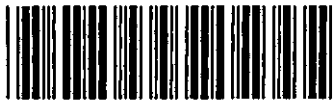

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UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

In re SUREBEAM CORPORATION SECURITIES LITIGATION,

CASE NO. 03 CV 1721 JM (POR)

ORDER GRANTING IN PART AND DENYING IN PART DEFENDANTS' MOTIONS TO DISMISS

This class action is brought on behalf of all purchasers of SureBeam Corporation ("SureBeam") common stock between March 16, 2001 and August 27, 2003 (the "Class Period"). Defendants Titan Corporation ("Titan"), Merrill Lynch Pierce, Fenner & Smith Inc., Wachovia Corporation, Credit Suisse First Boston LLC ("CSFB")[1], Gene W. Ray, Susan Golding, Lawrence K. Oberkfell, David A. Rane and Kevin K. Claudio move to dismiss the Complaint pursuant to Fed. R.Civ.P. 12(b)(6) and 9(b). Plaintiffs oppose the motions. Having carefully considered the papers submitted, the record before the court, the oral arguments of counsel and the applicable authority, the Court grants in part and denies in part Defendants' motions to dismiss and grants plaintiffs 45 days from the date of this order to file an amended complaint.

I. Factual Background

Initially, it should be noted that the well pled allegations of the Complaint are taken as true for the purpose of ruling on these motions. Defendant Titan is a San Diego-based company that creates, builds and launches technology-based businesses. SureBeam began as a wholly owned subsidiary of

[1]Collectively, Merrill Lynch, Wachovia and CSFB are referred to as the underwriters.

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Titan. (Consolidated Complaint (("CC") ¶ 2). In 1998, SureBeam started building irradiators, machines that use electron beams to prevent contamination, spoilage, or disease in food. (CC ¶ 14).

The essence of the Complaint is that Defendants made materially false statements in an attempt to create the illusion that SureBeam was a viable business. (CC ¶¶ 15-17). The Complaint asserts that Titan was losing money on its SureBeam subsidiary and sought to avoid continuing financial losses by spinning off SureBeam. (CC ¶¶ 15-16). But before Titan could effectively rid itself of SureBeam, it allegedly needed to create the appearance of financial stability in the subsidiary. Id. In order to create such an appearance, Titan allegedly set up international joint ventures involving its subsidiary and foreign food irradiation companies, and improperly recognized revenues from the joint ventures. (CC ¶ 1).

The Tech Ion Venture

One such joint venture was with a Brazilian food irradiation company called Tech Ion Industrial Brasil S.A. ("Tech Ion"). The venture solidified in April of 2000 when Titan and Tech Ion agreed to form a joint venture called SureBeam Brasil. (CC ¶¶ 18-19). According to the agreement, the joint venture would purchase irradiators from SureBeam at prices that were, at most, market value. (CC ¶ 20). Not long after forming the agreement, SureBeam began to recognize revenue from the venture and project millions in future revenue. (CC ¶ 24). Despite Titan and SureBeam's optimistic portrayal of the venture, however, the Complaint alleges that Defendants were aware the Brazilian venture was doomed months before the Initial Public Offering ("IPO") on March 16, 2001. (CC ¶ 5). When Tech Ion entered into the deal with Titan, the Brazilian company had only $418,000 in assets, less than $2,000 in available assets, and $2.2 million in current liabilities. (CC ¶ 22). Titan contributed a $5 million line-of-credit to Tech Ion as part of the venture. Id. Because Tech Ion could not afford the systems, the parties agreed that Tech Ion and SureBeam Brasil would pay based on "the higher of 75% of profit or a fixed payment...." (CC ¶ 20).

At the time Titan and Tech Ion were solidifying their venture, in April of 2000, Defendants Lawrence Oberkfell and Kevin Claudio were executives at Titan. (CC ¶ 19). Both men were working with Tech Ion Executive Jose Francisco Medeiros to secure funding for the project. Id. Titan and

Tech Ion retained Delphos International ("Delphos") to assist in securing funding from the World Bank. (CC ¶ 25). Shortly after hiring Delphos, in November 2000, Oberkfell and Claudio received several emails from Delphos informing them that investors were expressing concern that "the customer base is not well-defined and established enough" in Brazil and obtaining funding would be "EXTREMELY *difficult*." *(CC ¶¶ 25-26).*

Because the World Bank declined financing, Titan and Tech Ion looked to SUDAM, a Brazilian development agency that only provided funding to companies in the Amazonian region. (CC ¶ 32). In order to convince SUDAM to provide funding, Oberkfell, Claudio, and Medeiros decided that SureBeam would ship two irradiation systems to Manaus, an Amazonian location. (CC ¶ 33). In January of 2001, SureBeam shipped two such systems to Manaus over objections from project managers and despite the fact that the machines were eventually going to used in Rio, approximately 2,000 miles away. (CC ¶¶ 33, 35). Oberkfell also allegedly agreed to increase the price of the two irradiators beyond their market value, from $5 million per machine to $6.5 million, and falsify the invoice to indicate Tech Ion paid for the systems in full. (CC ¶ 36). These changes were allegedly made in an attempt to increase the amount of financing from SUDAM. (CC ¶ 33). But on March 12, 2001, SUDAM was disbanded by the Brazilian government amid allegations of high-level corruption. (CC ¶ 37). With SUDAM's demise, Tech Ion allegedly witnessed its "last chance for funding disappear" and with it any possibility of SureBeam being paid on the contract. (CC ¶¶ 1, 38).

Four days after SUDAM's collapse, SureBeam went public. During the March 16, 2001 IPO, 6.7 million shares of SureBeam stock were sold at $10.00 per share. (CC ¶ 38). Although SureBeam was an independent company following the IPO, Titan owned 84% of SureBeam's stock and the two companies had overlapping directors. (CC ¶¶ 59, 71-76). Oberkfell was named President and Chief Executive Officer ("CEO"), and Director, and Claudio was named Vice President and Chief Financial Officer ("CFO"). (CC ¶¶ 71-72). Defendants Susan Golding and Dr. Gene Ray, also Titan executives, were named Director and Chairman of the Board of Directors of SureBeam respectively. (CC ¶¶ 75-76). Oberkfell, Claudio, Golding, and Ray each signed the Registration Statement for the IPO. (CC ¶¶ 71-76).

After SureBeam went public, the Brazilian joint venture continued to deteriorate. (CC ¶¶ 41-

45). In April 2001, Oberkfell traveled to Rio for a conference. (CC ¶ 41). While there he visited the SureBeam systems that had been shipped to Manaus three months earlier. (CC ¶¶ 35,41). Because the irradiation plant had yet to be constructed, the systems were sitting in a customs warehouse. (CC ¶ 41). In July of 2001, SureBeam employees traveled to Rio and visited Tech Ion's construction site. (CC ¶ 42). They reported that Tech Ion had accomplished very little of the plant's construction; it only leased the land, laid a foundation, dug "little holes," and constructed a ceiling. Id. These SureBeam employees reported daily during their trip via e-mail to Oberkfell and Claudio, informing them of the status of the construction. Id. A project manager even sent them a photograph of an empty field. Id.

Despite all the above obstacles, SureBeam recognized revenue from the Tech Ion venture throughout 2000 and 2001. (CC ¶¶ 2-3). SureBeam recognized a total of $15.5 million in 2000 and $6.8 million in 2001 from the Brazilian project, using the percentage of completion method of accounting. Id.

The RESAL Venture

Following the IPO, SureBeam entered into a joint venture with RESAL, a sole proprietorship engaged in the construction of businesses in Saudi Arabia. (CC ¶ 8). SureBeam and RESAL agreed that RESAL would build four irradiation facilities throughout Saudi Arabia and purchase ten SureBeam irradiation systems. Id. RESAL was to pay for the systems with the profits from the venture. (CC ¶ 49). Like the Tech Ion venture, the RESAL venture required funding before any profits could be generated and before any payment could be made to SureBeam. (CC ¶ 47). In fact, the agreement provided that RESAL would transfer the purchase order to the joint venture only once it "received sufficient funding from investors ... to finance the first processing facility." (CC ¶ 46). RESAL had trouble securing funding, however. (CC ¶ 48). Defendant David Rane, then SureBeam's CFO, was forced to renegotiate RESAL's payment schedule. (CC ¶ 50).

Despite the fact that payment was expressly contingent on outside funding that SureBeam executives allegedly knew was not forthcoming, SureBeam began to recognize revenue from the RESAL contract under a percentage of completion method. (CC ¶ 48). Surebeam recognized $6.8 million in the second quarter of 2001, $7.9 million in the third quarter, $5.1 million in fiscal year 2002, and $2.3 million in the first quarter of 2003. Id. In the end, RESAL never obtained the needed

funding. (CC ¶ 50). Although the contract called for $53 million and SureBeam recognized a total of $23.5 million, RESAL was only able to pay $7.5 million. Id.

The Domestic Operations

During the class period, SureBeam operated three irradiation service centers in the United States. (CC ¶ 51). SureBeam irradiated meat in those facilities, but SureBeam's domestic plants had very few customers, and even fewer paying ones. (CC ¶¶ 56-57). SureBeam employees reported that the company was actually irradiating meat at no charge in an effort to introduce the product into the market. Id. The plants were generally operating at approximately 2%-3% of capacity. (CC ¶ 54). During the class period, SureBeam repeatedly announced that demand had increased and that it expected demand to continue to increase. (CC ¶ 52). In the end, however, SureBeam's expectations of demand never came to fruition and SureBeam's capacity to irradiate meat far exceeded demand for the product. (CC ¶ 53).

Bankruptcy

Oberkfell resigned from SureBeam on March 6, 2003. (CC ¶ 129). On July 30, 2003 and again on August 12, 2003, SureBeam announced that the company would delay its earning results for the second quarter of 2003 because the company's outside auditor, Deloitte & Touche LLC ("Deloitte")[2] was investigating contracts from the year 2000. (CC ¶ 134). On August 21, 2003, SureBeam announced that it was firing Deloitte because the company refused to approve financial statements reflecting a contract from the year 2000. (CC ¶ 136). SureBeam later revealed that the disputed contract was the Tech Ion contract. (CC ¶ 137). Following the announcement, SureBeam's stock price dropped to $1.55 per share and never recovered. (CC ¶ 136). SureBeam was forced to close its Los Angeles irradiation plant and NASDAQ delisted its stock. (CC ¶ 138). On January 12, 2004, SureBeam filed for Chapter 7 bankruptcy. Id.

Misrepresentations and Omissions

The Complaint identifies several allegedly false statements made by some of the defendants, both in the registration statement or prospectus, and through press releases and direct statements by

[2]SureBeam had two prior outside auditors. Arthur Anderson was fired April 9, 2002 for unrelated reasons. SureBeam's second outside auditor KPMG was fired on June 3, 2003 due to a fee dispute. (CC ¶ 133).

SureBeam officers. A sampling of the statements includes:

- "We began construction of [the systems for Tech Ion] in July 2000, and have recorded revenues of $15.5 million under the percentage-of-completion method for the year ended December 31, 2000" and our "accounting policies comply with the provisions of SAB 101." (CC ¶¶ 38, 85).

- "...we received purchase orders from Tech Ion Industrial Brazil S.A. for eleven electronic food irradiation systems which we expect to result in approximately $55.0 million in sales revenues to us over the next three years." (CC ¶ 84).

- "we acquired a 19.9% equity interest in SureBeam Brasil without charge" and SureBeam Brasil was created "with no initial capital contribution from either party." (CC ¶ 40).

- Announcing fourth quarter 2002 results, Oberkfell stated, "consumer demand is obviously growing, as folks are embracing this as an added measure of food safety...." (CC ¶ 52).

II. Discussion

The first claim in the Complaint alleges Defendants Titan, Oberkfell, Claudio, Golding, Ray and the underwriters violated Section 11 of the Securities Act of 1933, by signing or preparing the misleading statements in the prospectus filed with the SEC on March 16, 2001. In the second claim, Plaintiffs allege that Titan violated Section 15 of the 1933 Act through its control of SureBeam. The third claim in the Complaint alleges that Oberkfell, Claudio and Rane violated Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5. Plaintiffs contend that the SureBeam executives disseminated or approved false statements that they knew were misleading. The fourth claim alleges that Titan violated Section 20(a) of the 1934 Act by controlling SureBeam.

A. Legal Standards

1. Rule 12(b)(6)

When ruling on a motion to dismiss, the court must accept all material allegations of fact as true and must construe those allegations in the light most favorable to the plaintiff. Burgert v. Lokelani Bernice Pauahi Bishop Trust, 200 F.3d 661, 663 (9th Cir. 2000). A complaint should not be dismissed unless it appears beyond doubt that the plaintiff cannot prove any set of facts that would entitle him or her to relief. Williamson v. General Dynamics Corp., 208 F.3d 1144, 1149 (9th Cir. 2000).

When deciding a motion to dismiss, the court may consider the facts alleged in the complaint, as well as documents whose contents are alleged in the complaint. Branch v. Tunnell, 14 F.3d 449, 454 (9th Cir. 1994). While ordinarily a Rule 12(b)(6) motion does not consider material outside of

the pleadings, material properly submitted as a part of the complaint may be considered. Sprewell v. Golden State Warriors, 266 F.3d 979, 988-89 (9th Cir. 2001).

2. Rule 9(b)

Rule 9(b) requires that "[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." Fed. R. Civ. P. 9(b). In order to comport with Rule 9(b)'s requirements the complaint must allege "the time, place, and content of the alleged fraudulent representation or omission; the identity of the person engaged in the fraud; and the 'circumstances indicating falseness' or 'the manner in which [the] representations [or omissions at issue] were false and misleading.'" In re Calpine Corp. Sec. Litig., 288 F. Supp. 2d 1054, 1074-75 (N.D. Cal. 2003) (quoting In re GlenFed Inc. Sec. Litig., 42 F.3d 1541, 1547-48 (9th Cir. 1994)). Pursuant to Rule 9(b), falsity must be pleaded with particularity, but scienter may be averred generally. Fed. R. Civ. P. 9(b) ("Malice, intent, knowledge, and other condition of mind of a person may be averred generally."); Ronconi v. Larkin, 253 F.3d 423, 429 n.6 (9th Cir. 2001).

3. Private Securities Litigation Reform Act

The Private Securities Litigation Reform Act ("PSLRA") imposes further pleading requirements in securities cases: falsity and scienter must be pleaded with particularity. No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Airlines, 320 F.3d 920, 931 (9th Cir. 2003) (citing In re Silicon Graphics Inc. Sec. Litig., 183 F.3d 970, 973 (9th Cir. 1999). The PSLRA requires that the complaint "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which the belief is formed." 15 U.S.C. § 78u-4. The PSLRA also mandates that the complaint plead with particularity facts establishing "a strong inference" of scienter. 15 U.S.C. § 78u-4(b)(2). Courts in the Ninth Circuit incorporate the dual pleading requirements of sections 78u-4(b)(1) and (b)(2) into a single inquiry because falsity and scienter are generally inferred from the same set of facts. Ronconi, 253 F.3d at 429.

B. Plaintiffs' Section 11 Claims

Count one alleges violations of Section 11 of the Securities Act of 1933 and is brought against

all Defendants with the exception of Rane and SureBeam.[3] Section 11 establishes liability for false or misleading statements or omissions contained within a registration statement. 15 U.S.C. § 77k(a). The issuer of a security is absolutely liable for material misstatements and omissions within the registration statement. Herman & MacLean v. Huddleston, 459 U.S. 375, 381-82 (1983). All other defendants are prima facie liable, but may raise a defense of due diligence. Id. Section 11 contains no scienter requirement and may be based on "innocent or negligent material misstatements or omissions." Anderson v. Clow (In re Stac Elecs. Sec. Litig.), 89 F.3d 1399, 1404 (9th Cir. 1996) (quoting Kaplan v. Rose, 49 F.3d 1363, 1371 (9th Cir. 1994).

In order to state a claim under Section 11 the plaintiff must prove that (1) the registration statement contained a material omission or misrepresentation, (2) the plaintiff purchased a security that was part of a registered offering, and (3) the defendant falls into one of the enumerated classes. Stac, 89 F.3d at 1403; Huddleston, 459 U.S. at 381-82. Defendants argue that none of these requirements have been adequately pled in the consolidated Complaint.

1. Material Omissions or Misrepresentations In the Registration Statement

A Registration Statement may violate Section 11 in three ways: (1) containing "an untrue statement of material fact"; (2) omitting "a material fact required to be stated therein"; or (3) omitting a material fact "necessary to make the statements therein not misleading." 15 U.S.C. § 77k; Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1204 (1st Cir. 1996). Materiality is ordinarily a factual question reserved for the jury. Fecht v. Price Co., 70 F.3d 1078, 1081 (9th Cir. 1995). Misstatements or omissions within a registration statement are judged considering the circumstances at the time the registration statement becomes effective. 15 U.S.C. § 77k(a); GlenFed, 42 F.3d at 1549 .

In this case, Lead Plaintiffs allege that the Prospectus for the Registration Statement (1) contained a material misstatement, (2) omitted required information, and (3) omitted material facts necessary to make the statements not misleading.

a. Applicability of Rule 9(b)

Defendants argue that Rule 9(b)'s particularity requirements should apply to Lead Plaintiff's

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[3] Although SureBeam is not a named defendant, in order for Titan to be vicariously liable as a control person of SureBeam under Section 15 of the 33 Act, the complaint must plead that SureBeam was primarily liable for a Section 11 violation. See Howard v. Everex Sys., Inc., 228 F.3d 1057, 1065 (9th Cir. 2000).

Section 11 allegations because those allegations sound in fraud. Lead Plaintiffs argue that this court should limit the use of Rule 9(b) to the claims arising under Section 10(b).

Rule 9(b) requires that "[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." Fed. R. Civ. P. 9(b). Because Section 11 does not require fraudulent conduct, Rule 9(b) ordinarily does not apply to a Section 11 claims. See Kaplan, 49 F.3d at 1371. However, in Stac the Ninth Circuit held that Rule 9(b)'s heightened pleading requirements apply to Section 11 claims that are "grounded in fraud." Stac, 89 F.3d at 1404-05. Where the "gravamen of the complaint is plainly fraud and no effort is made to show any other basis for the claims levied at the Prospectus," even the plaintiff's "nominal efforts" to disclaim the fraud allegations will not prevent the application of Rule 9(b). Id. at 1405 n.2.

The Ninth Circuit elaborated on the Stac holding in Vess v. Ciba-Geigy Corp., 317 F.3d 1097, 1103-05 (9th Cir. 2003). The Vess court held that in cases in which fraud is not an element of the claim and plaintiff chooses nonetheless to allege "a unified course of fraudulent conduct and rely entirely on that course of conduct as the basis of a claim" the claim sounds in fraud and the entire claim is subject to Rule 9(b). Id. at 1103-04. If, however, the plaintiff alleges some fraudulent and some non-fraudulent conduct, "only the allegations of fraud are subject to Rule 9(b)'s heightened pleading requirements." Id. at 1104. In the latter situation, "if particular averments of fraud are insufficiently pled under Rule 9(b), a district court should 'disregard' those averments, or 'strip' them" from the non-fraud-based claim and "then examine the allegations that remain to determine whether they state a claim." Id. at 1105.

In this case, Lead Plaintiffs have alleged a unified course of fraudulent conduct against the Titan and SureBeam Defendants. Nearly the entire Complaint alleges that the Titan Defendants and the SureBeam Defendants deliberately deceived the investing public into believing that SureBeam was financially sound and that the Tech Ion venture was generating a profit. The Complaint alleges that "Titan and Surebeam *knew* as of the date of the IPO [funding] would not be provided" and recognized revenue in the Prospectus despite this knowledge. (CC ¶ 39 (emphasis added)). The Complaint also states that Titan and SureBeam misled the public about the structure of the joint venture. (CC ¶ 40). Lead Plaintiffs' Section 11 and Section 10(b) claims are made up of a unified course of conduct

alleging the Titan and SureBeam Defendants used fraudulent omissions and misrepresentations to convince the public that SureBeam was generating a profit from the Tech Ion venture.

Lead Plaintiffs assert that the Section 11 claims are based on a negligence or strict liability theory. In the portion of the Complaint raising a Section 11 claim, Lead Plaintiffs "expressly exclude and disclaim any allegations that could be construed as alleging intentional or reckless misconduct or fraud" and maintain that all Section 11 claims are "based upon defendants' negligence or theories of strict liability." (CC ¶ 176). However, the court in Stac expressly held that "nominal efforts" to disclaim fraud allegations are insufficient to avoid Rule 9(b) when the gravamen of the complaint is fraud. 90 F.3d at 1405 n.2. See also In re Stratosphere Corp. Sec. Litig., 1 F. Supp. 2d 1096, 1104 (D. Nev. 1998) ("Plaintiffs cannot avoid the more stringent requirements of Rule 9(b) by merely inserting boilerplate language into their Complaint stating that claims are based in negligence, not fraud."). Furthermore, Lead Plaintiffs do not plead any facts regarding this alleged negligence. The Complaint only contains the conclusory statement that the Section 11 claim is based in negligence. Because the gravamen of Lead Plaintiffs' allegations against the Titan and SureBeam Defendants is fraud, the Section 11 claims against Titan and the SureBeam Defendants are subject to Rule 9(b)'s pleading requirements.

Lead Plaintiffs' allegations against the Underwriter Defendants, on the other hand, do not contain any allegations of fraud or intentional behavior. In fact, the Underwriters are hardly mentioned in the factual allegations portion of the Complaint. Other than the allegation that they underwrote the IPO without conducting due diligence, see CC ¶¶ 163-166, the only other instance an underwriter is mentioned in the Complaint is the portion in which Lead Plaintiffs allege that Merrill Lynch and First Union issued SureBeam a "buy" and "strong buy" rating. See CC ¶ 88. But even this allegation is based in negligence: "Had First Union, or any of the other underwriters conducted even the slightest due diligence on the venture, First Union would have known that its statement (and the statements about the Brazilian venture) were materially false and misleading." (CC ¶ 89). The Section 11 claims against the Underwriter Defendants are not subject to Rule 9(b)'s pleading requirements.

b. "We began construction of [the systems for Tech Ion] in July 2000, and have recorded revenues of $15.5 million under the percentage-of-completion method for the year ended December 31, 2000" and our "accounting policies comply with the provisions of SAB 101." (CC ¶ 85)

Lead Plaintiffs allege that these statements were false at the time of the March 16, 2001 IPO because SureBeam's revenue recognition violated Generally Accepted Accounting Principles ("GAAP") and SEC Staff Accounting Bulletins ("SAB") for recognizing revenue. GAAP allow revenue to be recognized under the percentage of completion method of accounting once services are rendered, even if payment has not actually been made. However, GAAP require that revenue can be recognized under the percentage of completion method only if "[t]he buyer can be expected to satisfy his obligations under the contract." Titan Ex. A at 35. Like the GAAP, SAB 101 requires that collectability be "reasonably assured" before revenue is recognized.[4] Lead Plaintiffs allege that Titan and its employees were aware as of the date of the IPO that revenue from the Tech Ion project was far from reasonably assured.

Defendants argue that Lead Plaintiffs are pleading falsity by hindsight. Defendants claim that while Tech Ion was ultimately unable to pay the amount owed under the contract and SureBeam's revenue was ultimately overstated, Lead Plaintiffs have not identified facts proving Tech Ion's inability to pay at the time the revenue was recognized.[5] Lead Plaintiffs respond that they have identified information available to Defendants at the time of the IPO, but never revealed to the investing public, proving Tech Ion's inability to pay for the systems under contract.

The Delphos Emails

On October 21, 2000, Oberkfell and Claudio received an email from Michael Telford at

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[4]The Underwriter Defendants argue that SEC SAB do not have the same force of law as SEC Rules, and therefore failure to follow SAB cannot constitute a Section 11 violation. See Ganino v. Citizens Utilities Co., 228 F.3d 154, 163 (2d Cir. 2000) (holding a SAB "does not carry with it the force of law"). However, Lead Plaintiffs are not asserting that SureBeam was required by law to follow SAB 101 in the Registration Statement. Rather, SureBeam's Prospectus claimed that all accounting complied with SAB 101.

[5]The parties seem to be disputing the exact date on which the statement must have been false. Lead Plaintiffs contend that although the revenue was recognized in 2000, SureBeam had an obligation to disclose that previously recorded revenue was improperly recognized in order to keep the Prospectus from being misleading. Therefore, Lead Plaintiffs argue the statement must have been false as of March 16, 2001, the date of the IPO. The Titan Defendants, in contrast, argue that the recognition of the revenue need only have been true as of December 31, 2000, the date it was initially recognized. The Titan Defendants' argument, however, would authorize SureBeam to recognize revenue for the fiscal year 2000 and then, knowing it was incorrectly recognized, report it again in the Prospectus in 2001. Such an interpretation would conflict with Section 11, which provides a cause of action if any part of a registration statement is false or misleading "*when such part became effective.*" 15 U.S.C. § 77k(a) (emphasis added).

Delphos. The email stated,

> As we discussed, the meetings at the IIC and IFC [the World Bank] went very well. Both organizations are genuinely interested but expressed some of the same reservations. Specifically, SureBeam Brasil aims to provide a high technology service that is currently under-utilized (or non-existent) in Brazil. Although this is at the heart of its potential for success, lenders secured only by the project's assets need greater assurances that there will be customers to generate revenue to pay the debt. As presented in the information memorandum, the customer base is not well-defined and established enough to provide comfort . . . . convincing a lender that clients will line up for a new service when the doors are thrown open (what we refer to as the 'if you build it, they will come' or 'Field of Dreams' approach is *EXTREMELY difficult*." (CC ¶ 25).

Again, on December 28, 2000 Oberkfell and Claudio received an email from Delphos regarding funding. The second email was from Alan Beard and stated,

> Attached is the information we had sent last week. We have highlighted within the Word document that specific questions and issues that need addressing. To reiterate them here more broadly, we need to justify the revenues and construct a plausible business case for marketing the SureBeam services (i.e., letters of interest from potential customers, alliances, etc.). Additionally, we need as many specifics on the construction of the project as possible. (CC ¶ 27).

Lead Plaintiffs allege that Titan and SureBeam never provided the needed information. Lead Plaintiffs contend these emails are proof that financing from the World Bank was not "reasonably assured."

The Medeiros Memorandum

In December of 2000, Medeiros faxed a memorandum to Oberkfell and Claudio regarding major flaws in the concept for the joint venture. (CC ¶ 29). Medeiros stated "Delphos' material needs enormous rewriting and deep changes in the concept and numbers." Id. Medeiros opined that "[a]s it is now, I believe that it will not be approved, and if the World Bank asks for outside experts to examine the technical aspects, they will certainly locate our weak spots." Id. Medeiros went on to explain that the plan of servicing Brazil's CEASAs was deeply flawed. He stated "if we use only X-rays, the facility will surely go bankrupt..., if we go E-beams, numbers will improve but the market will be limited." (CC ¶ 31). Medeiros suggested "[l]et's change the image of Rio to a Center of Excelence [sic] to justify the presence of X-ray and E-beam there, and to enable us to obtain government funds - hopefully grants – to finance the project." (CC ¶ 29). Lead Plaintiffs allege that this memorandum is evidence that financing from any party, especially the World Bank, was not likely because the entire design of the project was fundamentally flawed.

The Shipment of Irradiators and Invoice

On January 16, 2001 and January 25, 2001, SureBeam shipped two irradiation systems to Manaus. (CC ¶ 35). The Complaint states that a project manager expressed concern to Oberkfell before the shipment was made, but was overruled. Id. The project manager's concern stemmed from the fact that the irradiators were to be used in Rio, some 2,000 miles away from the Manaus shipping destination, in a building that had yet to be constructed. He feared the systems would deteriorate as they repeatedly traveled and waited for installation. Id. Lead Plaintiffs also emphasize that the invoices for the systems that indicated the systems were "prepaid," despite the fact that the term sheet stated the systems would be paid using the profits of the venture. Finally, Lead Plaintiffs cite an email sent on February 26, 2001, concerning the amount charged for these irradiators. The email sent by Medeiros stated, "please send me your proforma invoice for US$ 6.5 million ASAP. Otherwise, I will change the numbers to US$ 5.0 million. If I do not hear from you or receive the amend Proforma invoice, I will use the existing one of $5.0MMM." (CC ¶ 36). Oberkfell replied "We should change the amount to $6.5 definitely . . . . Keep going as fast as you can to get the $ to prove to all that this is as we all claim it to be... Thank you." (CC ¶ 37).

Lead Plaintiffs argue the shipment and alteration of the invoice prove the importance of securing financing from SUDAM. SureBeam would allegedly not have falsified an invoice and shipped the systems to Manaus had they not needed SUDAM's funding so badly.

The Collapse of SUDAM

Finally, four days before the IPO on March 12, 2001, SUDAM was disbanded by the Brazilian government due to high-level corruption. (CC ¶ 37). The Associated Press reported the disbanding of the company. Id. Lead Plaintiffs allege that when SUDAM collapsed, SureBeam lost its last hope for funding. (CC ¶ 38).

Defendants contend that no facts have been pleaded proving that SUDAM was the venture's last hope. Defendants contend that Lead Plaintiffs merely make the conclusory assumption that with SUDAM's undoing, SureBeam witnessed its "last chance for funding disappear." Defendants contend that the evidence pleaded in the Complaint actually proves that SUDAM was not the venture's last hope, pointing out that the emails from Delphos indicate that meetings went "very well" and that while the lack of use of SureBeam's technology in Brazil scared some investors away, it was also "at the

heart of its potential for success." Furthermore, Medeiros' memorandum did not state that the flawed concept spelled doom for the venture. In fact, he stated that he was "ready with my team to rewrite the document" even if he had to work overnight. Finally, Medeiros expressed optimism about securing government grants once the project became a "Center of Excellence."

Because all reasonable inferences must be resolved in the plaintiff's favor when evaluating a motion to dismiss, America West, 320 F.3d at 931, Lead Plaintiffs have pleaded with sufficient particularity that the recognition of $15.5 million from Tech Ion was false and misleading at the time it was made. The facts and documents alleged in the Complaint identify with particularity events transpiring before the IPO that indicate SureBeam was recognizing revenue from an insolvent customer who was having extreme difficulty securing financing to pay its bills.

c. "...we received purchase orders from Tech Ion Industrial Brazil S.A. for eleven electronic food irradiation systems which we expect to result in approximately $55.0 million in sales revenues to us over the next three years."

Lead Plaintiffs allege that projecting $55 million from the Tech Ion venture was false and misleading for the reasons outlined above, including Tech Ion's insolvency and inability to secure funding. The Complaint contends that Tech Ion could not pay the contract price of $55 million, or any amount, as of the March 16, 2002 IPO. Defendants contend that this statement is forward-looking and not actionable as securities fraud.

Although the projection of future revenue is a statement of expectation, such a forward-looking statement can constitute securities fraud. In re Apple Computer Sec. Litig., 886 F.2d 1109, 1113 (9th Cir. 1989). A "projection or statement of belief contains [an] implicit factual assertion [that] the speaker is not aware of any undisclosed facts tending to seriously undermine the accuracy of the statement." Id.; Cooper v. Pickett, 137 F.3d 616, 629 (9th Cir. 1997).

Lead Plaintiffs contend that the projection of $55 million in revenue contained the implicit factual assertion that the speaker was not aware of any undisclosed reason why the $55 million could not be collected. Despite the implicit factual assertion to the contrary, Lead Plaintiffs contend that SureBeam and Titan were aware that: (1) Tech Ion was insolvent, (2) Tech Ion had "no recorded historical revenues or profits that could be displayed at this time," (3) Tech Ion's payment of the $55 million was contingent on outside funding, and (4) all outside funding prospects had failed. The

Prospectus failed to disclose any of this specific information and therefore, Lead Plaintiffs contend, the projection of $55 million was misleading.

1. The Bespeaks Caution Doctrine

Defendants argue that some of the allegedly misleading omissions were actually included in the Prospectus and that the projection of $55 million in future revenue from Tech Ion is a forward-looking statement protected by the Ninth Circuit's "bespeaks caution" doctrine. See In re Worlds of Wonder Sec. Litig., 35 F.3d 1407, 1415 n.3 (9th Cir. 1994). Pursuant to this doctrine, the court may hold as a matter of law that "defendants' forward-looking representations contained enough cautionary language or risk disclosure to protect the defendant against claims" based on those predictive statements. Id. at 1413. "[A] motion to dismiss for failure to state a claim will succeed only when the documents containing defendants' challenged statements include '*enough* cautionary language or risk disclosure,' that 'reasonable minds' could not disagree that the challenged statements were not misleading." Fecht, 70 F.3d at 1082 (quoting Worlds of Wonder, 35 F.3d at 1413).

In this case, the Defendants argue that SureBeam's projection of $55 million in the Prospectus was forward-looking and accompanied by enough cautionary language regarding the Tech Ion venture to put the public on notice. Defendants point to the following cautionary disclosures in the Registration Statement and Prospectus:

- "You should not place undue reliance on these forward-looking statements." Titan Ex. 1 at 23.
- SureBeam Brasil is a "start up company that was created with no initial capital contribution." SureBeam Ex. 5 at 35.
- "We have entered into agreements to establish operations in both Japan and Brazil. Expansion of our international operations could impose substantial burdens on our resources, divert management's attention from domestic operations and otherwise adversely affect our business. Furthermore, international operations are subject to several inherent risks that could increase our costs and decrease our profit margins including . . . changes in a specific country's or region's political or economic conditions." Id. at 10-11.
- "Our historical revenues are primarily attributable to the design and construction of systems for a limited number of third party service centers . . . Some of these systems are not yet installed or in operation and we expect to continue to derive system sales revenue as we complete construction of these systems. . . . We cannot assure you that we will continue to derive revenues from these customers, that revenues from these customers will continue at current or historical levels. . ." Id. at 12.
- **"DELAYS IN THE CONSTRUCTION AND INSTALLATION OF OUR SYSTEMS COULD NEGATIVELY AFFECT OUR REVENUE."** Id. at 15.
- "For example, the expected completion date of the first service center in Brazil was postponed from the fourth quarter of 2000 to the third quarter of 2001 as a result of unanticipated delays in the construction process. Any delay in the deployment of our systems could adversely affect our revenue and cash flow." Id.

- "The markets for our SureBeam system are unproven." Id. at 7-8.
- "We expect to derive our future revenues from sales of our SureBeam systems and related food processing services. However, these revenues are highly uncertain." Id. at 7-8.

Lead Plaintiff argues that many of these cautionary statements are general, boilerplate warnings. A statement does not adequately bespeak caution if it is overly generalized and does not directly address the allegedly misleading future projection. Provenz v. Miller, 102 F.3d 1478, 1494 (9th Cir. 1996). Lead Plaintiffs also argue that the Prospectus' omission of past problems – including the failure to secure funding and the failure of the business plan – cannot be remedied by forward-looking statements about potential similar problems. Apple Computer, 886 F.2d at 1115 ("There is a difference between knowing that any product-in-development may run into a few snags, and knowing that a particular product has already developed problems . . .")

In this case, the Complaint adequately alleges that the Tech Ion venture had encountered problems that made recognition of revenue improper. Cautionary statements about future results cannot shield Defendants from liability for revenues already being improperly recognized. The motions to dismiss based upon the bespeaks caution doctrine are denied.

d. "we acquired a 19.9% equity interest in SureBeam Brasil without charge" and SureBeam Brasil was created "with no initial capital contribution from either party."

Lead Plaintiffs argue that this statement was untrue because Titan, then the sole shareholder of SureBeam, actually provided Tech Ion with $5 million dollars at the time the joint venture was created. Defendants argue that no misrepresentation was made regarding the $5 million line-of-credit because the loan was disclosed in the Prospectus.

The Complaint alleges that the "loan" concept was untrue and a guise for a contribution of capital to get the joint venture started. Lead Plaintiffs' only evidence that the money was a contribution is that no provision for repayment was included in the Prospectus, Tech Ion did not make any payments to Titan prior to the IPO, and Tech Ion ultimately could not repay the full $5 million.

Lead Plaintiffs' evidence that the money was a contribution rather than a loan is inadequate. The fact that Tech Ion ultimately could not pay the money back in 2001 does not prove that it was not a loan in 2000. In fact, information included in the Complaint actually contradicts Lead Plaintiffs' characterization of the money. Lead Plaintiffs admit that at the time Titan forgave the debt, the

balance was only $3.5 million. Additionally, the $5 million payment to Tech Ion was disclosed in the Prospectus, which stated that Titan would "provide a $5 million working capital line of credit to Tech Ion." This statement was not materially misleading.

e. Omissions: Item 303 of SEC Regulation S-K

Lead Plaintiffs allege that a Registration Statement must disclose all information required under SEC rules. SureBeam's registration statement allegedly failed to disclose information required under Item 303 of SEC Regulation S-K ("Item 303"). Item 303 requires disclosure of "any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." 17 C.F.R. § 229.303. The Ninth Circuit has held that because Section 11 imposes liability if a registrant "omits to state a material fact required to be stated" in the registration statement, "any omission of facts 'required to be stated' under Item 303 will produce liability under Section 11." Steckman v. Hart Brewing, 143 F.3d 1293, 1296 (9th Cir. 1998). Lead Plaintiffs contend that more than one known adverse "trend, demand, commitment, event, or uncertainty" was not disclosed in SureBeam's Registration Statement, especially the collapse of SUDAM and the lack of funding.

Defendants argue nothing was omitted from the Prospectus because the document disclosed that the venture was "a start up company that was created with no initial capital contribution from either party." SureBeam Ex. 5 at 35. The Prospectus also informed customers that "international operations are subject to several inherent risks that could increase our costs and decrease our profit margins including . . . changes in a specific country's or region's political or economic conditions." Id. at 10-11. Defendants argue that, based on the above disclosures, investors were aware that the joint venture had no proven track record, no customer base, and no assets.

Adequacy of disclosure under Item 303 is a factual question and "adequacy of disclosure is normally a jury question." Durning v. First Boston Corp., 815 F.2d 1265, 1268 (9th Cir. 1987). The Complaint sufficiently alleges enough facts from which a reasonable jury could conclude that the SureBeam prospectus violated Section 303. For these reasons, the motions to dismiss claims of misstatements under Item 303 are denied.

f. The Corporate Mismanagement Exclusion

The Underwriter Defendants contend that Lead Plaintiffs' allegations of omitted information are "nothing more than a corporate mismanagement claim" and therefore cannot form the basis of securities fraud. The Underwriter Defendants point to Santa Fe Indus., Inc. v. Green, where the Supreme Court held that a mere breach of corporate fiduciary duty or "corporate mismanagement" does not constitute securities fraud. 430 U.S. 462, 474-77 (1977).

However, Santa Fe does not stand for the proposition that when a breach of fiduciary duty and a misrepresentation in the sale of securities occur at the same time, only the former claim may be brought. See In re Wells Fargo Sec. Litig., 12 F.3d 922, 927 (9th Cir. 1993) (holding "we do not believe that the broad corporate management exclusion from § 10(b) and Rule 10b-5, set forth in Santa Fe, is implicated when plaintiffs allege specific misrepresentations or material nondisclosures in violation of the federal securities laws."). The fact that Lead Plaintiffs' allegations could potentially state claims for corporate mismanagement or a breach of fiduciary duty does not negate the applicability of federal securities laws, if the statements in the Prospectus were materially false or misleading at the time they were made.

2. Securities Purchased Were Part of a Registered Offering

Defendants also move to dismiss the Section 11 claims on the ground that Lead Plaintiffs have not established standing by showing that the Plaintiffs' shares are traceable to the IPO or by showing reliance on the registration statement.

a. Securities Traceable to the IPO

Defendants argue that Lead Plaintiffs have not alleged that they purchased securities during the IPO or that the securities they purchased are traceable to the IPO and therefore have not established standing under Section 11.

Stock purchasers have standing under Section 11 if they acquired their shares directly in the IPO or if they can trace their purchases to the IPO. Hertzberg v. Dignity Partners, Inc., 191 F.3d 1076, 1080 n.4 (9th Cir. 1999). The Complaint alleges that all three Lead Plaintiffs "purchased shares of SureBeam publicly-traded during the Class Period" and that two named, non-lead Plaintiffs, Delaware Charter Gty. Trust Tr. Melvyn Manaster IRA R/O and James Janette, "purchased shares of Surebeam publicly-traded stock during the Class Period, including shares directly from or traceable to

SureBeam's Initial Public Offering." (CC ¶ 69).

Defendants contend that these allegations of standing are insufficient. In particular, Defendants contend that Lead Plaintiffs must plead the particular dates of acquisition or facts establishing a connection to the IPO. To support this assertion, Defendants cite two cases, Lilley v. Charren, 936 F. Supp. 708, 715 (N.D. Cal. 1996), and Guenther v. Cooper Life Sciences, Inc., 759 F. Supp. 1437, 1439 (N.D. Cal. 1990). Those cases require that the plaintiff set forth specific dates and facts in the Complaint that establish the representative plaintiffs' § 11 standing. Drawing on these cases, Defendants contend that the Complaint's conclusory statements that named Plaintiffs purchased "shares directly from or traceable to SureBeam's Initial Public Offering" are insufficient because they do not reveal the specific dates and facts of purchase.

Lead Plaintiffs maintain that they have adequately established standing under § 11 by filing certificates during the motion to be appointed lead plaintiff. They point out that both Lilley and Guenther were decided prior to the enactment of the PSLRA. In their motions to be appointed lead plaintiff, Lead Plaintiffs provided the court with certificates in which plaintiffs identified when they purchased their shares of SureBeam.

By asserting that the named plaintiffs bought shares directly from or traceable to SureBeam's IPO and by filing certificates detailing the transactions, the plaintiffs have established standing under Section 11. See In re Seebeyond Techs. Corp. Secs. Litig., 266 F. Supp. 2d 1150, 1172 (C.D. Cal. 2003) (holding allegation that "Lead Plaintiff and the members of the Class purchased [stock] issued pursuant to the Registration Statement/Prospectus filed by the Company with the SEC" is sufficient to plead § 11 standing).

b. Reliance on the Registration Statement

Defendants argue that Plaintiffs' Section 11 claim should be dismissed because Lead Plaintiffs fail to plead reliance on the Registration Statement. Reliance is not required under Section 11 unless the purchaser "acquired the security after the issuer has made generally available ... **an** earnings statement covering a period of at least twelve months beginning after the effective date of the registration statement...." 15 U.S.C. § 77k(a). Defendants allege that SureBeam filed a Form 10-K with the SEC on April 1, 2002 and a Form 10-Q on May 15, 2002, and claim that these two forms

taken together constitute an earnings statement. The text of 15 U.S.C. § 77k(a) requires a single earnings statement, so the filings on April 1, 2002 and May 15, 2002 cannot be linked to require Plaintiffs to prove reliance.

3. The Enumerated Classes of Defendants

Titan, sued as both primary violator of Section 11 and as vicariously liable for SureBeam's Section 11 violation under Section 15, moves to dismiss on the ground that it is an improper Section 11 defendant. Titan argues that regardless of whether Lead Plaintiffs have stated a claim under Section 11, the Complaint fails to adequately state how Titan is primarily liable under Section 11. Plaintiffs did not respond to Titan's motion to dismiss the Section 11 claims against it.

Section 11 authorizes suit against (1) "every person who signed the registration statement," (2) directors of the issuer, (3) individuals named in the registration statement as "being or about to become a director," (4) professionals named as having prepared or certified any part of the registration statement," and (5) every underwriter. 15 U.S.C. § 77k(a). Titan does not fall under any of the enumerated categories of Section 11 defendants, so the Section 11 claim against Titan is dismissed.

The Underwriter Defendants have also moved to dismiss the Section 11 claims against them. As underwriters of a security, the Underwriter Defendants will be liable for material misstatements in the registration statement. Section 11(b) allows a defendant to avoid liability if the defendant proves he made a reasonable, independent investigation and believed the statement was true when made. Any dismissal of an Underwriter Defendant based upon a showing of a reasonable, independent investigation must come at a later time, not at this pleading stage. The motion of the Underwriter Defendants to dismiss the Section 11 claims against them is denied.

4. Section 11 Conclusion

Lead Plaintiffs have adequately pled a false or misleading statement or omission in the Registration Statement with respect to revenue recognition and projection for the Tech Ion venture but not with respect to the capitalization of SureBeam Brasil. It was not necessary for Lead Plaintiffs to plead reliance on the Registration Statement to present a valid Section 11 claim. Oberkfell, Claudio, Ray, Golding and the Underwriter Defendants are proper Section 11 defendants and the claims against them remain. But the Section 11 claims against Titan are dismissed under Fed. R.Civ.P. 12(b)(6).

C. Count Three: Section 10(b) of the 34 Act and SEC Rule 10b-5

The third claim in the Complaint names Oberkfell, Claudio, and Rane and alleges that they are liable for violations of Section 10(b) and Rule 10b-5. Section 10(b) makes it unlawful to employ, in connection with the purchase or sale of any security, any manipulative or deceptive device contrary to SEC rules. 15 U.S.C. 78j. Rule 10b-5, promulgated under Section 10(b), provides it is unlawful for any person, by the use of any means of interstate commerce,

(a) to employ any device, scheme or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

In order to establish a violation of Section 10(b) or Rule 10b-5, a plaintiff must demonstrate the following elements: (1) a connection to the purchase or sale of a security, (2) defendants made a false statement or omission, (3) materiality, (4) scienter, (5) reliance, and (6) causation. Broudo v. Dura Pharms., Inc., 339 F.3d 933, 937 (9th Cir. 2003).

Under the PSLRA both falsity and scienter must be stated with particularity. Ronconi, 253 F.3d at 429. The complaint must "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed." 15 U.S.C. § 78u-4(b)(1)(B). The PSLRA also requires the complaint to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2).

1. False Statement or Omission

In order to amount to a Section 10(b) violation, the statement or omission at issue must be false or misleading. Brody v. Transitional Hospital Corp., 280 F.3d 997, 1006 (9th Cir. 2002). The plaintiff may plead falsity with particularity by "pointing to inconsistent contemporaneous statements or information (such as internal reports) which were made by or available to the defendants." Yourish v. Cal. Amplifier, 191 F.3d 983, 994 (9th Cir. 1999) (quoting GlenFed, 42 F.3d at 1549).

a. The Group Published Theory

The Complaint alleges that the SureBeam Defendants are liable for all written false statements, "as those statements were 'group-published' information." (CC ¶ 74). Defendants argue that Lead Plaintiffs cannot rely on the "group published" doctrine to prove that they made a false statement or omission, in light of the PSLRA's particularized pleading requirements. This court previously held that the group published doctrine's inference of wrongdoing based on a defendant's status "cannot be reconciled with the statutory mandate that plaintiffs must plead specific facts as to each act or omission by the defendant." Allison v. Brooktree Corp., 999 F. Supp. 1342, 1350 (S.D. Cal. 1998). Lead Plaintiffs' counsel conceded this point during oral arguments.

b. The Tech Ion Venture Statements

The Complaint alleges that SureBeam made several false statements and omissions regarding the Tech Ion Venture before the IPO, in the Prospectus, and following the Prospectus.

The Pre-IPO Statements

The only allegedly false statements made prior to the IPO were statements Oberkfell and Rane made at a roadshow in February 2001. The Complaint alleges that Oberkfell and Rane orally informed investors that SureBeam had recognized revenue of $15.5 million from the Tech Ion deal and was expecting $55 million in the future. (CC ¶ 82). The roadshow occurred before the collapse of SUDAM and before the purported falsification of the invoice on the shipment to Manaus. Absent the problems with SUDAM, statements regarding the Tech Ion venture are far less misleading and do not support a claim for securities fraud.

The IPO Statements

As outlined above in the portion of this decision addressing the Section 11 claims, Lead Plaintiffs allege a number of statements in the Prospectus were false or misleading at the time of the IPO. As stated above, Lead Plaintiffs have adequately pleaded with particularity that the Prospectus contained misleading statements and omissions regarding revenue from the Tech Ion venture but not regarding the capitalization of SureBeam Brasil.

The Post-IPO Statements

On May 15, 2001, SureBeam filed a Form 10-Q with the SEC. In that report, SureBeam recognized $5.5 million in revenue for the first quarter of 2001, with $4.7 million of the revenue

coming from Tech Ion. Lead Plaintiffs allege that this revenue recognition violated GAAP because payment for Tech Ion was not reasonably assured, as required under the percentage-of-completion accounting method. Financing was still unavailable and Tech Ion's construction of the irradiation facility was at least six months behind schedule. Oberkfell traveled to Brazil and witnessed that the irradiators he sent there in January of 2001 were sitting in a warehouse unused.

SureBeam again recognized almost $1 million in revenue from the Tech Ion venture in the company's 10-Q filed on August 14, 2001. However, SureBeam employees had traveled to Rio prior to this announcement and witnessed that Tech Ion had done very little construction on the project. Tech Ion had merely laid a foundation, constructed a ceiling and dug "little holes." The project was nowhere near completion and SureBeam employees were skeptical as to how Tech Ion was using the $5 million loan from Titan.

Again in a 10-Q filed November 14, 2001, SureBeam recognized $1.3 million of revenue from Tech Ion. Prior to this recognition, the facility in Rio was only 40%-50% completed and was over twelve months behind schedule. In fact, Tech Ion was so far behind in construction by that time that SureBeam replaced Tech Ion with a different construction company and bought out Tech Ion's interest in October of that year.

Lead Plaintiffs have pleaded with particularity that the revenue recognition following the IPO was misleading for the same reasons revenue recognition was misleading in the IPO. Lead Plaintiffs have demonstrated that Tech Ion's financial situation and ability to pay only deteriorated after the IPO, yet SureBeam continued to recognize revenue from the venture.

Lead Plaintiffs allege that Oberkfell made other false statements after the SureBeam IPO. Oberkfell allegedly stated in a July 13, 2001 press release that SureBeam's "joint venture, SureBeam Brasil, will be supporting the new Food Irradiation Center of Excellence being instituted in the State of Rio de Janeiro" and the "joint venture between SureBeam Corporation and Tech Ion . . . expands our revolutionary, patented SureBeam® technology into one of the largest and most diversified food markets in the world." (CC ¶ 97-98). On August 14, 2001, Oberkfell stated, "I am pleased with the progress we have made in executing our business strategy since our IPO just four months ago." (CC ¶ 99). After resigning on March 6, 2003, the Complaint alleges that Oberkfell stated "My goal of

moving SureBeam from an excellent idea to building a business foundation for its continued growth has been realized. I am excited by the success we've had." (CC ¶ 129). These general statements of optimism are not actionable as securities fraud. See Southland Sec. Corp. v. INSpire Ins. Solutions Inc., 365 F.3d, 353, 372 (5th Cir. 2004); Lasker v. New York State Elec. & Gas Corp., 85 F.3d 55, 59 (2d Cir. 1996).

Finally, the Complaint alleges that Oberkfell and Rane stated during a July 29, 2002 conference call that delays in Rio were attributable to "time needed to obtain regulatory permits and licensing." (CC ¶ 115). Lead Plaintiffs have not alleged facts demonstrating that this statement was false.

c. The RESAL Venture Statements

Plaintiffs allege that SureBeam made misrepresentations relating to the agreement with RESAL to purchase ten irradiators. During the class period, SureBeam recognized $23.5 million on that contract: $6.8 million in Q2-01, $7.9 million in Q3-01, $5.1 million in fiscal year 2002, and $1.1 million in Q1-03. Defendants argue that although RESAL was ultimately only able to pay SureBeam $7.5 million of the $23.5 million recognized and $53 million projected, Lead Plaintiffs have not demonstrated that recognizing revenue from the project was improper *at the time* it was done.

While Lead Plaintiffs may have adequately pleaded that the success of the RESAL venture was dependant on outside funding, they do not plead any specific facts showing that funding was unavailable or unlikely. Lead Plaintiffs' only evidence of RESAL's inability to pay is the fact that Rane renegotiated the payment schedule at some point. This is insufficient to plead with particularity that the SureBeam's Defendants' statements regarding revenue from RESAL were false or misleading at the time they were made.

d. The Domestic Operations Statements

The Complaint cites numerous statements by the SureBeam Defendants regarding current and future domestic demand for SureBeam's irradiated meat. Defendants contend that all statements made about domestic demand are not actionable as securities fraud.

Future Demand

The Complaint identifies several statements by some Defendants that projected that demand, revenue, and production from SureBeam's domestic meat processing would increase in the future.

(CC ¶¶ 52, 90, 91, 99, 101). Oberkfell and Rane are also alleged to have projected $14 to $18 million from meat irradiation and a utilization rate of 20% during a July 29, 2002 conference call with analysts and investors. (CC ¶ 115).

Lead Plaintiffs allege that these statements were misleading at the time they were made because they gave investors the impression that new facilities were needed to meet demand when in fact there was no current demand for SureBeam processed meat and no need to construct new plants.

Lead Plaintiffs have not sufficiently alleged that SureBeam's statements of expected growth were false when made. Although demand was low when the statements were made and never increased, Lead Plaintiffs have not demonstrated that SureBeam did not expect demand to increase. In fact, many of SureBeam's actions during this period indicate that the company did expect demand to increase and had some reason to be hopeful. The company was negotiating contracts with grocery stores for "roll-outs" of processed meat and building new facilities. The fact that SureBeam's expectations never materialized does not demonstrate that the company misled the public when it announced anticipated growth.

Current Demand

The Complaint alleges that some of the Defendants made statements that current demand for SureBeam's irradiated meat had grown. These statements include: (1) Oberkfell and Rane's statements at the 2000 roadshow that demand is increasing; (2) Oberkfell's statement in a February 11, 2002 press release that "consumer acceptance grew"; (3) Oberkfell's statement in a February 20, 2003 press release that "[c]onsumer demand is obviously growing"; and (4) Oberkfell and Rane's statement during a February 20, 2003 conference call that "[t]he consumer is buying [irradiated meat] and, in fact, demanding that the retailer supply irradiated products." (CC ¶ 52, 82, 108, 124, 125).[6]

Lead Plaintiffs allege these statements were false because demand had not and was not increasing. The Complaint contends that during the class period, SureBeam's domestic plants were operating at 2%-3% of capacity company-wide and some plants were operating a .01% of capacity. Anonymous project managers report that there were very few paying customers and SureBeam was irradiating meat for free in an effort to introduce the product into the market.

[6] None of the allegedly false statements regarding domestic demand are attributed to Claudio.

While Lead Plaintiffs' allegations regarding statements of current demand are stronger than those of future demand, Lead Plaintiffs do not plead with particularity that these statements were false when made. Lead Plaintiffs simply point to the average class period capacity and anonymous reports that during the class period SureBeam had few customers. Lead Plaintiffs provide no information regarding capacity use or demand before or during the time the statements were made. Furthermore, they do not claim that sales never increased during the class period. Lead Plaintiff's inferences from the average capacity use over a two year period do not establish with particularity that the specific statements regarding demand were false at the particular time in which each statement was made.

2. Scienter Allegations

In the Ninth Circuit, the requisite state of mind for a 10(b) claim, at a minimum, is deliberate or conscious recklessness. Silicon Graphics, 183 F.3d at 979. In the case of forward-looking statements, plaintiffs must allege facts creating a strong inference that defendants acted with "actual knowledge" that the statement is false or misleading. Id. Each allegation should be supported by particularized facts and corroborating details. Silicon Graphics, 183 F.3d at 985. Beyond each individual allegation, courts also consider "whether the total of plaintiffs' allegations, even though individually lacking, are sufficient to create a strong inference that defendants acted with deliberate or conscious recklessness." Lipton v. PathoGenesis Corp., 284 F.3d 1027, 1038 (9th Cir. 2002).

a. Scienter Allegations Relevant to All Three Ventures

1. Stock Sales

The Complaint outlines a number of sales of SureBeam stock by Oberkfell and Claudio. Unusual or suspicious stock sales may serve as circumstantial evidence of scienter. Silicon Graphics, 183 F.3d at 986. Stock sales by insiders are only suspicious when they are "dramatically out of line with prior trading practices at times calculated to maximize the personal benefit from undisclosed inside information." Ronconi, 253 F.3d at 435. Factors to consider in making this determination are: 1) the amount and percentage of shares sold by insiders; 2) the timing of the sales; and 3) whether the sales were consistent with the insider's prior trading history. Id.

Oberkfell

The Complaint alleges that between March 4, 2002 and March 8, 2002, Oberkfell sold 350,000

shares of SureBeam stock, 37.5% of his total holdings, at $5.70-$5.78 per share. (CC ¶ 110). While the percentage of stock sold by Oberkfell is suspicious enough to question it further, see Vantive, 283 F.3d at 1095 (finding a sale of 32% of the executive's holdings worthy of further investigation), the timing of these sales is not suspicious. Lead Plaintiffs have not alleged why the timing of Oberkfell's sales from March 4, 2002 to March 8, 2002 supports an inference of scienter, and have not shown that the trades were made to capitalize on undisclosed inside information. At the time Oberkfell sold the stock, SureBeam had already taken over the Tech Ion project, a fact that was made public. SureBeam executives allegedly knew that the RESAL project and the domestic operations were doomed long before Oberkfell's sales as well. Lead Plaintiffs have not alleged a connection between any allegedly concealed inside information and the stock sales. See In re PETsMART, Inc. Secs. Litig., 61 F. Supp. 2d 982, 1000 (D. Ariz. 1999) ("Plaintiffs have the burden at the pleading stage of explaining why the stock sales were unusual or suspicious.").

Lead Plaintiffs point to the stock price before and after Oberkfell's sales as evidence that his behavior was improper. When Oberkfell sold his stock, SureBeam was valued at $6.00 per share. Following his sales, the stock descended to $1.62 per share. However, at the time Oberkfell sold, the market price had already began a descent from a high of $19.45 per share and continued to fluctuate following his sales.

Furthermore, although Rane, SureBeam's CFO, is alleged to have concealed information regarding SureBeam's financial woes as well, Lead Plaintiffs concede that he did not sell stock. The fact that "equally knowledgeable insiders" act inconsistently is evidence negating the inference of scienter. Vantive, 283 F.3d at 1093 (citing Ronconi, 253 F.3d at 436).

The Complaint does not allege that Oberkfell's sale was inconsistent with his prior trading history. In fact, nothing is alleged regarding Oberkfell's prior trading. Considering all the factors, Oberkfell's sale of SureBeam stock does not give rise to an inference of scienter.

Claudio

The Complaint alleges that on November 1, 2001, Claudio sold 92,670 shares of Surebeam, 49.6% of his stock holdings, at $12.40 per share. (CC ¶ 106). Between March 4, 2002 and March 8, 2002, Claudio also sold 30,000 shares of SureBeam at $6.20 per share. (CC ¶ 110). This represented

31.8% of his remaining holdings. Id.

The above analysis of Oberkfell's March 2002 sales also applies to Claudio's March 2002 sales. However, Claudio also sold 31.8% of his remaining shares on November 1, 2001. Lead Plaintiffs allege that the time of this sale is suspicious because November 1, 2001 was one week after Surebeam executed its agreement with Tech Ion to take over the venture. (CC ¶ 106). However, Lead Plaintiffs also allege that SureBeam disclosed the fact that it bought out Tech Ion and the details of that buy out. Lead Plaintiffs do not allege how this sale correlates with insider information. Furthermore, neither Rane nor Oberkfell sold during this time period. Lead Plaintiffs do not allege that this was inconsistent with Claudio's prior trading history. Claudio's sales of SureBeam stock do not appear "calculated to maximize the personal benefit from undisclosed inside information." Ronconi, 253 F.3d at 435.

2. Accounting Errors

Lead Plaintiffs allege that scienter can be inferred from SureBeam's many accounting irregularities and troubles with outside auditors. Merely publishing inaccurate accounting figures, or failing to follow GAAP does not result in a strong inference of scienter. See DSAM Global Value Fund v. Altris Software, Inc., 288 F.3d 385, 390 (9th Cir. 2002). To amount to securities fraud, the plaintiff must establish that defendants "knew or must have been aware of the improper revenue recognition, [or] intentionally or knowingly falsified the financial statements." DSAM, 288 F.3d at 390-91 (citing Worlds of Wonder, 35 F.3d at 1426-27). The Complaint fails to sufficiently allege that the individual defendants charged with violating Section 10(b) acted knowingly, or with deliberate recklessness with respect to the accounting errors.

3. Job Duties

Lead Plaintiffs allege scienter based on Oberkfell, Claudio, and Rane's positions and job duties at SureBeam. (CC ¶¶ 139-40). Oberkfell, Claudio and Rane each attended a daily 7:30 a.m. meeting in which SureBeam's revenue recognition was discussed. (CC ¶ 140).

Job duties and position in the corporation do not establish scienter in the particularized manner required by the PSLRA. See In re Read-Rite Corp. Sec. Litig., 335 F.3d 843, 848-49 (9th Cir. 2003) (holding job duty alone "does not satisfy the PSLRA's requirement that Plaintiffs allege particular

facts that give rise to a 'strong inference' of scienter on part of the Defendants"); Vantive, 283 F.3d at 1088 (vague allegations of attendance at meetings and a "hands-on" managerial style do not amount to scienter).

b. Scienter Allegations Regarding the Tech Ion Venture

Lead Plaintiffs contend that Oberkfell, Claudio and Rane must have been aware at the time that they caused SureBeam to recognize revenue from the Tech Ion venture that the revenue would never be forthcoming. (CC ¶ 140). Oberkfell and Claudio were at all the original meetings with Medeiros in which the venture's parameters were established, and knew that Tech Ion was basically insolvent. Oberkfell and Claudio received the emails from Delphos indicating that funding would be "extremely difficult" and both men received the memorandum from Medeiros indicating the venture required "deep changes in design and concept." Allegedly desperate for funding, Oberkfell agreed to ship systems early and to the wrong part of Brazil. He even falsified the amount of the systems and indicated that Tech Ion had paid for them. SureBeam's hope for funding from SUDAM fell through when the organization was disbanded by the government prior to the IPO. Following the IPO, Oberkfell visited the systems in a warehouse in Manaus. Later, a number of other SureBeam representatives visited Tech Ion's construction site and discovered it woefully behind schedule. They repeatedly sent this information to Oberkfell and Claudio and even sent the men a photograph of an "empty field." Despite all of this information, SureBeam continued to recognize revenue from the Tech Ion venture every quarter.

From these allegations, a jury could reasonably conclude that Oberkfell and Claudio knowingly or recklessly misled the public when they caused SureBeam to recognize millions of dollars in revenue from the Tech Ion venture. The Complaint sufficiently pleads scienter allegations with respect to Oberkfell and Claudio for the Tech Ion venture. However, the Complaint does not adequately establish Rane's scienter in this area, especially considering the fact that he joined the company late in the sequence of events.

c. Scienter Allegations Regarding the RESAL Venture and Domestic Demand

As discussed above, there is insufficient evidence in the Complaint to conclude that SureBeam materially misstated the results of the RESAL venture. Similarly, statements about domestic demand

for SureBeam's services were not actionable misstatements when made. See Demarco v. Depotech Corp., 149 F. Supp. 2d 1212, 1232 (S.D. Cal. 2001) (holding if the statement is not false, "scienter entails the illogical inquiry into whether the defendant intended to deceive when, in fact, there was no deception").

3. Reliance

Ordinarily, a Section 10(b) plaintiff must prove reliance on the defendant's misleading statements or omissions. Ambassador Hotel Co. v. Wei-Chuan Inv., 189 F.3d 1017, 1025 (9th Cir. 1999). However, a plaintiff is entitled to a presumption of reliance if he or she can establish "fraud-on-the-market." Binder v. Gillespie, 184 F.3d 1059, 1064 (9th Cir. 1999); see also Basic v. Levinson, 485 U.S. 224, 247 (1988). The fraud-on-the-market presumption is "based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business" so "[m]isleading statements will ... defraud purchasers of stock even if the purchasers do not directly rely on the misstatements." Binder, 184 F.3d at 1064 (quoting Basic, 485 U.S. at 241-42). To qualify for the fraud-on-the-market presumption of reliance, the plaintiff must establish that the defendant made a misstatement or omission regarding a security that is actively traded in an "efficient market." Id.

The Ninth Circuit has not decided what constitutes an efficient market. However, in Binder the court referred to Cammer v. Bloom, 711 F. Supp. 1264, 1286-87 (D.N.J. 1989), in which the district court of New Jersey created a five-factor test for evaluating whether a market is efficient. Binder, 184 F.3d at 1064. The Cammer court listed five factors: 1) the weekly volume of trades in the security; 2) the extent of analyst coverage; 3) arbitrageurs and market makers in the security; 4) whether the company is eligible to file a registration form S-3; and 5) facts showing a cause and effect relationship between unexpected corporate events or financial releases and an immediate response in the stock price. Cammer, 711 F. Supp. at 1286-87.

In this case, none of the Cammer factors are included in the Complaint. The Complaint only alleges "SureBeam's stock traded in an efficient market on the Nasdaq National Market System under the symbol SURE" and investors purchased SureBeam "[i]n reliance on the integrity of the market." (CC ¶ 188). The Titan Defendants contend Lead Plaintiffs have failed to plead, with the particularity

Rule 9(b) requires, that SureBeam traded in an efficient market. See In re NationsMart Corp. Sec. Litig., 130 F.3d 309, 321-22 (8th Cir. 1997) (holding Rule 9(b) applies to the reliance prong of section 10(b)); In re Turbodyne Techs. Sec. Litig., 2002 U.S. Dist. LEXIS 25738, at *46 (C.D. Cal. Mar. 13, 2002) (same).

Lead Plaintiffs also urge this court to apply Cammer. They argue that under Cammer, stating that the fact that SureBeam's stock traded on the NASDAQ exchange is sufficient to establish that the market is efficient. The Cammer court ultimately held that "a rule which *per se* subjects a party to protracted litigation merely because a company's stock trades within a certain Nasdaq grouping (i.e., the National Market System) is also rejected." Cammer, 711 F. Supp. at 1293. The case cited by Plaintiff to prove they need only plead that the stock was traded on Nasdaq itself states that being listed on Nasdaq, while relevant to efficiency, is "not dispositive." Levine v. SkyMall, Inc., 2001 U.S. Dist LEXIS 24705, *13.

Because both parties agree that the Cammer factors should determine fraud on the market and Plaintiff has not addressed any of the Cammer factors, the Complaint does not adequately plead reliance through the fraud-on-the-market theory. Similarly, the Complaint does not set out any factors that would indicate direct reliance on the misstatements, so reliance is inadequately pled.

4. Conclusion of 10(b) Claims

Lead Plaintiffs have adequately pled that revenue recognition for the Tech Ion deal was false when made but have failed to establish that any statements regarding the RESAL venture or domestic operations were false or misleading. The Complaint establishes the requisite degree of scienter for Oberkfell and Claudio with respect to the Tech Ion venture. But the Complaint does not adequately plead the Plaintiffs' reliance on the misstatements allegedly made by Defendants.

D. Counts Two and Four: Section 15 of the 33 Act and Section 20(a) of the 34 Act

The Complaint alleges that Titan violated Section 15 of the 1933 Act because it controlled SureBeam, a person liable under Section 11. Section 15 provides:

> Every person who, by or through stock ownership, agency, or otherwise . . . controls any person liable under sections [11 or 12] of this title, shall also be liable jointly and severally with and to the same extent as such controlled person . . . unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.
> 15 U.S.C. § 77o.

The fourth claim alleges that Titan violated Section 20(a) of the 1934 Act because it controlled SureBeam, whom the Complaint asserts violated a rule or section of the 1934 Act. Section 20(a) provides:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person . . .is liable unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.
> 15 U.S.C. § 78t(a).

The standard for establishing control liability is the same under both sections 15 and 20(a). Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1578 (9th Cir. 1990). Under both statutes, Plaintiff must prove (1) a primary violation of federal securities laws, and (2) "that the defendant exercised actual power or control over the primary violator." Howard v. Everex Sys., 228 F.3d 1057, 1065 (9th Cir. 2000).

The primary violator alleged in this case is SureBeam. SureBeam was the issuer of a security containing allegedly material misstatements its the registration statement, so Plaintiffs have stated a claim that SureBeam violated Section 11. The second prong of control person liability requires Lead Plaintiffs to plead facts establishing that Titan "exercised actual power or control over SureBeam." It is also "not necessary to show actual participation or the exercise of power," but Defendants are entitled to a good faith defense based upon no scienter and an effective lack of participation. America West, 320 F.3d at 945.

A defendant's status as a control person is "an intensely factual question, involving scrutiny of the defendant's participation in the day-to-day affairs of the corporation and the defendant's power to control corporate actions." Kaplan, 49 F.3d at 1382. The Ninth Circuit has also adopted the SEC's definition of control: "The possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through ownership of voting securities, by contract, or otherwise." Howard, 288 F.3d at 1065 (citing 17 C.F.R. § 230.405(f)). The traditional indicia of control are: having a prior lending relationship, owning stock in the target company, or having a seat on the board. Paracor Finance, Inc. v. General Electric Capital Corp., 96 F.3d 1151, 1162 (9th Cir. 1996).

In America West, the court found that shareholder relationships, majority stock ownership,

power to elect the majority of the board, and presence of officers on board were sufficient to prove a prima facie case of control person liability. 320 F.3d at 945-46. In this case, Lead Plaintiffs allege that Titan owned 100% of SureBeam at the time of the IPO and 84% of SureBeam following the IPO until the August 5, 2002 spin-off. The Prospectus stated that Titan has the power "to control the election of our directors and all other matters requiring stockholder approval" and to "ultimately control our management." Titan had a representative on SureBeam's Board of Directors; Defendant Ray served as Titan's CEO, and Board Chairman as well as a director on SureBeam's Board. These allegations are sufficient to establish a prima facie case of Titan's liability as a control person of SureBeam.

III. Conclusion

For the foregoing reasons, the Court **grants** Titan's motion to dismiss the Section 11 claims against it. The Underwriter Defendants' motion to dismiss the Section 11 claims against them is **denied**. All other Defendants' motions to dismiss the Section 11 claims are **denied**. Titan's motion to dismiss the Section 15 claims against it is **denied**. The SureBeam Defendants' motion to dismiss the Section 10(b) and Rule 10b-5 claims against them is **granted** for failure to adequately plead reliance. Titan's motion to dismiss the Section 20(a) claim against it is **denied**.

IT IS SO ORDERED

DATED: 12/30, 2004

JEFFREY T. MILLER
United States District Judge

cc: all parties