

24 
25 Hon. Anthony J. Battaglia
26 United States District Judge
27
28