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AI Image Co. Hit With $14.1M Verdict Over Lowball Buyout

By **Dorothy Atkins**

Law360 (February 6, 2024, 9:11 PM EST) -- A California federal jury returned a $14.1 million verdict Monday in favor of investors alleging AI-imaging software company ArcSoft and its billionaire CEO duped them into selling their shares for less than they were worth by hiding information about the business's success, its move to China and its eventual IPO.

After a day of deliberating, a unanimous jury in Oakland, California, found ArcSoft liable for negligent misrepresentation and concealment, and found ArcSoft's CEO Michael Deng liable for breach of his fiduciary duty, according to the 25-page verdict form.

Jurors also rejected ArcSoft and Deng's affirmative defenses, but they cleared the defendants of other claims of intentional misrepresentation and breach of contract.

The jury awarded investor Marc Chan and his family $2.815 million in damages, and the family's British Virgin Island-based investment entities Pacific Smile Ltd. $2.62 million and Strong Wealth Ltd. $4.271 million — for a total of $9.07 million in compensatory damages — plus roughly $5.03 million in prejudgment interest. The added interest reflects a 7% interest rate since October 2017, which is when their shares were purchased, according to the investors' counsel.

The investors' attorney, Howard E. King of King Holmes Paterno & Soriano LLP, said in a statement Tuesday that after four years of a "scorched earth defense by one of the largest law firms in the world," Chan and his family are gratified by the jury's finding of liability on multiple causes of action.

"Mr. Chan has shown remarkable persistence and fortitude to achieve compensation for the fraud perpetrated against him by his former friend Michael Deng and Arcsoft — the company that Mr. Chan financially supported for almost 18 years before having his stock redeemed at an artificially low value as the company covertly pursued its eventual IPO," King said.

Counsel and representatives for the defendants didn't immediately respond to requests for comment Tuesday.

The verdict is the latest development in hotly contested litigation investors launched in 2019, alleging ArcSoft and its top brass duped them into agreeing to a less-than-fair-value buyout offer by omitting certain material information such as quarterly financial reports, audited financials, revenue projections and a fairness opinion.

According to the complaint, the omitted information showed that the company was doing much better financially than the defendants represented to the investors in 2017.

Deng founded the company, which was originally based in Fremont, California, in 1994, and although the business initially made and sold photo processing software for digital cameras, it has since shifted its business model and products to provide software and algorithms to original equipment manufacturers, the suit says. The technology is used in smartphones for 3D sensing, facial and gesture recognition and image processing and correction, as well as for visual processing in self-driving cars, according to the latest rendition of the investors' complaint.

The plaintiffs were early investors in the then-private company, which was called ArcSoft Inc., but in September 2017, they agreed to sell their shares after Deng allegedly told them the company was insolvent and facing a "dire" situation, when in reality its customer contracts and software downloads were tripling, and it was seeing more than 40% profit margins, according to the complaint.

Unbeknownst to the investors at the time, Deng had already begun transferring the California-based company's IP assets to its Chinese subsidiary, ArcSoft Corp. Ltd., and Deng eventually flipped the corporate structure using a series of complex corporate transactions and made ArcSoft Corp. the parent, and ArcSoft Inc. the subsidiary, the suit alleges.

The investors claim that after they sold their shares, Deng covertly moved the business to China, without notice to the U.S. government and without notifying the Committee on Foreign Investment in the U.S. ArcSoft completed its initial public offering in China in July 2019, and its value quickly grew 30 times greater than the buyout price paid to shareholders in 2017, the suit claims.

After multiple pleading rounds, in November, U.S. District Judge Jeffrey S. White granted the investors summary judgment in part, agreeing that Deng had a duty to disclose certain material information when soliciting votes for the buyout, and the judge accepted some of the alleged omitted information as material — such as Generally Accepted Accounting Principles, or GAAP, financials for the first two quarters of 2017.

However, the judge found that other omitted information, like the more detailed 2016 financial statements, was immaterial, and left the materiality of other items, such as the 2016 audited financial statements and Deng's most recent financial projections for ArcSoft, as a question for the jury.

Judge White also handed the investors a pretrial win on their claims of reliance and whether Deng had a fiduciary duty but said, "the question of whether Deng breached his duty by failing to provide a fairness opinion is a fact question for the jury."

The case went to a jury trial that kicked off last month on Jan. 22, and jurors began deliberations Friday, before returning the verdict against the defense Monday afternoon, according to court documents.

The investors are represented by Howard E. King, John Snow and Tor R. Braham of King

Holmes Paterno & Soriano LLP.

ArcSoft and Deng are represented by Michael Yoder, William Pao, Brittany Rogers and Daniel J. Tully of O'Melveny & Myers LLP.

The case is Lei Li et al. v. ArcSoft Inc. et al., case number 4:19-cv-05836, in the U.S. District Court for the Northern District of California.

--Additional reporting by Katryna Perera. Editing by Jeremy Abrams.
