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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE INITIAL PUBLIC OFFERING SECURITIES LITIGATION	Master File No. 21 MC 92 (SAS)
THIS DOCUMENT RELATES TO	
IN RE CORVIS CORP. INITIAL PUBLIC OFFERING SECURITIES LITIGATION	No. 01 Civ. 3857
IN RE FIREPOND, INC. INITIAL PUBLIC OFFERING SECURITIES LITIGATION	No. 01 Civ. 7048
IN RE IXL ENTERPRISES, INC. INITIAL PUBLIC OFFERING SECURITIES LITIGATION	No. 01 Civ. 9417
IN RE SYCAMORE NETWORKS, INC. INITIAL PUBLIC OFFERING SECURITIES LITIGATION	No. 01 Civ. 6001
IN RE VA SOFTWARE CORP. F/K/A VA LINUX, INC. INITIAL PUBLIC OFFERING SECURITIES LITIGATION	No. 01 Civ. 242

MEMORANDUM OF LAW IN SUPPORT OF ISSUER DEFENDANTS' MOTION TO DISMISS THE SECOND CONSOLIDATED AMENDED COMPLAINTS

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The issuers named in the focus cases (the "Focus Cases")[1] (collectively, the "Issuer Defendants") respectfully submit this memorandum of law in support of their motion to dismiss the Second Consolidated Amended Complaints ("Second Amended Complaints" or "2AC"). The Issuer Defendants incorporate by reference the legal standards and arguments set out by the underwriters named in these proceedings (the "Underwriter Defendants") in their memorandum of law submitted in support of their motion to dismiss, served November 14, 2007 (the "Und. Brief"), to the extent such arguments apply to the claims made against the Issuer Defendants. To avoid duplication and to provide context, certain of the Underwriter Defendants' arguments are also explicitly referenced herein. These references are not intended to limit the Issuer Defendants' incorporation of the arguments raised in support of the Underwriter Defendants' motion to dismiss.

[1] Six cases (out of more than 300) were selected to proceed as Focus Cases for purposes of class certification: (i) *In re Corvis Corp. IPO Sec. Litig.*, No. 01 Civ. 3857; (ii) *In re Engage Technologies, Inc. IPO Sec. Litig.*, No. 01 Civ. 8404; (iii) *In re Firepond, Inc. IPO Sec. Litig.*, No. 01 Civ. 7048; (iv) *In re iXL Enterprises, Inc. IPO Sec. Litig.*, No. 01 Civ. 9417; (v) *In re Sycamore Networks, Inc. IPO Sec. Litig.*, No. 01 Civ. 6001; and (vi) *In re VA Software Corp. f/k/a VA Linux, Inc. IPO Sec. Litig.*, No. 01 Civ. 242. *See In re IPO Sec. Litig*., 227 F.R.D. 65 (S.D.N.Y. 2004). Because plaintiffs have filed Second Amended Complaints only in these Focus Cases, this memorandum addresses claims against the Issuer Defendants in those complaints (*i.e.*, Corvis Corp. ("Corvis"); Firepond, Inc. ("Firepond"); iXL Enterprises, Inc. ("iXL"); Sycamore Networks, Inc. ("Sycamore"); and VA Software Corp. ("VA Linux")). Engage Technologies, Inc. ("Engage") is currently in bankruptcy proceedings in the U.S. Bankruptcy Court, District of Massachusetts, Western Division. On May 20, 2004, the court entered the Order Confirming Debtors' Second Amended Plan of Liquidation under Chapter 11 of the Bankruptcy Code, dated March 30, 2004, which provides that "[f]rom and after the entry of this Order . . . all injunctions or stays provided for in the Chapter 11 Case pursuant to sections 105, 362 or 524 of the Bankruptcy Code . . . shall remain in full force and effect until the entry of a final decree by this Court[.]" (Declaration of Joel C. Haims submitted in support of the Issuer Defendants' Motion to Dismiss ("Haims Decl.") Ex. 7 at ¶ 18.) Because a final decree has not been issued in these bankruptcy proceedings, plaintiffs are enjoined from proceeding against Engage. Accordingly, Engage is not a party to this motion to dismiss and the claims against it will not be discussed herein. Plaintiffs have indicated that claims against Engage are restated for purposes of preservation for a possible appeal, and that plaintiffs do not intend to press those claims at this time.

PRELIMINARY STATEMENT

After six years of litigation, millions of pages of document discovery, and more than one hundred depositions, plaintiffs' allegations against the Issuer Defendants are essentially unchanged. At the heart of the Second Amended Complaints is the assertion that the Issuer Defendants (indeed, virtually any high-tech company with an initial public offering ("IPO") in 1998 to 2000) must have known about, and been complicit in concealing, a scheme by their underwriters to manipulate their respective stocks in the aftermarket. Plaintiffs have persisted with this theory, and with the same deficient allegations, even though the alleged scheme presented no benefit to the Issuer Defendants and, in fact, would require each of them to forego millions in capital.

Though plaintiffs may be resistant to change, the law is not. It has evolved significantly since the Court's first ruling on motions to dismiss in these cases. *See In re IPO Sec. Litig*., 241 F. Supp. 2d 281 (S.D.N.Y. 2003) (the "2/19/03 Decision"). For example, to plead the required "strong inference" of scienter, plaintiffs must now posit a theory of intent that is both "cogent and compelling" and that is not overcome by a plausible nonculpable explanation – a pleading burden made especially difficult by the very obvious and countervailing inference that the Issuer Defendants had *no* incentive to further an alleged scheme by their underwriters that defies their own financial interests. Plaintiffs make no effort to meet this high standard – they either advance the same deficient allegations this Court has already rejected, or rely on unparticularized allegations of stock sales or corporate transactions in order to allege "motive" to commit fraud. When examined in context, however, these sales and transaction allegations are fundamentally flawed for the following reasons, among others:

- Many of the alleged corporate transactions took place months (sometimes more than a year) after the IPO, when the effect of the alleged manipulation had, according to plaintiffs, "dissipated" and when, in some

cases, the stocks in question were trading *below* the IPO price. The corporate transactions also often involved infinitesimal fractions of the Issuer Defendant's issued and outstanding shares or large cash payments;

- The alleged stock sales by individual officers and directors of the Issuer Defendants did not represent a significant portion of the seller's holdings; the sales took place long after the IPO and after the expiry of lengthy lock-up agreements (and, in some cases, took place after the end of the class period); and not all individuals identified in the Second Amended Complaints are alleged to have sold stock.

The notion that the Issuer Defendants were motivated to commit fraud at the time of their IPOs, only to wait months for the effect of the alleged manipulation to "dissipate," so they could then use a tiny fraction of their outstanding shares (and, in many cases, large amounts of cash) in a corporate transaction is not "cogent and compelling" – it is absurd. Similarly, the alleged stock sales – which were not unusual in timing or amount, and which were necessarily distanced from the IPO by lengthy lock-up periods – do not provide any coherent motive for scienter, much less the powerful inference required by the Private Securities Litigation Reform Act, 15 U.S.C. § 78u-4 (the "Reform Act") and Federal Rule of Civil Procedure 9(b) ("Rule 9(b)").

The allegations of loss causation fare no better. To state a fraudulent misrepresentation claim under Section 10(b) and Rule 10b-5 (collectively referred to herein as "Section 10(b)") of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78j(b) – the *only* 1934 Act claim against the Issuer Defendants – the law now demands the pleading of two critical and correlated elements in order to show cognizable harm: (1) some form of revelation to the market of the allegedly concealed information and (2) a related, negative impact on stock price. However, plaintiffs ignore these requirements, and instead advance the novel theory that 'nothing plus nothing equals something' – they contend that the *absence* of disclosure of the alleged manipulation at the time of the IPO, followed by the *absence* of public information exposing the scheme somehow "proximately" caused harm. That is not loss causation.

Even if plaintiffs could advance coherent theories of scienter and loss causation (and they plainly cannot), their claims would still fail for lack of the required particularity. The claims against the Issuer Defendants rest on the alleged failure to disclose an underlying manipulation by the Underwriter Defendants. Yet plaintiffs make no attempt to plead the sort of particulars (such as size, timing or price of the alleged "laddering" transactions) that are now clearly required to determine, in each case, whether "manipulation" even occurred, much less whether it was material. Without these particulars, it is impossible to assess whether the alleged misstatements and omissions were "false and misleading." Thus, where the particularity required for the underlying manipulation is utterly lacking, recent decisions show that courts have not hesitated to dismiss claims for failure to disclose the manipulation.

Finally, the law governing the pleading of claims under Section 11(a) ("Section 11") of the Securities Act of 1933 (the "1933 Act"), 15 U.S.C. § 77k, has also changed. The Second Circuit has ruled that plaintiffs can no longer bootstrap a Section 10(b) claim for fraudulent misrepresentation into a Section 11 claim without meeting the pleading requirements of Rule 9(b). As such, the lack of particularity, as described above, is equally fatal to plaintiffs' Section 11 claims.

All of plaintiffs' claims against the Issuer Defendants in the Focus Cases have no substance, and leave to replead at this point in the proceedings would be futile. The claims should be dismissed in their entirety, with prejudice.

PROCEDURAL HISTORY

Since the Court's 2/19/03 Decision,[2] plaintiffs have conducted over one hundred depositions, and the parties have exchanged millions of pages of document discovery. Plaintiffs also requested and received interviews with witnesses and documents from the issuers pursuant to cooperation provisions of a proposed settlement agreement. *See In re IPO Sec. Litig.*, 226 F.R.D. 186, 198 (S.D.N.Y. 2005).

Subsequent to this discovery, on August 14, 2007, plaintiffs filed the Second Amended Complaints in the Focus Cases and the Amended Master Allegations ("AMA"). The amendments to plaintiffs' allegations against the Issuer Defendants[3] (which continue to be based solely on alleged misstatements for failing to disclose the Underwriter Defendants' alleged scheme) are virtually nil.[4] The following points are significant:

- There is no allegation that any Issuer Defendant participated in the alleged manipulation;
- In the Amended Master Allegations, the allegations against the Issuer Defendants have not changed and remain buried in just two paragraphs (AMA ¶¶ 111, 112);
- The allegations of scienter have not changed, even where the Court previously found certain of these allegations to be insufficient (*see*, *e.g.*, Haims Decl. Ex. 2 ¶¶ 97-100). Plaintiffs still do not allege a single instance of an Issuer Defendant who actually knew of the alleged scheme;

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[2] The Court described plaintiffs' allegations at length in its 2/19/03 Decision. To avoid repetition, this memorandum will focus on the substance of plaintiffs' amendments.

[3] Individual officers and directors are no longer named as defendants in the Focus Cases and are now referred to as "Additional Persons" (*see*, *e.g.*, Sycamore 2AC ¶¶ 22-27).

[4] *See*, *e.g.*, blackline comparisons of Consolidated Amended Complaints and Second Amended Complaints in each Focus Case, and of the Corrected Master Allegations and the Amended Master Allegations, generated by the Issuer Defendants and attached as Exhibits 1-6 to the Haims Declaration.

- Plaintiffs add no detail (such as size, timing or price) to the general and conclusory allegations describing Tie-In Agreements and Undisclosed Compensation (*see* Haims Decl. Ex. 1 ¶ 37);

- The end of the class period in each Focus Case is still December 6, 2000 – however, plaintiffs no longer allege that any information concerning the alleged scheme was disclosed on that date. (*See*, *e.g*., Haims Decl. Ex. 5 at 19). Instead, plaintiffs now contend that the inflationary effect of the alleged manipulation "dissipated over time," and that by December 6, 2000, "much of the . . . inflation" had dissipated (*see id*. at ¶ 68).

Additionally, plaintiffs have attempted to plead around the Second Circuit's decision in *Miles v. Merrill Lynch & Co. (In re IPO Sec. Litig.)*, 471 F.3d 24, 52 (2d Cir. 2006), *reh'g denied*, 483 F.3d 70 (2d Cir. 2007), in which the Court of Appeals found that "[plaintiffs'] claim that lack of knowledge [of the manipulation] is common to the class is thoroughly undermined by the [p]laintiffs' own allegations as to how widespread was knowledge of the alleged scheme." 471 F.3d at 58. Now, rather than allege that the Underwriter Defendants' "customers" entered into Tie-in Agreements and paid Undisclosed Compensation (indicating widespread knowledge), plaintiffs now allege that only "certain customers" did so, without further specificity. (*See* Haims Decl. Ex. 5 ¶¶ 3-4.) Without any factual support, plaintiffs further allege that by entering into Tie-in Agreements with these "certain" customers, the Underwriter Defendants were somehow able to strike a perfect balance and "infect enough shares to manipulate stock prices, while maintaining enough secrecy to ensure that the investing public remained ignorant of the scheme." (AMA ¶ 35.)

ARGUMENT

I. PLAINTIFFS FAIL TO STATE A CLAIM UNDER SECTION 10(b) OF THE 1934 ACT.

A. The Standard for Pleading Scienter Has Changed Significantly Since the Court's 2/19/03 Decision.

The Supreme Court has recently ruled that to meet the Reform Act's pleading requirements, plaintiffs' factual allegations must support an inference of scienter that is "powerful or cogent" and "at least as compelling as any opposing inference" that could be drawn from the facts alleged. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, __ U.S. __, 127 S. Ct. 2499, 2504-05 (2007) (interpreting 15 U.S.C. § 78u-4(b)(2)). In order to determine whether this high standard has been met, "[t]he inquiry is inherently comparative" and requires consideration of "competing inferences," including "plausible nonculpable explanations for the defendant's conduct." *Id.* at 2510. *See also ATSI Comms., Inc. v. The Shaar Fund, Ltd.*, 493 F.3d 87, 104 (2d Cir. 2007) (facts must show that there is no "plausible nonculpable explanation" for the defendants' actions that is more likely than the inference of fraudulent intent). The allegations should not be "scrutinize[d] . . . in isolation," but instead viewed "holistically" in order to make this assessment. *Tellabs*, 127 S. Ct. at 2511. This standard for pleading scienter is markedly different from prior law, as applied by the Court in its 2/19/03 Decision. *See* 241 F. Supp. 2d at 330-31; 369-70, n.124 (declining to consider competing inferences of non-fraudulent intent); *see also In re Scottish Re Group Sec. Litig*., No. 06 Civ. 5853, 2007 WL 3256660, at *7 (S.D.N.Y. slip op. Nov. 2, 2007) (Scheindlin J.).

Plaintiffs' allegations of conscious misbehavior or recklessness are unchanged in any respect from those in their prior complaints. (*See*, *e.g*., Haims Decl. Ex. 2 ¶¶ 96-100.) This Court has already rejected these identical allegations, and they must be rejected again here. *In re IPO Sec. Litig*., 241 F. Supp. 2d at 363 n.108. Accordingly, plaintiffs must rely on their

remaining allegations of motive to plead scienter in connection with the Issuer Defendants, and as discussed below, these allegations do not survive scrutiny under current pleading standards.

B. The Allegations of Scienter Do Not Survive the Comparative Evaluation Mandated by *Tellabs* and *ATSI*.

When the comparative analysis mandated by *Tellabs* is applied to plaintiffs' allegations, they fall apart. To assess the allegations of scienter "holistically," they must be viewed in the context of the manipulative scheme plaintiffs allege the Underwriter Defendants and their customers conducted. As the Underwriter Defendants discuss in their brief, the attempt to plead around the Second Circuit's holding in *Miles*, 471 F.3d at 52, leaves plaintiffs advancing a nonsensical "goldilocks" theory of manipulation – the scheme was allegedly *just pervasive enough* to have a significant inflationary effect on the stocks at issue, but *not pervasive enough* to be "common knowledge." (*See* AMA ¶ 35; Und. Brief, Part I.) Yet plaintiffs maintain at the same time that the scheme was of massive proportions, and involved over *900 IPOs over a three-year period*. (AMA Ex. C.) How the Underwriter Defendants and their customers could conceivably have walked this tightrope and achieved the alleged long-term but "dissipating" inflation (in a market that plaintiffs have alleged was efficient) remains a mystery.

But even assuming such a scheme could have been achieved, plaintiffs do not explain why the Underwriter Defendants would share their alleged plans with the Issuer Defendants, since the sort of scheme described by plaintiffs would have been conducted at the Issuer Defendants' expense. As this Court noted in its 2/19/03 Decision, because the IPOs at issue may have been underpriced, it could be argued that "money that was rightfully [the Issuer Defendants'] ended up in the pockets of the Underwriters and the select investors who received the initial allocations," and thus the Issuer Defendants "may have lost a good deal of money . . . [and] may have had no motive to go along with the Underwriters' alleged scheme." 241 F. Supp.

2d at 369-370 & n.124. Indeed, the money allegedly "left on the table" by the Issuer Defendants as a result of underpricing is significant, and in some cases amounted to hundreds of millions of dollars.[5] Additionally, because *none* of the Issuer Defendants were profitable at the time of their IPOs, it defies logic for them to go along with a scheme that would enrich the Underwriter Defendants and their customers when the Issuer Defendants arguably could have used additional capital raised from their IPOs to fund their operations.[6]

Against this background, allegations showing that the Issuer Defendants were motivated to go along with a scheme that, by its nature, would cost the Issuer Defendants so much would have to be extraordinarily strong. In other words, plaintiffs have to allege motive-related facts that are so powerful and unusual that, standing alone, they create an inference of fraudulent intent sufficient to overcome the competing and compelling facts that the alleged underlying scheme would require the Issuer Defendants to behave contrary to their financial interests, and to agree to conceal a fraud that presented no direct financial benefit to them.

Plaintiffs do not come close to meeting this burden, and instead allege that the Issuer Defendants were motivated to conceal the Underwriter Defendants' alleged manipulation

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[5] In its 2/19/03 Decision, the Court calculated the "money left on the table" as the difference between the first-day closing price and IPO price, multiplied by the number of shares in the offering. 241 F. Supp. 2d at 370 n.124. Using this methodology, the differential for the Issuer Defendants is as follows: Firepond: $391,250,000 (*see* Haims Decl. Ex. 8 at 1 (showing the number of shares issued in Firepond's IPO; Ex. 12); iXL: $35,280,000 (*see* Haims Decl. Ex. 9 at 1; Ex. 13); Sycamore: $176,260,500 (*see* Haims Decl. Ex. 10 at 1; Ex. 14); and VA Linux: $920,700,000 (*see* Haims Decl. Ex. 11 at 1; Ex. 15).

[6] *See*, *e.g.*, Haims Decl. Ex. 11 at 7 ("[w]e do not expect to generate sufficient revenues to achieve profitability and . . . [will] incur net losses for at least the foreseeable future"); Haims Decl. Ex. 10 at 7 ("[w]e have not achieved profitability on a quarterly or annual basis, and anticipate that we will continue to incur net losses"); Haims Decl. Ex. 8 at 4 ("[w]e may not sustain our growth or generate sufficient revenues to attain profitability"); Haims Decl. Ex. 9 at 13 ("we may not be able to achieve or sustain profitability").

so that they could use the "inflated stock" as "currency" in corporate transactions. (*See*, *e.g.*, Sycamore 2AC ¶ 129(c).) But the alleged transactions are routine business events that typically involved only small fractions of the Issuer Defendants' issued and outstanding shares (and in some cases, large cash payments), and took place months after the IPO when the effect of the alleged manipulation was "dissipating" and when, in many cases, the stocks were trading below the IPO price. Plaintiffs also allege individual stock sales as motive, but *all* these alleged sales were necessarily distanced from the IPO by lengthy lock-up agreements. (*See, e.g*., Haims Decl. Exs. 16-17.) Plaintiffs nevertheless allege that the Issuer Defendants' directors and officers were motivated to conceal a scheme to give initial but dissipating price support to the Issuer Defendants' stocks *knowing* that they could not sell their personal holdings for at least six months after the IPOs.

In its 2/19/03 Decision, which pre-dated *Tellabs*, the Court declined to consider competing inferences arising from the allegations. 241 F. Supp. 2d at 370 n.124 ("on a motion to dismiss, alternative theories offered by Defendants cannot defeat the pleading"). *Tellabs* and *ATSI* now direct that alternative theories *must* be considered, and more particularly, that "the significance . . . ascribed to an allegation of motive, or lack thereof, depends on the entirety of the complaint." *Tellabs*, 127 S. Ct. at 2511. Viewing the pleadings in their entirety, it is neither cogent nor compelling to infer that the Issuer Defendants knew of and concealed the Underwriter Defendants' alleged "laddering" scheme, where such a scheme (a) could benefit only the Underwriter Defendants (who had no reason to disclose the scheme to the Issuer Defendants) and their customers; and (b) was executed at the expense of the Issuer Defendants (and may have limited their opportunity to raise much-needed capital), all so that (c) the Issuer Defendants could engage in routine corporate transactions or individual directors or officers could sell stock

long after the IPO when the effects of the manipulation had largely dissipated. Instead, the highly plausible, alternative explanations for the Issuer Defendants' alleged actions – *i.e.*, that the Underwriter Defendants did not engage in the pervasive manipulation alleged, or if such a manipulation occurred, the Issuer Defendants were unaware of it – are far more likely (indeed, *more* "cogent and compelling") than any inference of fraudulent intent.

The comparative evaluation prescribed by *Tellabs* and *ATSI* properly includes consideration of the details of the alleged transactions and sales available from public documents ordinarily considered on a motion to dismiss. *In re Scottish Re Group*, 2007 WL 3256660, at *7 n.99. These details were not before the Court at the time of its 2/19/03 Decision because of the omnibus briefing on behalf of more than 300 defendants required for the initial motion to dismiss. As set out below, when these details (which in many cases are not even pled) are examined, the weakness of plaintiffs' allegations is confirmed.

C. Plaintiffs' Allegations of Motive Do Not Support Any Inference of Scienter.

For ease of reference, plaintiffs' allegations of "motive" may be grouped into three categories: (1) the "Stock Holding Allegations" (*i.e.*, motive based on the "increase[] in value" of some officers' or directors' stock holdings); (2) the "Stock Sale Allegations" (*i.e.* motive based on sales of stock by certain directors or officers); and (3) the "Corporate Transaction Allegations" (*i.e.*, motive based on corporate transactions using "inflated" stock as "currency"). (*See*, *e.g.*, VA Linux 2AC ¶ 95(a)-(c).) The following chart summarizes the motive allegations made against the Issuer Defendants, with the exception of Corvis (plaintiffs' Section

10(b) claim against Corvis has already been dismissed with prejudice. *See* 241 F. Supp. 2d at 371 and App. 5C).[7]

Issuer Defendant	Stock Holding Allegations	Stock Sale Allegations	Corporate Transaction Allegations
Firepond	☒	☐	☒
iXL	☐	☐	☒
Sycamore	☒	☒	☒
VA Linux	☒	☒	☒

These allegations are discussed below.

1. Firepond

a. Mere Stock Holdings Cannot Support an Inference of Scienter and Stock Sales are Non-Existent.

Plaintiffs claim that Firepond was motivated to defraud investors because the personal stock holdings of some Additional Persons "substantially increased in value." It is well established that "mere ownership of stock . . . [is] insufficient to establish motive." *Kalnit v. Eichler*, 264 F.3d 131, 141 (2d Cir. 2001); *In re Gilat Satellite Networks, Ltd.*, No. CV-02-1510, 2005 WL 2277476, at *19 (E.D.N.Y. Sept. 19, 2005) (same). Accordingly, in its 2/19/03 Decision, the Court dismissed these allegations as against the Individual Defendants because allegations limited to simple ownership of shares could not possibly support the required strong inference of scienter. 241 F. Supp. 2d at 366-67. Because such allegations support *no* inference

[7] In pre-motion communications, plaintiffs indicated that the Section 10(b) claims against Corvis are restated for the purpose of preservation for a possible appeal. Plaintiffs stated that they do not intend to press those claims at this time and that they would stipulate that the Court would reach the same result if briefed at this time.

of scienter as to the directors or officers holding the stock, they cannot possibly suffice to infer scienter on the part of his or her corporate employer.[8]

Moreover, there are *no* stock sales by Firepond officers or directors alleged in the Second Amended Complaint. Since competing inferences must be considered (and assuming *arguendo* that individual stock sales can be imputed to the issuer as a basis for inferring fraud (*see* discussion *infra*, Part I.C.3.a.)), the complete absence of any personal benefit to insiders from the sale of stock militates against any inference of scienter (much less a strong inference). *See*, *e.g.*, *Kalnit*, 264 F.3d at 142 (allegations of motive were insufficient where plaintiffs did not point to "any specific benefit that would inure to the defendants").

b. The Alleged Corporate Transactions Clearly Support a "Nonculpable Explanation."

Plaintiffs allege that Firepond was motivated to commit fraud at the time of its IPO on February 4, 2000, because its "artificially inflated stock price could be utilized as currency in negotiating and/or consummating stock-based acquisitions after the IPO," specifically (1) the acquisition of Signature Software, Inc. ("Signature") on September 27, 2000 and (2) the acquisition of Brightware, Inc. ("Brightware") on February 16, 2001. (Firepond 2AC ¶ 96(c).)[9]

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[8] The same insufficient Stock Holding Allegations are made against Sycamore and VA Linux, and fail for the same reasons described above. To avoid unnecessary duplication, this point will not be repeated below in connection with the discussion of the particular scienter allegations against these Issuer Defendants.

[9] For ease of reference, the pertinent details of the Corporate Transaction Allegations (as set out in the Second Amended Complaints and in documents filed with the SEC) against Firepond and the other Issuer Defendants are set out in chart format as Exhibits 18-21 to the Haims Declaration. The Court may appropriately consider documents filed with the SEC on a motion to dismiss. *In re eSpeed, Inc. Sec. Litig.*, 457 F. Supp. 2d 266, 290 n.182 (S.D.N.Y. 2006) (Scheindlin, J.); *In re Scottish Re Group*, 2007 WL 3256660, at *7 n.99.

In its 2/19/03 Decision, the Court held, in general, that Corporate Transaction Allegations sufficed to allege scienter because "[t]hese benefits are sufficiently concrete and personal so as to provide a motive." 241 F. Supp. 2d at 369.[10] At that time, the omnibus briefing in support of the initial motion to dismiss prevented the Court from reviewing the pertinent details of each of the alleged transactions (such as size, timing, structure and the market price of the issuers' stock). As noted above, however, the "comparative evaluation" prescribed by *Tellabs*, 127 S. Ct. at 2504, requires an examination of these details and the relative strength or weakness of any competing inferences to be drawn therefrom. This exercise, when applied to the allegations against Firepond, reveals the fatal flaws in plaintiffs' motive allegations. For example:

- Firepond's acquisition of Signature took place on September 27, 2000, seven months *after* Firepond's IPO. (*See* Haims Decl. Ex. 18.)
- The stock price at the time of the transaction was approximately $14 per share, well *below* its IPO offering price of $22.00. (*See id.*; Firepond 2AC ¶ 27.)
- The stock portion of the Signature 'purchase price' constituted only about 0.8% of the total number of Firepond shares issued and outstanding. (Firepond did not even treat the transaction as material and did not file a Form 8-K or file the agreement as a "material contract" in its SEC filings.) (*See* Haims Decl. Ex. 18.)

Plaintiffs' contention that Firepond was "motivated" to commit fraud in connection with its IPO in order to complete an immaterial acquisition using an infinitesimal amount of its stock –

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[10] Recent (pre-*Tellabs*) cases in this District have concluded, however, that general allegations concerning acquisitions are insufficient to allege scienter. *See In re DRDGold Ltd. Sec. Litig.*, 472 F. Supp. 2d 562, 570-71 (S.D.N.Y. 2007) (finding allegation that defendants made misrepresentations in order to keep the stock price high so company could use inflated stock as capital for acquisitions insufficient to allege scienter); *In re JP Morgan Chase Sec. Litig.*, 363 F. Supp. 2d 595, 620 (S.D.N.Y. 2005) ("The unstated presumption that Chase began defrauding its own shareholders in contemplation of entering into merger talks is too nebulous to raise a strong inference of scienter.").

months *after* its stock price had declined below its offering price and *after* the effects of the alleged manipulative scheme, according to plaintiffs, had largely "dissipated" – fails as a matter of logic and law. (Firepond 2AC ¶ 53.) Indeed, it would make no sense for Firepond to leave $391 million "on the table" in order to make a $3 million acquisition seven months later. The competing inference that this was a minor corporate transaction completed long after the IPO, without knowledge of or reliance upon any underlying manipulative scheme, is far more "cogent and compelling." *Tellabs*, 127 S. Ct. at 2510. Moreover, there is no allegation that the Signature transaction was even considered by Firepond at the time of its IPO. Each of these facts detracts from any weak inference of motive the fact of the transaction alone might create.

The allegations concerning Firepond's acquisition of Brightware likewise undermine any inference of scienter. For example:

- The Brightware acquisition took place in February 2001, *over a year* after the IPO and *after the end of the class period*. (*See* Haims Decl. Ex. 18.)
- The stock price at the time of the transaction was approximately $5.13, well *below* the IPO price of $22.00. (*Id.*)
- The cash component ($8.5 million) represented approximately 37% of the purchase price. (*Id.*)
- The shares issued to Brightware constituted approximately 7.9% of the Firepond shares issued and outstanding at the time. (*Id.*)

It is difficult to imagine that Firepond was motivated to commit fraud so that it could execute this transaction (using a significant amount of cash) more than a year after its IPO and long *after the close of the class period* (when plaintiffs assert the effects of the manipulation had largely "dissipated" and when Firepond's stock was trading *well below the IPO price*). Again, the size, timing and structure of these two transactions – details of which are noticeably absent from the Second Amended Complaint – support the far more likely inference that Firepond had no awareness of the alleged scheme at the time of the IPO and no intent to commit fraud. *See In re*

DRDGold, 472 F. Supp. 2d at 571 (allegations that defendant kept stock price high to generate capital for acquisitions were insufficient to allege motive).

2. iXL[11]

a. Stock Sale Allegations are Non-Existent.

There are no allegations of stock sales by iXL directors or officers. Again, the absence of any "concrete benefit" to insiders from the alleged fraud undercuts any inference of scienter. *Goplen v. 51job, Inc.*, 453 F. Supp. 2d 759, 772 (S.D.N.Y. 2006) (no benefit shown where plaintiffs failed to allege that individual defendants "actually sold any stock during the Class Period").

b. The Secondary Offering and Alleged Corporate Transactions Do Not Support Any Inference of Scienter.

Plaintiffs have made several different Corporate Transaction Allegations against iXL, each of which is insufficient for different reasons. First, plaintiffs allege that iXL was motivated to commit fraud, so that it could "[sell] shares pursuant to a Secondary Offering on November 24, 1999," nearly six months after its IPO. (iXL 2AC ¶ 125(a).) Though the Court previously found such allegations concerning secondary offerings generally to be sufficient, 241 F. Supp. 2d at 370, this must be reexamined in light of *Tellabs*/*ATSI*. iXL's secondary offering is properly viewed in the context of iXL's public disclosures that it was not profitable at the time

[11] In addition, plaintiffs' claims against iXL should be barred due to iXL's bankruptcy proceeding. In November 2001, iXL was merged into a subsidiary of Scient, Inc. (*see* iXL 2AC ¶ 21), which filed a voluntary Chapter 11 petition on July 16, 2002 with other affiliated companies. *See In re Scient, Inc.*, No. 02-13455 (Bankr. S.D.N.Y.) (the "iXL Bankruptcy Proceeding"). At the conclusion of the iXL Bankruptcy Proceeding, all of the debtors' assets were distributed, the debtors were dissolved, and a Notice of Dismissal was approved by the court stating that all persons and entities with claims against the debtors are "enjoined from taking any action or asserting any claim against," among others, the successor to iXL as well as the other Debtors. (See Haims Decl. Ex. 24 at 1-2; Ex. 25 ¶ 3; and Ex. 26 at ¶¶ 4, 16.) (*Cf.* Haims Decl. Ex. 26 at ¶ 24.)

of its IPO or secondary offering, and had "incurred substantial losses since [its] inception and . . . anticipate[d] continuing to incur substantial losses for the foreseeable future." (Haims Decl. Ex. 22 at 7.) Thus, the inference of scienter plaintiffs advance on the basis of the secondary offering must be viewed alongside the competing inference that iXL simply had an urgent need to raise capital. As the district court held in *In re Turnstone Sys. Inc. Sec. Litig.*, No. 01 Civ. 1256 (SBA), 2003 U.S. Dist. LEXIS 26709, at *146 (N.D. Cal. Feb. 4, 2003):

> Plaintiff's suggestion that the conducting of the Secondary Offering itself gives rise to a strong inference of [the company's] scienter is meritless. . . . [A] corporation and its officers and directors are always motivated to raise capital for the corporation's cash needs. That [they] sought to do so by conducting the Secondary Offering is unremarkable. Were it to give rise to a strong inference of scienter, a corporation and its officers and directors would find themselves subject to a securities fraud lawsuit every time they conducted a public offering of the corporation's securities. This result is clearly not what Congress intended in passing the Exchange Act and the PSLRA.

See also In re Scottish Re Group, 2007 WL 3256660, at *14 ("plaintiffs' argument that an inference of fraud may be drawn based on the [defendants'] desire to raise funds in securities offerings fails") (citing *Rombach v. Chang,* 355 F.3d 164, 177 (2d Cir. 2004)). Moreover, the Additional Persons identified in the Second Amended Complaint are not alleged to have sold stock in connection with the iXL secondary offering, further undermining any inference of fraudulent intent. *Goplen*, 453 F. Supp. 2d at 772.

The other corporate transactions alleged by plaintiffs equally fail to support an inference of scienter. For example, plaintiffs allege, with no particularity whatsoever, that "25 companies were acquired in 1998 and 1999." (iXL 2AC ¶ 125.) This allegation does not provide *any* basis on which to infer scienter – including whether these acquisitions were stock- or cash-based, or even whether the acquisitions took place after iXL's IPO on June 2, 1999. In any event, iXL disclosed in its IPO prospectus that since inception, it had pursued a strategy of

acquiring smaller companies in order to rapidly expand its customer base and increase revenues. (*See*, *e.g.*, Haims Decl. Ex. 9 at 4 ("since our founding in March 1996 . . . [w]e have completed 34 acquisitions to gain critical mass, experienced professionals, industry expertise, technical skills and geographic coverage").) It further disclosed that it intended "to continue to invest heavily in acquisitions," and that it was "currently holding preliminary discussions with a number of candidates." (*Id.* at 12, 23.)

In light of these disclosures, it is hardly surprising that iXL completed certain acquisitions following its IPO. Plaintiffs nevertheless allege that iXL's acquisition of Tessera Enterprises "for a combination of cash and approximately 3.4 million shares of stock" and other alleged transactions involving iClick, Interactive Corporate Communications, Living Abroad Publishing and Health Pages were part of a motive to commit fraud. (iXL 2AC ¶ 125(b).) These allegations fail to allege scienter for at least the following reasons:

- The acquisition of Tessera Enterprises took place seven months after the IPO and iXL used just 5% of its issued and outstanding shares in that transaction, and less than the 4,000,000 shares iXL stated that it would be using for acquisitions. (*See* Haims Decl. Ex. 19.)
- iClick and Interactive Corporate Communications ("ICC") are the same entity (iClick changed its name in connection with this transaction). More importantly, iXL stock was not used to finance this transaction. iXL's wholly-owned subsidiary Consumer Financial Network, Inc. ("CFN") acquired ICC using CFN stock and warrants. (*Id.*)

No public information is available for the Living Abroad and Health Pages acquisitions, which in any event are properly seen as part of the overall growth strategy iXL had been pursuing since its founding and long before its IPO. Once again, when the details of the alleged corporate transactions are examined in context, the allegations collapse and fail to support any inference of scienter. The far more plausible inference is that iXL entered into these transactions – months

after the IPO, without using stock-based financing, and/or using cash – without the remotest contemplation of any alleged manipulative scheme.

3. Sycamore

a. The Alleged Stock Sales Negate Any Inference of Scienter.

Plaintiffs contend that because the Additional Persons identified in the Second Amended Complaint were "enabled" to sell their stock at allegedly inflated prices, scienter can be inferred as to Sycamore. (Sycamore 2AC ¶ 129(b).) However, in its 2/19/03 Decision, the Court specifically dismissed four issuers, notwithstanding the Court's finding that Stock Sale Allegations in those cases were sufficient to allege scienter as to the Individual Defendants.[12] The Court thus implicitly ruled that scienter should not be imputed to a corporate employer on the basis of stock sales by its individual officers or directors. *See* 241 F. Supp. 2d at 366 n.114 and 371 n.128.[13]

Even assuming that sales by individuals may be invoked to allege scienter against his or her corporate employer, the Stock Sale Allegations are doomed from the outset. The issue in securities fraud cases in which plaintiffs rely on stock sales to plead scienter is whether insiders' sales *before* adverse information is released support the inference that the insiders knew such information at the time of their sales. But in these cases, there is *no* alleged disclosing event whereby the alleged underlying manipulative scheme was revealed to the market (*see*

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[12] The four issuers are Diversa Corp.; IMPSAT Fiber Networks, Inc.; NetRatings, Inc.; Transmeta Corp. *See* 241 F. Supp. 2d at 366 n.114 (App. 4A) and 371 n.128 (App. 5C).

[13] It is not clear, however, whether stock sales by insiders could ever properly allege scienter as to their corporate employer. *See Adams v. Kinder-Morgan, Inc.,* 340 F.3d 1083, 1106 (10th Cir. 2003) (citing *Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87 (2d Cir. 2001) (scienter of senior controlling officers may be attributed to corporation only where "those senior officials were acting within the scope of their apparent authority")).

discussion *infra*, Part I.D.2). Plaintiffs assert instead that the "artificial inflation" caused by the alleged underlying manipulation "dissipated" over time, but the pleadings do not indicate when this alleged dissipation began or ended. Without these particulars, it is impossible to infer, for any particular sale, that its timing was "unusual" or "suspicious" so as to support an inference of scienter. Additionally, as discussed above, *all* alleged sales were necessarily distanced from the manipulation by lengthy lock-up agreements entered into at the time of the IPO.

Moreover, when examined in context, the details of the stock sales negate any inference of scienter. As this Court explained in its decision in *In re eSpeed, Inc. Sec. Litig.*, 457 F. Supp. 2d 266 (S.D.N.Y. 2006) (Scheindlin, J.), stock sales may not be considered in a vacuum. Rather, several factors must be weighed to determine whether the required strong inference of scienter has been pled as to an Issuer Defendant, such as (1) whether high-ranking individuals with significant stock holdings did *not* sell stock (or even increased their holdings) during the class period; (2) whether individuals who sold stock earned a profit; and (3) whether the alleged sales constituted a significant percentage of stock holdings (including consideration of exercisable stock options). 457 F. Supp. 2d at 289-92.

When these particulars – which are entirely absent from the Second Amended Complaints – are considered, it is clear the Stock Sale Allegations against Sycamore fail to support an inference of scienter. For example:

- Not all Additional Persons identified in the Second Amended Complaint are alleged to have sold stock during the class period. (Sycamore 2AC ¶¶ 22-27 and 129(b).)
- Two of the sellers were board members whose class period sales amounted to just over 6% and 9% of their holdings (including exercisable stock options), respectively. (*See* Haims Decl. Ex. 17 at 1, 2.)
- The remaining two sellers (Sycamore's CFO and its President/CEO) had class period sales totaling just 11.4% and 2.3% of their holdings (including exercisable stock options), respectively. (*See id.* at 3, 4.)

- All sales took place in late June 2000, approximately eight months after Sycamore's IPO and well after the expiry of the 180-day lock-up period in April 2000; the remaining sales took place *after the end of the class period.* (*See id*. at 1-4.)[14]

First, as to timing of the sales, plaintiffs indiscriminately lump together pre- and post-class period stock sales in an attempt to make them look "unusual," but stock sales after the end of the class period are irrelevant to any inference of scienter. *See Lirette v. Shiva Corp.*, 27 F. Supp. 2d 268, 283 n.10 (D. Mass. 1998) (citing *Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 54 (2d Cir. 1995) (stock sales outside of class period do not support an inference of scienter)). The timing of the other sales is notable only because the individuals did *not* sell at the first opportunity, but waited until well after expiration of the lock-up period, as the effect of the alleged manipulation "dissipated." *See Ressler v. Liz Claiborne, Inc.,* 75 F. Supp. 2d 43, 60 (E.D.N.Y. 1998) ("[t]he timing of a transaction is unusual or suspicious when its timing is calculated to maximize personal benefit from inside information.").

Second, as to the amount, the percentage of holdings sold during the class period by each of the Sycamore individuals was equal to or lower than the 11% that was deemed insufficient by the Second Circuit in *Acito*, 47 F.3d at 54 (stock sales of approximately 11% of director's holdings were not "unusual" so as to permit inference of scienter); *see also Kwalbrun v. Glenayre Technologies, Inc.*, No. 99-7125, 1999 WL 1212491, at *2 (2d Cir. Dec. 16, 1999) (finding scienter allegations insufficient where defendants' stock sales were well below 11% of holdings).[15] For any and all of these reasons, the Stock Sale Allegations against Sycamore fail.

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[14] Only one transaction by Mr. Deshpande took place prior to expiry of the lock-up period in connection with Sycamore's secondary offering on March 14, 2000. However, this transaction concerned just 0.3% of Mr. Deshpande's holdings. (*See* Haims Decl. Ex. 17 at 2.)

[15] Courts within the Second Circuit regularly dismiss Section 10(b) claims for failure to plead motive where the percentage of stock sold is not unusual or suspicious. *See*, *e.g*.,
(Footnote continues on following page.)

b. The Secondary Offering and Single Alleged Corporate Transaction Do Not Support Any Inference of Scienter.

Plaintiffs' Corporate Transaction Allegations against Sycamore include the company's secondary offering, which took place nearly five months after its IPO, and one acquisition which took place more than 10 months after Sycamore's IPO.

As discussed above, a secondary offering, standing alone, does not support an inference of scienter. *In re Turnstone Sys.*, 2003 U.S. Dist. LEXIS 26709, at *146. At the time of its secondary offering, Sycamore disclosed that "[w]e have incurred significant losses since inception and expect to continue to incur losses in the future. . . . We have not achieved profitability on a quarterly or annual basis and anticipate that we will continue to incur net losses." (Haims Decl. Ex. 23 at 6.) Sycamore clearly had a need to raise capital and viewed in context, the secondary offering has an obviously "plausible nonculpable explanation." *Tellabs*, 127 S. Ct. at 2510.

Finally, the sole alleged acquisition used only 11% of Sycamore's issued and outstanding shares and again, took place over 10 months after Sycamore's IPO when the effects of the alleged scheme were "dissipating." (Haims Decl. Ex. 20.) These facts do not support a strong inference of scienter.

4. VA Linux

a. The Alleged Stock Sales Negate Any Inference of Scienter.

Plaintiffs' Stock Sale Allegations against VA Linux are limited to a single allegation that one of the two Additional Persons identified in the Second Amended Complaint

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(Footnote continued from previous page)
In re Corning Inc. Sec. Litig., No. 01-CV-6580, 2004 WL 1056063, at *27-30 (W.D.N.Y. Apr. 9, 2004) (no inference of scienter based on sales of 4% and 14.8% by one officer, and 11% by another), *aff'd*, No. 04-2845-CV, 2005 WL 714352 (2d Cir. Mar. 30, 2005).

sold stock. (VA Linux 2AC ¶ 95(b).)[16] Plaintiffs assert that this lone seller disposed of "130,000 shares," but leave out the date of this alleged sale and any indication of the seller's overall holdings – once again making it impossible to assess this transaction in context. *Id.*

Once these details are examined, the allegations fall to pieces. Public filings indicate that the seller sold just 30,000 shares – *not* 130,000, as alleged – spread over separate transactions in June and September 2000. (*See* Haims Decl. Ex. 16.) Each transaction represented a small fraction of the seller's holdings at the time and the largest percentage sold (approximately 10%) took place in September 2000, long after the expiration of the lock-up period and about nine months after the IPO when, according to plaintiffs, "much" of the inflationary effect of the alleged scheme had "dissipated." (*See id.*; VA Linux 2AC ¶ 52.) *Fishbaum v. Liz Claiborne, Inc.*, No. 98-9396, 1999 WL 568023, at *4 (2d Cir. July 27, 1999) (no inference of scienter where most insider trades pre-dated or post-dated alleged misstatements by months). Accordingly, the Stock Sale Allegations fail to support any inference of scienter on the part of the Issuer Defendant and, again, a nonculpable explanation for the sales is far more likely.

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[16] This allegation fails under the standard set out in *eSpeed*, where the Court viewed the fact that one of the individual defendants did not sell any stock as a "dispositive factor." *In re eSpeed*, 457 F. Supp. 2d at 291. Indeed, a strong inference of scienter on the part of the Issuer Defendant cannot be supported on the basis of allegations of one selling shareholder. *See*, *e.g.*, *In re Corning Inc. Sec. Litig.*, No. 04-2845-CV, 2005 WL 714352, at *2 (2d Cir. Mar. 30, 2005) (Summary Order) (stock sales by only one executive are insufficient to create inference of scienter).

b. The Alleged Corporate Transactions Involving Large Cash Components Do Not Support Any Inference of Scienter.

Plaintiffs also allege that VA Linux was motivated to commit fraud so that it could engage in three alleged acquisitions. (VA Linux 2AC ¶ 95(c).) Once again, the details of these transactions undermine any inference of scienter:

- All three acquisitions were conducted using miniscule percentages of VA Linux's issued and outstanding stock: 0.6% for the acquisition of NetAttach, Inc.; 0.07% for the acquisition of Precision Insight, Inc.; and less than 2% for TruSolutions, Inc. (*See* Haims Decl. Ex. 21.)
- All three transactions took place more than three and a half months after the IPO. (*See id.*)
- All three transactions had significant cash components: $10 million (27% of purchase price) for Net Attach, Inc.; $1.8 million (44% of purchase price) for Precision Insight, Inc.; and $10 million (14% of purchase price) for TruSolutions, Inc. (*See id.*)

In each case, rather than using its "inflated stock price as currency," VA Linux was using *actual* currency in significant amounts. Like the other Issuer Defendants, VA Linux was not profitable at the time of its IPO. (Haims Decl. Ex. 11 at 7.) Yet plaintiffs contend that VA Linux nevertheless went along with the alleged manipulative scheme of the Underwriter Defendants – even though it allegedly involved underpricing the IPO and foregoing millions in much-needed capital – so that VA Linux could later engage in transactions using small fractions of its issued and outstanding stock and a large amount of cash. The inference plaintiffs ask the Court to draw is not only far too attenuated, it is irrational and clearly overcome by more plausible, nonculpable explanations for the transactions. For all of these reasons, the Corporate Transaction Allegations against VA Linux fail to support any inference of scienter, much less the "strong" inference required under the Reform Act.

D. Plaintiffs Fail to Allege Loss Causation.

Even if plaintiffs had adequately pled scienter (and they have not), the Section 10(b) claims against the Issuer Defendants would still fail because plaintiffs cannot plead the required element of loss causation. Plaintiffs apparently contend that the absence of any disclosure of the alleged manipulative scheme, followed by the absence of any public information revealing the alleged scheme to the market, somehow adds up to proximate cause. It does not.

At most, the Second Amended Complaints allege unquantified and unspecific "dissipating" price inflation throughout the class periods that was (somehow) achieved by the Underwriter Defendants' alleged manipulative scheme. Plaintiffs do not (and cannot) point to any inflation in stock price caused by the alleged concealment of the scheme *or* any subsequent decline in stock price caused by a disclosure of the scheme. Absent such a showing, plaintiffs fail to identify *any* loss resulting from the Issuer Defendants' alleged failure to disclose, as required by recent decisions of both the Supreme Court and the Second Circuit. Moreover, even if a loss were identified and a connection were made to the Issuer Defendants' alleged misstatements or omissions (hurdles that cannot be overcome), there is still no allegation to suggest even what rough proportion of loss could be ascribed to the Issuer Defendants. As a result, loss causation is not alleged and the Section 10(b) claims against the Issuer Defendants must be dismissed.[17]

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[17] For purposes of this motion to dismiss only, the Issuer Defendants accept plaintiffs' allegations that the market in each of the stocks at issue was efficient. (*See*, *e.g.*, Firepond 2AC ¶ 63.) The Issuer Defendants reserve the right to dispute this allegation at an appropriate later time. Indeed, as discussed in the Underwriter Defendants' brief, there is a fatal tension in the Second Amended Complaints between the explicit claim that the market was efficient for purposes of transaction causation, and the implicit conclusion that the long-term inflationary effect alleged by plaintiffs could only have persisted in a severely inefficient market.

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1. The Pleadings Allege Only "Artificial Inflation" and Therefore Fail Under *Dura, Lentell* and *Emergent Capital*.

In simplest terms, economic loss may arise where a stock that was once worth more is now worth less. To plead loss causation in a securities fraud case, plaintiffs must allege *facts* (not conclusions) to show that alleged misstatements or omissions were the proximate cause of that decline in value. However, both the Supreme Court and the Second Circuit have made it abundantly clear that merely alleging price "inflation" is entirely insufficient to plead loss causation for a Section 10(b) claim based on alleged misstatements and omissions. *See Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 346 (2005);[18] *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 173-75 (2d Cir. 2005); *Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc.*, 343 F.3d 189 (2d Cir. 2003).

In *Lentell*, the Second Circuit extended the holding in *Dura* and ruled that to plead loss causation for a Section 10(b) misrepresentation claim, plaintiffs must further allege

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The Issuer Defendants join in the Underwriter Defendants' arguments concerning this fundamental incoherence in the pleadings, which provides an independent basis for dismissal.

[18] The Supreme Court in *Dura* left open the issue of whether the pleading of loss causation is governed by Rule 8(a) or 9(b). *Dura*, 544 U.S. at 346. The Second Circuit has required, however, that a plaintiff "allege loss causation with sufficient particularity such that we can determine whether the factual basis for its claim, if proven, could support an inference of proximate cause." *First Nationwide Bank v. Gelt*, 27 F.3d 763, 770 (2d Cir. 1994). As discussed herein, plaintiffs' vague allegations of an inflationary effect that somehow persisted but "dissipated" throughout the class periods do not meet even the most basic notice pleading standard. Moreover, allegations of the underlying manipulation and its effect on each of the stocks at issue are essential to pleading the "circumstances constituting fraud" in connection with both the market manipulation claims against the Underwriter Defendants and the misrepresentation claims against all defendants. Accordingly, allegations describing the "nature, purpose, and effect of the fraudulent conduct" *must* be pled with particularity. *See ATSI*, 493 F.3d at 102 (citing *In re Blech Sec. Litig.*, 928 F. Supp. 1279, 1291 (S.D.N.Y. 1996)) and discussion *infra*, Part III. Thus, insofar as allegations concerning the "effect" of the manipulation in these cases are part and parcel of loss causation, the particularity requirement attaches.

facts to show "that the misstatement or omission concealed something from the market that, *when disclosed*, *negatively affected the value of the security*." 396 F.3d at 173 (emphasis added). Indeed, because myriad factors may affect the value of a security, pleading facts to show specifically that *disclosure of the concealed information* led to a decline in stock price is critical to circumscribing potential liability under the securities laws. *See Dura*, 544 U.S. at 345 (these "statutes make [private] actions available, not to provide investors with broad insurance against market losses, but to protect them against those economic losses that *misrepresentations actually cause*" (emphasis added)); *Lentell*, 396 F.3d at 174 (loss causation requirement "fix[es] a legal limit on a person's responsibility") (citation omitted). Thus, "[u]nless plaintiffs can allege that their losses were attributable to *some form of revelation* to the market of wrongfully concealed information, they are not recoverable in a private securities action." *In re Ramp Corp. Sec. Litig.*, No. 05 Civ. 6521, 2006 WL 2037913, at *9 (S.D.N.Y. July 21, 2006) (emphasis added).

A review of the allegations of loss causation in the Second Amended Complaints – which are identical in each Focus Case – shows that plaintiffs fail to plead this element of their claims:

> Defendants' conduct alleged herein *created artificial demand* for aftermarket stock and *inflated the price of the Issuers' common stock above the price that otherwise would have prevailed* in a fair and open market *from the time of the first open market trade of the Issuer's stock through the end of the Class Period.*
>
> As the undisclosed risk of Defendants' misconduct materialized, *the artificial inflation in the stock price dissipated over time*, causing the stock price to drop. *By December 6, 2000*, much of the risk caused by Defendants' wrongful conduct had materialized, and *much of the artificial inflation in the stock price caused by Defendants' wrongful conduct as alleged herein had dissipated*, thereby causing Plaintiffs and Class members to sustain substantial and foreseeable damages.

(*See, e.g.*, Sycamore 2AC ¶¶ 67-68 (emphasis added).) Plaintiffs' theory of loss causation is fundamentally indistinguishable from the theory rejected in *Dura* – they essentially allege nothing more than price inflation (albeit lengthy and "dissipating"). And the source of this price inflation, according to plaintiffs, was alleged laddering purchases (or purchase orders) undertaken by the Underwriter Defendants' customers, over whom the Issuer Defendants had no control whatsoever. The Issuer Defendants' alleged "misstatements" (which purportedly concealed an underlying manipulative scheme) had no bearing on the investment value of the securities being offered, and could not independently have had any inflationary effect on price.[19] But even assuming these misstatements could conceivably have inflated the stock price in the long-term way that plaintiffs have alleged (and they could not), there is no allegation that either the alleged concealed scheme or the false statements were ever revealed to the market and, thus, in turn, there can be no allegation that the Issuer Defendants' stock prices ever declined in reaction to such news.

In this regard, a distinction must first be drawn between claims based on market manipulation and claims based on misstatements or omissions, as this Court recognized in *In re IPO Sec. Litig.*, 297 F. Supp. 2d 668 (S.D.N.Y. 2003) (denying Underwriter Defendants' motion for judgment on the pleadings based on *Emergent Capital*). In this decision – which pre-dated both *Dura* and *Lentell* – the Court reviewed the Second Circuit's holding in *Emergent Capital*, and reiterated that in a misstatement case, "allegations of artificial inflation, without more, do not suffice to plead loss causation." *Id.* at 672. By contrast, the Court found that allegations of artificial inflation may suffice to plead loss causation in the *manipulation* context, because

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[19] Plaintiffs do not explain how the alleged "artificial demand for aftermarket stock" managed to sustain this alleged inflation for months and, in some cases, years. These additional pleading deficiencies are discussed *infra*, Part I.E.

(unlike a misstatement or omission case, where the inflationary effect "should be constant" until "contradictory information becomes available") market manipulation is a "discrete" inflationary act – once the manipulation ceases, the stock price should recede to its "true value." *Id*. at 674. The Court reasoned that because a "dissipation" of inflation may be inherent to market manipulation (but not to misstatements or omissions), loss resulting from manipulative activity could be inferred from allegations of artificial inflation alone.[20] *Id*.

The Court extended this reasoning to the Section 10(b) misstatement claims against the Underwriter Defendants because "the misstatements and omissions did nothing more than conceal the Underwriters' alleged market manipulation." *Id*. at 675 (footnotes omitted). This reasoning should not apply, however, to the Issuer Defendants, who are not alleged to have participated in the alleged manipulation. Instead, plaintiffs' Section 10(b) claims against the Issuer Defendants concern *only* alleged misstatements and omissions in the Registration Statements. In its more recent decision in *Liu v. Credit Suisse First Boston Corp. (In re IPO Sec. Litig.)*, 383 F. Supp. 2d 566 (S.D.N.Y. 2005), decided subsequent to *Lentell*, this Court made clear that bare allegations of dissipation do *not* suffice to plead loss causation where a fraud claim is based purely on misstatements or omissions:

> Because . . . manipulation occur[s] in secret, artificial inflation can be presumed to dissipate gradually as investors analyze all available information . . . and come to realize that the stock is overvalued. *This stands in sharp contrast to the method by which loss causation is shown in a misrepresentations case.* In such a case, artificial inflation is presumed to dissipate *when the false information is publicly corrected*. Thus, plaintiffs *must identify particular 'disclosing events'* that corrected the false information, and *tie dissipation of artificial price inflation to those events*.

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[20] It should be noted, however, that the distinction between loss causation for a misstatement claim and a manipulation claim was not briefed in connection with this Court's prior decision in *In re IPO Sec. Litig.*, 297 F. Supp. 2d 668 (S.D.N.Y. 2003).

Id. at 580 (emphasis added). The factual allegations needed to plead loss causation identified in *Liu* – *i.e.*, a disclosure of the concealed information and a decline in stock price tied to that disclosure – accord with the pleading requirements set out by the Second Circuit in *Lentell*, and are completely absent from the Second Amended Complaints. And as discussed below, failure to allege a "disclosure" and a "decline" are not saved by plaintiffs' vague allegations of "materialization" of a risk and "dissipation."

2. Vague Allegations of "Materialization of a Risk" and "Dissipation" Do Not Amount to Loss Causation in a Fraud Claim Based on Misstatements or Omissions.

The Second Circuit has held that in order to plead loss causation, plaintiffs must allege facts to show that "concealed information" was revealed to the market and caused a decline in stock price.[21] Thus, plaintiffs must allege (1) a corrective disclosure of the concealed information or (2) "materialization" of a concealed risk. *Lentell*, 396 F.3d at 173-176; s*ee also ATSI*, 493 F.3d at 106-107. As discussed below, under *either* scenario, plaintiffs must show some public revelation of the fraud and a resulting negative impact on the stock. Because these allegations are nowhere in the Second Amended Complaints, plaintiffs have failed to plead loss causation.

[21] As this Court noted in *Liu v. Credit Suisse First Boston Corp. (In re IPO Sec. Litig.)*, 399 F. Supp. 2d 298, 302-303 (S.D.N.Y. 2005), *aff'd sub nom. Tenney v. Credit Suisse First Boston Corp.*, No. 05-3430-CV, 2006 WL 1423785 (2d Cir. May 19, 2006), "*Lentell*'s full discussion of loss causation spans several pages, at times asserting different formulations of the loss causation standard." This Court noted, however, that "the common thread" is that the loss is "foreseeable" and "caused by the materialization of the concealed risk." *Id*. at 303 (quoting *Lentell*). To the extent that pleading loss causation requires an allegation of foreseeability, loss causation becomes inextricably bound with allegations of scienter, which, as discussed *supra*, Part I, are insufficient. *In re Ramp Corp.*, 2006 WL 2037913, at *10 (loss causation not pled where allegations of scienter were insufficient to show defendants were aware of allegedly concealed scheme).

First and foremost, the element of disclosure is essential to alleging loss causation in a misstatements case. As this Court has recognized, "it is axiomatic that '[a] concealed fact cannot cause a decrease in the value of a stock before the concealment is made public.'" *In re eSpeed, Inc.*, 457 F. Supp. 2d at 296. Thus, in *Lentell v. Merrill Lynch & Co., Inc.*, 396 F.3d 161 (2d Cir. 2005), where plaintiffs alleged that Merrill Lynch analysts issued false "buy" and "accumulate" ratings, the Second Circuit held that the eventual downgrades of those stocks (which had a negative effect on price) did not amount to a "corrective disclosure" causing loss because they "[did] not reveal to the market the falsity of the prior recommendations." *Id.* at 175 n.4. In other words, the information allegedly concealed from the market – *i.e.*, that Merrill Lynch *never* believed the companies to be good investments – was not revealed by the later analyst downgrades. As a consequence, "Merrill's *concealed opinions* . . . could not have caused a decrease in the value of those companies before the concealment was made public." *Id.*

In the instant case, plaintiffs do not contend that the alleged manipulative scheme (much less the Issuer Defendants' alleged concealment of the scheme) was *ever* disclosed to the market during the proposed class periods, and instead allege in vague and conclusory terms that the "undisclosed risk of Defendants' misconduct materialized" over time. (*See*, *e.g.*, Sycamore 2AC ¶¶ 67-68.) Even assuming *arguendo* that market manipulation by a third party could be construed as a "risk" affecting investment value – a dubious proposition – numerous cases (including decisions of this Court) show that when a risk "materializes," the market must also, at some point, *become aware of it* (with impact on stock price), just as with a corrective disclosure.[22] As noted, plaintiffs nowhere allege facts to show that the "risk" of market

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[22] *See, e.g.*, *Catton v. Defense Tech. Sys., Inc.*, No. 05 Civ. 6954, 2006 WL 27470, at *10 (S.D.N.Y. Jan. 3, 2006) (Scheindlin, J.) (finding that to allege materialization of a concealed risk, plaintiffs would have to allege facts to show stock price reacted to public disclosure of the
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manipulation ever "materialized" such that the market was alerted not just to the alleged manipulative activity, but to the alleged fraudulent misstatements and omissions of the Issuer Defendants, with a resulting decline in stock price. As such, the lack of any allegation of "revelation" to the market is fatal to plaintiffs' allegations of loss causation. *Liu v. Credit Suisse First Boston Corp. (In re IPO Sec. Litig.)*, 399 F. Supp. 2d 261, 266 (S.D.N.Y. 2005) ("[b]ecause plaintiffs do not allege that the scheme was ever disclosed, they fail to allege loss causation").

Even if plaintiffs could show that the "risk" of the alleged manipulative scheme was revealed to the market (and they have not), the lack of any related price decline is equally fatal. Plaintiffs merely plead – again in vague and conclusory terms – that the inflationary effect of the alleged manipulation "dissipated" over time. These pleadings are not remotely adequate to allege causation by the Issuer Defendants. Instead, as this Court held in a case where "plaintiffs [did] not provide any support for the allegation that their loss was caused by the materialization of the concealed risk," *facts* must be pled to show a direct link between the revelation of the fraud and a decline in stock price:

> To establish such a link, *plaintiffs could mention the price of the Company's stock on specific dates*, indicating that the stock price went *up after misstatements and went down after disclosures*. To the extent these allegations tend to show that *the materialization of the concealed risk* caused plaintiffs' damages, they would constitute an acceptable pleading of loss causation. Alternatively, plaintiffs could offer factual support that the ten press releases they mention *constituted specific disclosures of the fraudulently concealed information* and then *support the contention that the stock price dropped significantly after their issuance*. But in its

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concealed information); *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Inc.*, No. 05 Civ. 1898, 2005 WL 2148919, at *12 (S.D.N.Y. Sept. 6, 2005) (Scheindlin, J.) ("[t]he concealed risk materialized when the collateral pool experienced high delinquency rates and repossession on a sustained basis" and "company announced that it would write off the losses").

> current form, the Complaint merits dismissal under the reasoning of *Dura*.

Catton, 2006 WL 27470, at *10 (emphasis added); *see also In re Scottish Re Group*, 2007 WL 3256660, at *16 (loss causation pled where facts show disclosure and subsequent price decline). Similarly, the Second Amended Complaints are devoid of any facts establishing the necessary causal link between a revelation of the alleged scheme and a related decline in stock price. These complaints also merit dismissal.

Notably, the First Amended Complaints that were the subject of the Court's 2/19/03 Decision *did* allege a "disclosing event" when THE WALL STREET JOURNAL reported on "various improper IPO practices" in a December 6, 2000 news article. (*See*, *e.g.*, Firepond Consolidated Amended Complaint dated April 20, 2002 ¶ 53.) However, as this Court held in *Liu*, 399 F. Supp. 2d at 267, a "single article, standing alone" that discussed alleged misconduct in general terms, "was not specific enough to constitute actual disclosure of the alleged fraud with respect to any of the Issuers." Moreover, *none* of the Focus Case stocks suffered because of a corrective decline on that date.[23] To avoid confronting these fatal realities, plaintiffs have simply deleted reference to this "disclosure" in the Second Amended Complaints and now, apparently, randomly choose December 6, 2000 as the date by which "much of the risk . . . had materialized, and much of the artificial inflation . . . had dissipated," without any explanation as to why that date is appropriate.[24] (*See*, *e.g.*, Sycamore 2AC ¶ 68.) These allegations of loss

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[23] *See* Haims Decl. Exs. 12-15.

[24] These vague, non-committal allegations are a function of plaintiffs' (vain) attempt to plead around the finding in *Miles v. Merrill Lynch & Co. (In re IPO Sec. Litig.)*, 471 F.3d 24 (2d Cir. 2006). In that decision, the Second Circuit suggested that plaintiffs' allegations of persistent price inflation (even past December 6, 2000) despite "widespread knowledge" of the alleged scheme undermined the presumption of an efficient market, on which plaintiffs rely to

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causation are essentially meaningless – absent a disclosing event, there is no indication of how the Issuer Defendants' misstatements or omissions could conceivably have caused loss. Not only is plaintiffs' "theory" of loss causation fundamentally flawed, such vague allegations do not comply with *Dura*'s requirement that plaintiffs "provide[] the defendants with notice of what the relevant economic loss might be" and "what the causal connection might be between that loss and the misrepresentation." *Dura*, 544 U.S. at 347. Plaintiffs' Section 10(b) claims must therefore be dismissed.

3. Plaintiffs' Conclusory Allegations of Loss Do Not Indicate What "Rough Proportion" of the Alleged Loss Could Be Attributed to the Issuer Defendants.

The Second Circuit recently affirmed the dismissal of Section 10(b) misrepresentation claims where plaintiffs failed to specify which portions of the alleged loss were caused by which defendant. In *Lattanzio v. Deloitte & Touche LLP*, 476 F.3d 147 (2d Cir. 2007), the Court held that plaintiffs alleged an insufficient connection between Deloitte's misstatements and a company's bankruptcy, because "[p]laintiffs have not alleged facts to show that Deloitte's misstatements, among others (made by [the company]) that were *much more consequential and numerous*, were the proximate cause of plaintiffs' loss; nor have they alleged facts that would allow a factfinder to ascribe some rough proportion of the whole loss to Deloitte's misstatements." *Id.* at 158 (emphasis added); *see also In re AOL Time Warner, Inc. Sec. Litig.*, 503 F. Supp. 2d 666, 680 (S.D.N.Y. 2007).

In *Lattanzio*, although the plaintiffs alleged that both Deloitte and the company made misstatements, the Court required the plaintiffs to plead facts demonstrating some

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plead transaction causation. In the attempt to preserve transaction causation, plaintiffs have gutted loss causation.

apportionment of plaintiffs' loss to the less "consequential" statements by Deloitte. Here, plaintiffs similarly allege misstatements by both the Issuer Defendants and Underwriter Defendants, yet the Underwriter Defendants and their customers are also alleged to have directly affected stock price through manipulative activity. These allegations are "much more consequential and numerous" than the allegations against the Issuer Defendants, who plaintiffs acknowledge "are not . . . the principal wrongdoers." (Joint Declaration of Melvyn I. Weiss and Stanley D. Bernstein in Support of Motion for Final Approval of Partial Class Action Settlement, dated April 12, 2006 ¶ 40.)

In addition, plaintiffs allege a long and complicated causal chain – they assert: (a) misstatements by both the Issuer Defendants and the Underwriter Defendants, followed by (b) a future allocation of stock by the Underwriter Defendants to certain customers subject to a Tie-in Agreement or agreement to pay Undisclosed Compensation, followed by (c) a purchase order placed by those customers pursuant to Tie-in Agreements, and in some cases, an actual purchase, followed by (d) "artificial demand" as a result of the purchase orders and/or purchases, and an inflated stock price, followed by (e) a plaintiff's purchase of securities at some unknown subsequent point at an "inflated price," followed by (f) a sale at some later point resulting in a loss (though at a still-inflated price because of the "dissipating" inflation). (*See*, *e.g.*, Sycamore 2AC ¶¶ 2-4.) In light of the complexity of this chain of events, plaintiffs' failure to "ascribe [any] proportion of the whole loss to [the Issuer Defendants'] misstatements" is fatal to the Section 10(b) claims against the Issuer Defendants, as the Second Circuit held in *Lattanzio*.[25]

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[25] *See also Lentell*, 396 F.3d at 174 ("the relationship between the plaintiff's investment loss and the information misstated or concealed" must be "sufficiently direct"); *Liu*, 383 F. Supp. 2d at 577 n.60 ("a fundamental principle of causation which has long prevailed under the common law of fraud and which has been applied to comparable claims brought under the federal securities acts . . . is, quite simply, that the injury averred must proceed directly from

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This Court's decision in *Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Sec., LLC*, No. 05 Civ. 9016, 2007 WL 528703 (S.D.N.Y. Feb. 20, 2007) (Scheindlin, J.), is also illuminating. In dismissing aiding and abetting fraud claims against a defendant for failure to allege proximate cause, the Court held that alleging that another defendant's "fraudulent scheme 'may only have been possible because of [a second defendant's] actions, or inaction,' . . . does not make [the latter defendant's] conduct a proximate cause of the scheme." *Id*. at *8 (citations omitted). *See also Randolph Equities, LLC v. Carbon Capital, Inc.*, No. Civ. 10889, 2007 WL 914234, at *8 (S.D.N.Y. Mar. 26, 2007) (finding loss causation sufficiently pled as to misrepresentations of one defendant but "far too attenuated" as to another). Because plaintiffs here have failed to identify any loss caused by the Issuer Defendants' misstatements or omissions, their claim amounts to no more than an allegation of aiding and abetting the Underwriter Defendants by concealing the alleged manipulative scheme, a claim that is impermissible under the 1934 Act. *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994).[26]

Finally, "when the plaintiff's loss coincides with a marketwide phenomenon causing comparable losses to other investors, the prospect that the plaintiff's loss was caused by the fraud decreases, and a plaintiff's claim fails when it has not adequately [pled] facts which, if proven, would show that its loss was caused by the alleged misstatements as opposed to intervening events." *Lentell*, 396 F.3d at 174 (internal quotations omitted); *see also In re Merrill*

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the wrong alleged and must not be attributable to some supervening cause.") (quoting *Marbury Mgmt., Inc. v. Kohn*, 629 F.2d 705, 716-17 (2d Cir. 1980) (Meskill, J. dissenting)).

[26] The Eighth Circuit in *In re Charter Communications, Inc. Sec. Litig.*, 443 F.3d 987, 991 (8th Cir. 2006), *cert. granted*, 127 S. Ct. 1873 (Mar. 26, 2007) rejected scheme liability under Section 10(b). The issue is now *sub judice* before the Supreme Court.

Lynch & Co. Research Reports Sec. Litig., 289 F. Supp. 2d 416, 421 n.6 (S.D.N.Y. 2003) (taking judicial notice of "the existence of the internet bubble and its subsequent crash"); *see also* Und. Brief, Part II.B. Thus, plaintiffs are required to plead facts that would show loss caused by the Issuer Defendants' misstatements and omissions, and not the broad market decline that occurred during the proposed class periods. Plaintiffs' bare allegations of loss causation simply do not meet this burden.

In sum, plaintiffs' amended allegations do not provide the Issuer Defendants "with notice of what the relevant economic loss might be or of what the causal connection might be between that loss and the misrepresentation." *Dura*, 544 U.S. at 347. In the absence of such notice, allowing plaintiffs' Section 10(b) claims to stand against the Issuer Defendants "would tend to transform a private securities action into a partial downside insurance policy," an outcome proscribed by the *Dura* Court. *Id.* at 347-48. Accordingly, the Section 10(b) claims against the Issuer Defendants must be dismissed.

E. Plaintiffs Fail to Plead the Underlying Manipulation With Particularity.

Plaintiffs' claims against the Issuer Defendants are based solely on misrepresentation – in essence, plaintiffs contend that the Issuer Defendants failed to disclose the Underwriter Defendants' alleged manipulative scheme. (*See*, *e.g.*, Sycamore 2AC ¶¶ 135-136.) However, the complete lack of particulars in the Second Amended Complaints regarding the size, timing or effect of the alleged manipulative transactions means there is no way to assess, for any Focus Case, whether market manipulation even *occurred*, much less whether it was material. Without such a determination, plaintiffs cannot adequately allege an omission or misstatement concerning a "manipulative" scheme. *Miller v. Lazard, Ltd.*, 473 F. Supp. 2d 571, 587 (S.D.N.Y. 2007).

Specifically, the Second Circuit recently held that pleading market manipulation in accordance with Rule 9(b) requires allegations setting forth "'what manipulative acts were performed, which defendants performed them, *when the manipulative acts were performed, and what effect the scheme had on the market* for the securities at issue.'" *ATSI*, 493 F.3d at 101-102 (emphasis added) (quoting *Baxter v. A.R. Baron & Co.*, No. 94 Civ. 3913, 1995 WL 600720, at *6 (S.D.N.Y. Oct. 12, 1995)); *see also Miller v. Lazard, Ltd.*, 473 F. Supp. 2d 571 (S.D.N.Y. 2007).[27] The Second Amended Complaints do not come close to meeting this standard. As discussed in the Underwriter Defendants' brief, the pleadings still do not include *any* facts concerning the timing, volume or prices of the alleged Tie-in Agreements. (*See* Und. Brief, Part II.A).

Accordingly, where, as here, the particularity required for the alleged underlying manipulation is utterly lacking, courts have not hesitated to dismiss Section 10(b) and Section 11 claims for failure to disclose the manipulation. For example, in *Miller v. Lazard, Ltd.*, plaintiffs' allegations were virtually identical to the cases at bar, and included, among other things, a misrepresentation claim for failure to disclose post-IPO market manipulation by an underwriter. The manipulation was allegedly designed to "artificially bolster and sustain the price of Lazard's common stock in the post-IPO market . . . [by] sell[ing] millions of shares to hedge funds with side agreements so that they could immediately 'flip the shares' without negative consequences

[27] While courts have noted that the application of Rule 9(b) may be somewhat relaxed where manipulation is alleged because the claim "can involve facts solely within the defendant's knowledge," *ATSI*, 493 F.3d at 102, that rationale should not apply where, as here, plaintiffs have chosen to ground misrepresentation claims on alleged underlying manipulative conduct. In any event, as discussed herein, the broad strokes with which plaintiffs describe the alleged manipulation would not meet even the most lenient standard for alleging the "circumstances constituting fraud" with particularity. *Miller*, 473 F. Supp. 2d at 587 (citing *Catton v. Defense Tech. Sys.*, 457 F. Supp. 2d 374, 381 (S.D.N.Y. 2006)).

such as penalty bids or being locked out of future IPOs." 473 F. Supp. 2d at 585. The court dismissed *both* the misrepresentation and underlying manipulation claims for failure to plead with the requisite particularity:

> [T]he complaint does not identify any specific sales of shares to hedge funds that were allegedly "flipped" immediately after the IPO, nor does it indicate to whom the shares were sold. One of Plaintiffs' sources makes broad reference to Goldman Sachs' sale of "many of the shares to hedge funds with quick trigger fingers," but says nothing more . . . . The same is true of . . . Goldman Sachs' purchases after the IPO. Throughout the Complaint, Plaintiffs list substantial purchases of Lazard stock by Goldman Sachs and note that those purchases are "far from typical." As with the pre-IPO sales, however, *plaintiffs provide no particularized facts* other than the volume of stocks purchased; *such conclusory statements are not adequate to allege an omission or misstatement with respect to manipulative trading* . . . .

Id. at 586 (emphasis added) (citations omitted)[28]; *see also Vogel v. Sands Bros. & Co.*, 126 F. Supp. 2d 730, 738-39 (S.D.N.Y. 2001) (dismissing Section 10(b) misrepresentation claim for failure to plead falsity where allegations that defendants failed to disclose alleged scheme "to

[28] Additionally, the court in *Miller* found no basis on which to impose on an issuer the duty to disclose alleged manipulation of the aftermarket by an underwriter. Indeed, the court could not determine "what standard would compel the form of disclosure that Plaintiffs contend is required." *Id*. at 585. In dismissing the claims, the court added:

> It is doubtful . . . whether the public disclosure required by the applicable rules would demand that, in the terms of their public offerings, *issuers of stock actually advertise with self-incriminating candor that they contemplate the transaction to involve unlawful market manipulation and that the sellers could be brought to task for failing to provide advance notice of the avowed, wrongful scheme*, detailed with sufficient particularity. *The Court knows of no warrant for such a standard*.

Id. (emphasis added). Such a sweeping standard is no more appropriate in these cases. Insofar as an issuer's disclosure obligations should not encompass a duty to disclose the uncharged misconduct of a third party, both the Section 10(b) and Section 11 claims should be dismissed on this basis as well.

take control of [the company] at a low market price" were "circular, speculatory and conclusory").

Detail is required. Accordingly, the Second Circuit affirmed dismissal where "allegations [of "death spiral" short-selling] fail[ed] to state *even roughly how many shares the defendants sold, when they sold them, and why those sales caused the precipitous drop in stock price*." *ATSI*, 493 F.3d at 103 (emphasis added). As the Court found, "[n]owhere does [plaintiff] *particularly allege what the defendants did* – beyond simply mentioning common types of manipulative activity – or state how this activity affected the market in [plaintiff's] stock." *Id.* at 104 (emphasis added). *See also Fisher v. Offerman & Co.*, No. 95 Civ. 2566, 1996 WL 563141, at *8 (S.D.N.Y. Oct. 2, 1996) (plaintiffs must plead details, such as "how many" transactions occurred, "at what prices, [and] with what impact on subsequent [transactions]"); *Baxter*, 1995 WL 600720, at *7.[29]

Plaintiffs avoid these details. Instead, on the basis of one vague, unsubstantiated "example" of a Tie-in Agreement in each case, plaintiffs contend that the prices of the stocks at issue were "inflated . . . above the price that otherwise would have prevailed in a fair and open market from the time of the first open-market trade of the Issuer's stock through the end of the

[29] The allegations in this case stand in stark contrast to the pleadings in *Internet Law Library v. Southridge Cap. Mgmt.*, 223 F. Supp. 2d 474, 479-80 (S.D.N.Y. 2002) (cited with approval (for manipulation claim) by *ATSI*, 493 F.3d 87) (allegations of "painting the tape," "hitting the bids," and "dumping" large amounts of stock were supported by allegations that "on July 18, 2000, Thomson Kernaghan sold 1,500 shares of ITIS stock short; on July 19, 2000, it sold 5,000 shares short; on July 27, 2000, it sold 10,000 shares short; on October 5, 2000, it closed 19,306 shares short; on October 6, 2000, it closed 29,306 shares short; and on October 10, 2000, it closed 61,806 shares short. A similar pattern of short sales continued until Thomson Kernaghan's short position had increased to nearly a million and a half shares by January 19, 2001 and back down to 876,894 shares by February 2, 2001, three days before Cootes Drive filed suit against ITIS in this court for breach of contract and fraud . . . . The daily trading volume in ITIS stock mushroomed from 15,000 shares a day before the closing to an average of 365,157 in the period between September 29, 2000 and October 27, 2000").

Class Period[s]." (Firepond 2AC ¶ 52.) But absent the required particularity as to the underlying manipulation, there is no way to assess whether the alleged transactions in each Issuer Defendant's stock were material, and thus no way to determine whether the alleged misstatements or omissions were, in fact, materially false and misleading. Indeed, on the basis of these vague allegations, it is far from clear what the Issuer Defendants should have included in their Registration Statements, aside from some general description of an intended "manipulation" without any detail as to when it might occur, how it might work, or how it might affect the Issuer Defendant's stock price. This is pure speculation, which there is clearly no duty to disclose. *In re Axis Capital Holdings Ltd. Sec. Litig.*, 456 F. Supp. 2d 576, 586 (S.D.N.Y. 2006) (quoting *In re Marsh & McLennan Cos. Sec. Litig.*, 501 F. Supp. 2d 452, 471 (S.D.N.Y. 2006) (holding that defendants "cannot be held liable for failing to make . . . speculative disclosures")).

Since plaintiffs do not (and, after years of discovery and yet another opportunity to amend their pleadings, presumably cannot) allege the details of the alleged manipulative and fraudulent scheme in compliance with Rule 9(b), the misrepresentation claims pursuant to Section 10(b) must necessarily fail.

II. PLAINTIFFS FAIL TO STATE A CLAIM UNDER SECTION 11 OF THE 1933 ACT.

A. Plaintiffs' Section 11 Claims are Subject to Rule 9(b).

The gravamen of plaintiffs' claims under Section 11 is that the Registration Statements failed to disclose the alleged fraudulent scheme on which the Section 10(b) claim is based. (*See* Sycamore 2AC ¶¶ 7, 9.) This is a classic bootstrap – plaintiffs begin with their faulty allegations of manipulative conduct, and then assert that the Registration Statements were false and misleading for concealing that conduct. However, the attempt to bootstrap a fraud claim into a claim under the 1933 Act must now comply with the pleading requirements of

Rule 9(b). *Rombach v. Chang*, 355 F.3d 164, 171 (2d Cir. 2004) ("[w]e hold that the heightened pleading standard of Rule 9(b) applies to Section 11 . . . claims insofar as the claims are premised on allegations of fraud."). *See also In re Scottish Re Group*, 2007 WL 3256660, at *9.

Though plaintiffs attempt, yet again, to renounce their allegations of fraud in connection with the Section 11 claims (*see*, *e.g.*, Sycamore 2AC ¶¶ 71-72), this attempt is unavailing. As this Court held in its 2/19/03 Decision, "it is obvious from the Complaints that Plaintiffs' disclaimer is superficial . . . [t]he Section 11 claims are 'grounded' in [plaintiffs'] fraud claims in a way that cannot be simply disavowed . . . ." *In re IPO Sec Litig.*, 241 F. Supp. 2d at 341.[30] Other courts have similarly held the insertion of a simple disclaimer of fraud insufficient. *See*, *e.g.*, *In re Marsh & McLennan*, 501 F. Supp. 2d at 492 ("[a]llowing plaintiffs to allege fraud over nine-hundred paragraphs and then withdraw those claims for eight paragraphs in order to state a Section 11 claim eviscerates Rule 9(b)'s mandate to 'safeguard a defendant's reputation from improvident charges of wrongdoing'" (citation omitted). *See also In re Alstom S.A. Sec. Litig.*, 406 F. Supp. 2d 402, 410 (S.D.N.Y. 2005) (same); *In re Axis Capital*, 456 F. Supp. 2d at 598 (same).

The substance of the allegations made in connection with the Section 11 claims against the Issuer Defendants is plainly fraud. Each Second Amended Complaint alleges as part of these claims that:

> [t]he Issuer . . . *benefited* from the manipulative and deceptive schemes described herein and *knew of* or *recklessly disregarded* the conduct complained of herein through their participation in, among other things, the "Road Show" process.

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[30] Moreover, it is not the Court's responsibility to sift through the complaints to construct a claim sounding in negligence. *Rombach*, 355 F.3d at 176 (court is not required to parse fraud allegations in search of a lesser included claim); *In re Alcatel Sec. Litig.*, 382 F. Supp. 2d 513, 530 (S.D.N.Y. 2005) (same).

(Corvis 2AC ¶ 8 (emphasis added)). S*ee also* iXL 2AC ¶ 11; VA Linux 2AC ¶ 8; Sycamore 2AC ¶ 11; Firepond 2AC ¶ 8.) In addition, the Amended Master Allegations state that "[b]y engaging in the misconduct alleged in the Coordinated Litigation, the Issuer Defendants were able to parlay the spectacular increase in their market capitalization into unparalleled wealth. The Issuers . . . benefited financially from the misconduct as the run up of their respective stock prices afforded them with substantial opportunities to utilize their stock as currency in connection with corporate acquisitions, and to raise even more money through add-on offerings." (AMA ¶ 112.) These sorts of allegations – describing intentional conduct as part of a deceptive scheme benefiting the defendants – are "classically associated with fraud" and thus Rule 9(b) must apply. *Rombach*, 355 F.3d at 172.

B. The Section 11 Claims are Not Pled With the Particularity Required by Rule 9(b).

Because "the same course of conduct" is pled in connection with both the Section 10(b) claims and the Section 11 claims, the latter must also be pled with particularity, which requires detailed factual allegations specifying "why the statements were fraudulent." *Rombach*, 355 F.3d at 170-71 (setting pleading requirements for Section 11 claims sounding in fraud) (citation omitted); *see also Cosmas v. Hassett*, 886 F.2d 8, 11 (2d Cir. 1989); *Mills v. Polar Molecular Corp.*, 12 F.3d 1170, 1175 (2d Cir. 1993). As discussed fully above in connection with plaintiffs' Section 10(b) claims, plaintiffs' allegations of manipulation are woefully lacking in the necessary particulars to sustain a claim for fraudulent misstatements against the Issuer Defendants. These deficiencies are just as fatal to plaintiffs' Section 11 claims. (*See supra*, Part I.E.)[31]

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[31] The Issuer Defendants do not concede that an issuer may be liable under Section 11 for omission of "information of which it had no knowledge at the time of the offering."

(Footnote continues on following page.)

Additionally, to show that the allegedly false statements in the Registration Statements were *fraudulent* – and not just false – plaintiffs must allege facts to show that the Issuer Defendants knew the statements were false when made; in other words, scienter must be pled. *In re JP Morgan Chase Sec. Litig.*, 363 F. Supp. 2d 595, 618 (S.D.N.Y. 2005) (holding that for Section 11 claim subject to Rule 9(b), "[t]he fourth particularity requirement – setting forth why the statements were fraudulent – requires the plaintiff to convey through factual allegations that the defendants made materially false statements, *and that they did so with scienter*") (emphasis added).[32] Indeed, courts in this District have regularly dismissed Section 11 claims grounded in fraud for failure to plead scienter with the requisite particularity.[33] As discussed at length in Part I, *supra*, plaintiffs' allegations of scienter are not sufficient to allege

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(Footnote continued from previous page)
9 Louis Loss & Joel Seligman, SECURITIES REGULATION, § 11.C.2.d(i), at 4249-50 n.137 (3d ed. 1992) (quoting *In re Ultimate Corp. Sec. Litig.,* No. 86 Civ. 5944, 1989 WL 86961, at *1 (S.D.N.Y. July 31, 1989)). The Issuer Defendants reserve their right to reassert this argument at a later appropriate time.

[32] The Court held in its 2/19/03 Decision that Rule 9(b) was inapplicable to the Section 11 claims in these cases. *In re IPO Sec. Litig.*, 241 F. Supp. 2d at 341. Accordingly, the Court did not analyze allegations of scienter in connection with the Section 11 claims.

[33] *See*, *e.g.*, *In re JP Morgan Chase*, 363 F. Supp. 2d at 635 (dismissing Section 11 claim where "plaintiffs have failed to plead with particularity a strong inference of scienter . . ."); *In re Marsh & McLennan*, 501 F. Supp. 2d at 492 (applying "heightened pleading requirements of Rule 9(b)" and dismissing claims where plaintiffs failed to plead that "the Individual Section 11 Defendants were reckless when the misleading statements . . . were made"); *Johnson v. NYFIX, Inc.*, 399 F. Supp. 2d 105, 122 (D. Conn. 2005) (dismissing Section 11 claims for failure to plead scienter where complaint did not "adequately allege that defendants knew or were reckless in not knowing that the statements included in the registration statement were false or misleading"); *Rombach v. Chang*, No. 00 Civ. 0958, 2002 WL 1396986, at *10 (E.D.N.Y. June 7, 2002) (finding "that the Amended Complaint does not plead the elements of fraud or scienter for Section 10(b) or Section 11 claims against the Individual Defendants with sufficient particularity"), *aff'd*, *remanded*, 355 F.3d 164 (2d Cir. 2004); *In re AXIS Capital*, 456 F. Supp. 2d at 598 (dismissing Section 10(b) claim for, among other things, failure to plead scienter with particularity and applying same analysis in dismissing Section 11 claim).

"why the statements were fraudulent" in accordance with Rule 9(b), and thus the Section 11 claims should be dismissed on this basis as well.[34]

III. LEAVE TO REPLEAD SHOULD BE DENIED.

Approximately six years since the start of this litigation and with the benefit of extensive discovery, plaintiffs have filed complaints for the third time. Once again, in connection with the Issuer Defendants, plaintiffs are choosing to stand on pleadings that are virtually identical to those previously submitted, even though plaintiffs' counsel is well aware of the recent changes in the relevant pleadings standards. Under these circumstances, dismissal of the claims against the Issuer Defendants with prejudice is warranted. *See ATSI*, 493 F.3d at 108 ("District courts typically grant plaintiffs at least one opportunity to plead fraud with greater specificity when they dismiss under Rule 9(b). [The plaintiff] was given that opportunity."); *In re Razorfish, Inc. Sec. Litig.*, No. 00 Civ. 94742001 WL 1111502, at *3 n.2 (S.D.N.Y. Sept. 21, 2001) ("Dismissal with prejudice is called for since . . . plaintiffs provided no particularized basis for any belief that any further amendment of the already-amended Complaint would cure its deficiencies.").

The Court granted plaintiffs leave to replead more than four years ago; at this point, it can be safely assumed that plaintiffs are aware of and have presented all the relevant facts. In the face of plaintiffs' inability to plead essential material even after reviewing millions

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[34] Additionally, the Issuer Defendants join in the Underwriter Defendants' arguments that all Section 11 claims brought by those plaintiffs who sold their securities above the offering price must be dismissed for lack of damages; and that the Section 11 class periods must be limited to the ranges set forth in this Court's decision in *In re IPO Sec. Litig*., 227 F.R.D. 65, 119 (S.D.N.Y. 2004) (*see* Und. Brief, Part III). In pre-motion communications, plaintiffs indicated that the extended class periods and the Section 11 claims where plaintiffs do not have damages are reasserted in order to preserve these issues for appeal. The Issuer Defendants also join the Underwriter Defendants in asserting that the new *Sycamore* plaintiffs' claims should be dismissed as time-barred (*see* Und. Brief, Part IV).

of pages of documents and taking hundreds of depositions, further amendments to the pleadings should be denied. *See Baxter*, 1995 WL 600720, at *3 ("[t]he lack of particularized pleading is remarkably egregious in this case because the plaintiffs have had access to extensive documentary discovery since the case was filed . . . nearly a year and a half ago"); *Devaney v. Chester*, 709 F. Supp. 1255, 1261 (S.D.N.Y. 1989) (dismissing repleaded fraud claim where movant had the benefit of wide-ranging discovery before filing amended complaint).

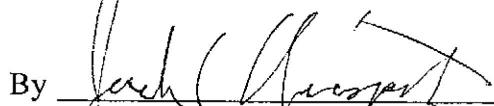
As this Court has recognized, "there comes a point where enough is enough." *Liu v. Credit Suisse First Boston Corp. (In re IPO Sec. Litig.)*, 341 F. Supp. 2d 328, 343 (S.D.N.Y. 2004). We are at that point. The pleading deficiencies in these cases have been repeatedly identified to plaintiffs, who have elected to recycle the old allegations without alteration. Accordingly, the cases should be dismissed with prejudice. *Dooner v. Keefe, Bruyette & Woods, Inc.*, No. 00 Civ. 572, 2003 WL 135706, at *4 (S.D.N.Y. Jan. 17, 2003) ("[T]his is the plaintiff's third complaint. Three bites at the apple is enough.").

IV. CONCLUSION.

For the reasons set forth above and in the appendices and declarations submitted herewith, the claims against the Issuer Defendants in the Focus Cases should be dismissed in full, with prejudice.

Dated: New York, New York
November 13, 2007

Respectfully submitted,
MORRISON & FOERSTER LLP

By 
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