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UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

In re SUREBEAM CORPORATION SECURITIES LITIGATION	Master File No. 03-CV-01721-JM(POR)
	CLASS ACTION
This Document Relates To: ALL ACTIONS.	PLAINTIFFS' OPPOSITION TO DEFENDANTS OBERKFELL, CLAUDIO AND RANE'S MOTION TO DISMISS CONSOLIDATED COMPLAINT
	DATE: September 17, 2004 TIME: 11:00 a.m. COURTROOM: The Honorable Jeffrey T. Miller

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

Page

Page

STATUTES, RULES AND REGULATIONS

I. INTRODUCTION

This is a compelling case of securities fraud. Defendants Larry A. Oberkfell ("Oberkfell") and Kevin K. Claudio ("Claudio") took SureBeam Corporation ("SureBeam" or the "Company") public on phony revenues and, with defendant David A. Rane ("Rane"), misled investors throughout the Class Period (3/16/01-8/27/03) about SureBeam's sales to its off-shore joint ventures in Brazil (the "Tech Ion joint venture") and Saudi Arabia (the "RESAL joint venture"), and about the state of demand for SureBeam's processed food in the United States. Defendants used their false statements to raise nearly ***$100M*** from investors in two separate offerings and disposed of $3.4M of their own shares for their own personal benefit. Then, ***after only 2-1/2 years of operating***, defendants caused SureBeam to file Chapter 7 (liquidation) to preserve a shocking "***couple of million***" dollars for SureBeam's creditors (*i.e.*, The Titan Corporation ("Titan")).

The Consolidated Complaint for Violation of the Federal Securities Laws (the "Complaint") shows (based on internal "contemporaneous" communications) that defendants knew that SureBeam's revenues were phony before the Initial Public Offering ("IPO") and that its off-shore joint ventures were incapable of paying SureBeam for its systems. It also shows that defendants knew or recklessly disregarded that SureBeam had virtually no demand for its services in the United States and that SureBeam was operating at a paltry 2%-3% of its operating capacity. Now, when plaintiffs have discovered the true facts that defendants should have disclosed long ago, defendants distance themselves from SureBeam's financial results and have disregarded well-settled motion to dismiss standards in search of dismissal. Defendants spend countless pages urging this Court to adopt their ***interpretation*** of the documents alleged in the Complaint despite the fact that recent Ninth Circuit precedent mandates that plaintiffs' allegations must be "taken as true and construed in the light most favorable to the plaintiff." *See No. 84 Employer-Teamster Joint Council Pension Trust Fund v. Am. West Holding Corp.*, 320 F.3d 920, 935 (9th Cir. 2003), *cert. denied*, 2003 U.S. Dist. LEXIS 7727 (2003).

The parties here are fighting over the interpretation of internal communications. This "battle" should give the Court comfort that this case is not one of those "frivolous" cases that the Private Securities Litigation Act of 1995 ("PSLRA") was designed to prevent. While defendants are

entitled to address plaintiffs' interpretations of evidence in any litigation, that opportunity must await summary judgment or trial. Defendants' motion should be denied.

II. SUMMARY OF THE CASE

Titan is a diversified technology company that purports to create, build and launch technology-based businesses. ¶77.[1] Titan took its SureBeam subsidiary public pursuant to a Prospectus dated March 16, 2001. ¶¶2, 38. In the Prospectus, defendants told investors that SureBeam and Titan had entered into a joint venture with Tech Ion Industrial Brazil ("Tech Ion") to irradiate food throughout Brazil and that the venture had generated $15.5M in revenue for SureBeam in 2000 (***more than 61% of its revenues for the year***) and would generate $55M in revenue (***more revenue than the Company had generated in its entire existence***) over three years. ¶¶38, 84. The Prospectus also sought to give the venture an appearance of economic substance by claiming that SureBeam had "acquired a 19.9% equity interest in SureBeam Brasil [*i.e.*, the joint venture entity] without charge" and that SureBeam Brasil was created "with no initial capital contribution from either party." ¶40. These statements generated excitement about SureBeam and allowed defendants to complete SureBeam's IPO – selling 6.7M shares of SureBeam stock at $10 per share for net proceeds of $62M. ¶¶38, 83.

Defendants continued to emphasize the Tech Ion joint venture after the IPO. They caused SureBeam to recognize from the venture a total of $6.8M in 2001 and claimed that the venture "'expands our revolutionary, patented SureBeam(R) technology into one of the largest and most diversified food markets in the world'" and even went so far as to claim that "the SureBeam Brazil network is expected to be the world's largest, most comprehensive system dedicated to enhancing food safety and preservation." ¶¶3, 24, 96-97. These positive but untrue statements propelled SureBeam's common stock to a Class Period high of $19.45 per share. ¶¶3, 65.

Defendants' statements about the Tech Ion joint venture and the revenue recognized (and to be generated) from the venture were untrue. ¶¶3-4, 7, 18-45, 86, 93-94, 98, 102, 105. Contrary to

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[1] All "¶" or "¶¶" references are to the Complaint, unless otherwise noted.

defendants' statements, the Tech Ion joint venture had not generated revenue for SureBeam before the IPO and could not (and would not) generate revenue for SureBeam after the IPO because neither the joint venture entity (SureBeam Brasil) nor Tech Ion (its joint venture partner) had the ability to pay for SureBeam's systems. ¶4. Both SureBeam Brasil and Tech Ion were new operations, and Tech Ion, even more than SureBeam Brasil, was in dire financial straits. ¶¶4, 22. At the time defendants formed the venture, Tech Ion's assets collapsed in a single year (leaving it with $1,753.00 in "available assets" in the bank) and it "[had] no recorded historical revenues or profits that could be displayed at [the] time." *Id.* In fact, contrary to defendants' claim that the venture was created with no capital contributions from either party, Titan donated $5M to Tech Ion (under the guise of a loan with no provision for repayment) just to get the venture off the ground. ¶¶16, 22, 40.

As a result of Tech Ion's financial position, defendants knew that it would not collect any revenue from the venture without substantial outside funding. ¶¶4, 139-146. And internal documents show that defendants Oberkfell and Claudio knew as early as November 21, 2000 that the Tech Ion joint venture would not be able to secure funding to pay for SureBeam's systems from the World Bank (or any other lender), and that its other source of funding (an Amazonian developmental agency called "SUDAM") had collapsed ***only four days before the IPO***. ¶¶5, 25-33, 37.

Given that the joint venture sought to establish its first location in Rio de Janeiro, defendants sought funding for the venture from the World Bank and enlisted the assistance of Delphos International ("Delphos"). ¶¶5, 25. But according to internal communications to defendants Oberkfell and Claudio, Delphos was unable to secure funding for the venture and indicated that ***no*** lender would likely fund SureBeam's "Field of Dreams" business plan because it "***aim[ed] to provide a high technology service that is currently under-utilized (or non-existent) in Brazil"*** and because its "***customer base [was] not well-defined and established enough to provide comfort***." ¶¶25-26. Delphos also told defendants that "***lenders*** secured only by the project's assets ***need greater assurances that there will be customers to generate revenue to pay the debt***." ¶25.

And when Delphos pushed SureBeam for "letters of interest from potential customers, alliances, etc." in order to "***justify the revenues and construct a plausible business case for marketing the SureBeam services***," defendants came up short. ¶27. In fact, they knew by

December 2000, that funding from the World Bank (or from ***any*** bank) was virtually impossible because, as Jose Francisco Medeiros ("Medeiros") – the head of Tech Ion and President of SureBeam Brasil – put it in a letter to defendants Oberkfell and Claudio, SureBeam's systems were "financially inadequate" to service Brazil's distribution facilities ("***X-rays and E-beams are financially inadequate for generic work such as the CEASAs***") and because the entire venture was flawed in "***the concept and numbers***." ¶¶28-31. Medeiros told both defendants that "[a]s it is now, I believe that it will not be approved, and if World Bank asks for outside experts to examine the technical aspects, they will certainly locate our weak spots." ¶29.

Neither the World Bank nor any other lender provided the necessary funding and the venture saw its last chance for funding (and for payment for SureBeam's systems) end four days before the IPO when SUDAM collapsed amid a political scandal – a scandal reported and confirmed by the *Associated Press*. ¶¶6, 32, 37. Although defendants challenge the truth of plaintiffs' allegations, the Complaint supplies evidentiary support for the fact that defendant Oberkfell shipped two irradiators to Brazil in a desperate attempt to secure funding and did so over his project managers' objection that doing so made "no sense" and could possibly harm the systems. ¶35. Indeed, defendant Oberkfell shipped those systems to Manaus (over 2,000 miles from their intended location), artificially inflated the price of the systems and indicated that Tech Ion had "prepaid" SureBeam just to secure funding from SUDAM. ¶34. SureBeam's Prospectus, which omitted these material facts, and defendants' representations about the amount of revenue that the venture had generated (and would generate) were, therefore, untrue when made. ¶¶40, 86.

SureBeam's recognition of revenue from the Tech Ion joint venture after the IPO was also improper. *See, e.g.*, ¶¶93, 105. Defendants knew, based on their travels to (and correspondence with employees in) Brazil, that venture was not operational at anytime during 2000 or 2001 and would not be operational for the foreseeable future. ¶¶41-43, 139, 146. Defendant Oberkfell traveled to Brazil between April 3 and April 5, 2001 with a consultant and expressed his frustration about not being able to "liberate" SureBeam's irradiators from customs because he had no place to put them in Rio. ¶41. A project manager sent a photograph of an "empty field" to defendants Oberkfell and Claudio between July 9 and July 12 2001, along with a letter that stated that he did not know what Medeiros

was doing with Titan's contribution but he certainly was not using those monies to build the facility. ¶42. And by November 2001, defendants Oberkfell and Claudio caused SureBeam to buy out Tech Ion's interest in the facility, hired a different construction company to complete the facility, and shipped brand new systems to Brazil because the Brazilian government had taken control of the original shipment. ¶43. These facts undisclosed, demonstrate that SureBeam's revenue recognition from the venture after the IPO was improper. ¶¶45, 93, 105.

Defendants also caused SureBeam to enter into a similar venture in Saudi Arabia three months after the IPO with RESAL – a Saudi Arabian sole proprietor engaged in the business of investing and construction in Saudi Arabia. ¶¶8, 46. Defendants claimed that the joint venture would generate $53M in revenue for SureBeam through the sale of ten SureBeam systems and recognized a total of $18.2M over two years despite the fact that RESAL could not secure funding to construct the irradiation facilities or to pay for SureBeam's systems. ¶¶8, 46-48, 50.

Pursuant to the terms of the venture, defendants agreed with RESAL that RESAL would build three facilities throughout Saudi Arabia and would issue a purchase order for ten SureBeam systems – ***which RESAL intended to pay for through the profits of the venture.*** ¶46. Under the agreement, RESAL was obligated to enter into a payment agreement for SureBeam's systems but would transfer its payment obligation to SureBeam Middle East "***at such time as the Company has received sufficient funding***." *Id.* Defendants knew, therefore, that RESAL needed (and intended) to secure funding to finance the project. *Id.*

RESAL's construction, however, was severely delayed because it could not secure funding, which caused defendant Rane to repeatedly renegotiate the payment schedule under which RESAL was supposed to pay for the systems. ¶¶8, 50. RESAL did not complete even the first of four planned facilities until August or September 2003 – ***more than two years after SureBeam announced the venture.*** ¶49. And SureBeam ended up manufacturing all ten systems for RESAL (and recognized revenue from the "sale" of those systems) despite the fact that it had no place to ship the systems because of RESAL's delays. ¶¶46, 49-50. In the end, SureBeam received only $7.5 million from RESAL despite the fact that it had recognized over $18.2M from the venture during the Class Period. ¶50.

Aside from its off-shore joint ventures with RESAL and Tech Ion, defendants also made positive but untrue statements about the demand for SureBeam's services and its alleged need for extra operating capacity in the United States. ¶¶51-58, 95-96, 101, 121. Defendants emphasized the growth in demand for irradiated meat (and SureBeam's services) and a dramatic increase in SureBeam's pasteurization capacity because of that demand. ¶¶10, 91. And defendants' statements were not limited to statements about future expectations. ¶¶52, 96. They told investors that ***existing*** demand for SureBeam's services was growing rapidly and that ***existing*** demand was causing defendants to prepare for strong future demand. In fact, they stated that "the availability of SureBeam [irradiated] ground beef had ***expanded*** 'rapidly,' reflecting '***growing customer demand***'" and that "'***[c]onsumer demand is obviously growing***, as folks ***are*** embracing this as an added measure of food safety in the products they purchase for their families.'" ¶52. It was with these positive, but false, present-tense statements that defendants utilized to mislead the market about the state of demand for SureBeam's products. ¶¶51-58, 95-96, 101, 121. And it was the purported ***existing*** demand that colored defendants' statements about future demand.

Defendants knew that their statements about existing demand were false and that they had no basis for their statements about strong expected demand. ¶¶139, 146. Internally, defendants knew that demand for SureBeam's services was negligible and that its service centers had very few paying customers and were operating at an anemic rate (***only 2.6% of capacity throughout the Class Period***). ¶11. They knew that SureBeam's Chicago facility was irradiating meat for Excel Corporation ("Excel") and IBP (large meat producers) free of charge, that its Vernon, California facility had only one paying customer (United Foods), and that large producers had rejected irradiated meat because advertising that irradiated meat was safe would imply that all other meat was unsafe. ¶¶11, 53-54. Indeed, *Consumer Reports* confirmed in 2003 that irradiated meat "ha[d] barely been used on foods in the U.S." and that ***grocery retailers withdrew a roll-out of irradiated meat "three years ago" "because of poor sales."*** ¶11.

After 2-1/2 years of emphasizing the success of its off-shore joint ventures, improperly recognizing revenue of $40.8M and emphasizing the growing demand for irradiated meat, SureBeam shocked the market when it announced two delays of its SEC filings, terminated Deloitte & Touche

LLP ("Deloitte") because it challenged defendants' accounting for the Tech Ion joint venture and then filed bankruptcy (Chapter 7 liquidation) to preserve "a couple of million" dollars for unsecured creditors. ¶¶1, 12, 64, 138.

III. ARGUMENT

A. Defendants Ignore Well-Settled Motion to Dismiss Precedent to Avoid the Evidentiary Facts Outlined in the Complaint

The general standards governing motions to dismiss remain unchanged under the PSLRA. *Am. West*, 320 F.3d at 931. "All allegations of material fact made in the complaint are taken as true and construed in the light most favorable to the plaintiff." *Id.* Although the Ninth Circuit has held that the Court may consider unfavorable inferences for claims under the Securities Exchange Act of 1934 ("Exchange Act"), the Court should not accept defendants' invitation to convert this motion to dismiss into a motion for summary judgment. *Id.* Indeed, the Ninth Circuit recently confirmed that after construing the allegations in plaintiffs' favor, the court must consider the pleadings in their "totality," and may not dismiss the complaint "unless it appears beyond a doubt that the plaintiff cannot prove any set of facts in support of the claim that would entitle him or her to relief." *Id.* Defendants ignore these standards.

Defendants begin their factual challenges by arguing with plaintiffs over the "true" meaning of the documents cited in the Complaint. *See, e.g.*, Memorandum of Points and Authorities in Support of Motion to Dismiss Consolidated Complaint Against Defendants Oberkfell, Claudio and Rane ("Defs.' Mem.") at 2. For example, defendants claim that the Medeiros e-mail "did not spell 'doom' for the project as plaintiffs ***erroneously*** conclude." Defs.' Mem. at 13. Ignoring that this factual challenge is improper, the Complaint alleges in evidentiary detail that the project was, in fact, "doomed" because SureBeam's systems could not service Brazil's CEASAs, which were vital to the venture. ¶30. SureBeam's internal business plan demonstrates that Brazil's CEASAs were critical to the project's operations. ¶30. Indeed, the business plan reveals that Titan, which called the plan the "RJ CEASA design concept," was looking to minimize the risk of the operation "by locating the facility near the RJ CEASA that provides most of the produce for Rio de Janeiro's 10 million residents" and was hoping to process "5 to 8% of the total RJ CEASA daily volume." ¶¶19-22.

Since SureBeam's irradiators were incapable of servicing the very food source that was critical to the venture's operations, Medeiros's e-mail demonstrates that the venture's prospects for survival were doomed three months before the IPO and that defendants could not have believed that it would receive $15M (let alone $55M) in revenues from the venture. ¶¶28-31. Defendants' challenge is not only improper, but is also demonstrably wrong.

Defendants also argue that "the more likely inference" from the Medeiros e-mail "is that the defendants understood if SUDAM (or World Bank) did not provide financing, there were other options to pursue, including other possible government sources, or private financing." Defs.' Mem. at 13. There is simply no factual (let alone evidentiary) basis for this improper factual argument. Medeiros's e-mail, which defendants do not deny having received, demonstrates that the venture could not service Brazil's CEASAs and needed "deep changes ***in the concept*** and numbers" in order for the venture to have any chance of securing funding from the World Bank (or any other lender). ¶29. Although defendants claim that a "reasonable inference" from the e-mail is that Medeiros was offering alternatives, the e-mail is clear that the venture could not secure funding under the existing concept and that the venture would go bankrupt if it continued with SureBeam's irradiators. ¶31. Defendants are not drawing inferences. They are improperly introducing unsupported facts on a motion to dismiss.[2] *See Am. West*, 320 F.3d at 941 (defendants' explanations are "question[s] for the jury, or at least [questions] that should be explored during discovery"); *Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 100 (2d Cir. 2001) ("defendants arguments ... are best left to a later stage in the litigation").

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[2] Defendants assert that plaintiffs are required to allege, with particularity, that the World Bank and SUDAM were the venture's only source of funding. Defs.' Mem. at 2, 11, 13. Defendants miss the point. Even if SureBeam believed SureBeam Brasil would be able to find funding from another source, "a reasonable investor would be concerned about the uncertainties of alternative financing sources." *Sheehan v. Little Switz.*, 136 F. Supp. 2d 301, 315-16 (D. Del. 2001). It is sufficient that plaintiffs have alleged that the venture's two "viable" sources of funding had been eliminated prior to the IPO – especially considering that the World Bank rejected the very concept behind the joint venture and its business plan. ¶¶25-27. In fact, the Delphos e-mail does not limit its discussion to the World Bank. Instead, it makes clear that "lenders" in general "secured only by the project's assets need greater assurances that there will be customers to generate revenue to pay the debt." ¶25. Defendants had no reason to believe that other lenders would overlook their faulty business plan.

Defendants continue their improper factual challenge by arguing that the content of the Delphos e-mail actually supports a conclusion that funding was possible. Defs.' Mem. at 12. Defendants simply ignore the contents of the e-mail. While it does state that the meetings went well, it continues to outline a set of circumstances (and demands) that the venture could not (and did not) overcome – that "lenders" would not lend it money without "customers to generate revenue to pay the debt." ¶25. In fact, the e-mail referred to the venture as using a "Field of Dreams" approach and explained that securing financing using this approach was "EXTREMELY difficult." ¶26. Then almost a month later, Delphos continued to press defendants for a way "to justify the revenues and construct a plausible business case for marketing the SureBeam services," which the venture did not and could not do. ¶27. Far from supporting a conclusion that funding was possible, these facts demonstrate anything but.

Defendants also attempt to hide behind their auditors by making the factual argument that defendants would not have committed fraud because they knew that a new accounting firm would conduct due diligence and discover their improprieties. Defs.' Mem. at 2, 9-11. According to defendants, this Court should rule (at the motion to dismiss stage) that "[t]he hiring of two subsequent national accounting firms following Arthur Andersen that the defendants ***must have known*** would conduct their own independent investigation concerning SureBeam's accounting makes it facially implausible that any of the defendants were 'deliberately reckless' or acted with 'conscious misconduct' in reporting SureBeam's revenue." *Id.* at 11. This argument is inappropriate for countless reasons – the most important of which is that it improperly assumes what defendants knew about the due diligence obligations of its auditors and whether the audit would encompass specific transactions that were entered into years earlier.[3] Since a publicly traded company is obligated to have its results audited, defendants' hiring of new auditors is of no moment.

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[3] The absurdity in defendants' argument is emphasized by their reference to the Enron fraud. Defs.' Mem. at 10. Defendants ask this Court not only to assume that defendants "must have known" that newly hired auditors would examine historical transactions, but also that defendants knew about the Enron fraud, Arthur Andersen's involvement in that fraud, and the effect that Arthur Andersen's involvement would have on the decision making of its future auditors. *Id.* Improper at any stage of the litigation – but especially on a motion to dismiss.

Defendants also challenge the truth of plaintiffs' purported "faulty conclusions" with respect to SureBeam's choice to ship irradiators to Brazil in January 2001 and Oberkfell's decision to increase the price of each irradiator to $6.5M. Defs.' Mem. at 12, 14. Defendants conclude that the shipment to ***Brazil*** "cannot plausibly give rise to a strong inference of scienter" and interpret the contents of an e-mail exchange between Medeiros and Oberkfell as suggesting nothing more than that "Medeiros was seeking financing" and "show[ing] the lender what he will pay for the systems." ¶14. Defendants' factual interpretations misconstrue plaintiffs' allegations. Plaintiffs have not alleged that the shipment to Brazil generally is what gives rise to a strong inference of scienter. ¶¶33-37. It was the shipment to ***Manaus*** that gives rise to this inference since the facility was purportedly being constructed in Rio de Janeiro (over 2,000 miles away). The only purpose for the shipment to Manaus was to secure funding from SUDAM – which would only fund projects designed to benefit the Amazon region of Brazil (where Manaus is located). ¶33. While defendants ignore it, the Complaint alleges that Oberkfell approved the shipment over his project manager's objection and agreed with Medeiros to artificially raise the price on the irradiators to secure additional funding. ¶36.[4]

Defendants continue their factual arguments by challenging the meaning of plaintiffs' allegation that SureBeam replaced Tech Ion with a new construction company in November 2001 to complete the project. Defs.' Mem. at 15. Defendants argue that this fact really means that defendants believed that the project ***could*** go forward. *Id.* Defendants' argument is illogical since ***Tech Ion was a major component of the entire venture***. ¶¶19-23, 39. When defendants terminated their joint venture partner, whose principal was one of the venture's most significant assets, they knew that SureBeam would not be paid for its systems – either from funding or through the venture's operations. ¶44.

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[4] Defendants' assertion that "Plaintiffs inflammatory allegation that Oberkfell and Medeiros agreed to 'artificially increase the price of the irradiators' is unsupported by any factual allegations" is belied by the e-mail itself. Defs.' Mem. at 14. While defendants quote Medeiros's language that that he would '"use the existing [invoice] of $5 million'" (*id.*) they ignore Oberkfell's response where he authorized a change in the invoice to $6.5M. ¶36. There was no justification for doing so since the irradiators were being sold to Tech Ion ***regardless of the source of funding***.

Defendants' primary factual argument with respect to RESAL is to plaintiffs' allegation that Rane knew that RESAL was not going to pay for SureBeam's systems without funding because he repeatedly agreed to extend RESAL's payment obligations. Defs.' Mem. at 16. Defendants urge this Court to adopt their interpretation that this fact shows that defendants had a "belief that payment would be made." *Id.* But defendants' interpretation ignores the substance of SureBeam's agreement with RESAL. ¶¶46-48. In that agreement, SureBeam gave RESAL the right to transfer its purchase order to SureBeam Middle East "at such time as the Company has received sufficient funding from investors." ¶46. Until that time, RESAL was obligated under the purchase order to pay for SureBeam's systems, which Rane's payment extensions show it could not (and would not) do. *Id.* Defendants' reference to their due diligence investigation of RESAL only reinforces the point that they knew that Rane's negotiations for RESAL's payment extensions would delay payment until RESAL secured funding. Defs.' Mem. at 16. Revenue recognition under these circumstances was improper. ¶¶154-155, 159.[5]

B. The Complaint Identifies Defendants' False Statements and Explains Why They Were False

The PSLRA requires plaintiffs to "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). This is consistent with this Circuit's Fed. R. Civ. P. 9(b) precedents which have "consistently required that circumstances indicating falseness be set forth." *In re GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541, 1548 (9th Cir. 1994). A complaint may demonstrate the false or misleading nature of a statement by identifying inconsistent

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[5] *DSAM Global Value Fund v. Altris Software, Inc.*, 288 F.3d 385, 390-91 (9th Cir. 2002), does not support defendants' factual arguments. Defs.' Mem. at 16. In *DSAM*, the court found that the plaintiffs had failed to allege any facts to establish that the company's "auditor" knew or must have been aware of the improper revenue recognition. 288 F.3d at 390-91. The facts here are far different. Unlike *DSAM*, defendants here are inside officers and directors who participated in the transactions which formed the basis of the improper revenue recognition and made the decision when to recognize that revenue. ¶¶143, 146, 148. They knew from their first hand experiences with Tech Ion, Medeiros and Delphos that potential lenders were rejecting the venture's business plan and that neither Tech Ion nor SureBeam Brasil had the ability to pay for SureBeam's systems.

contemporaneous information that was available to defendants. *Yourish v. Cal. Amplifier*, 191 F.3d 983, 994 (9th Cir. 1999). The Complaint meets these standards and its allegations belie defendants' claim that plaintiffs are pleading fraud by hindsight. Defs.' Mem. at 1, 3.[6]

1. SureBeam's Prospectus Was False When Issued

SureBeam's Prospectus, which highlighted the importance of SureBeam's relationship with Tech Ion, contained several false and misleading statements, the substance of which defendants also disseminated during their roadshow:

- "In May 2000, we received purchase orders from Tech Ion Industrial Brasil 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***." ¶¶38, 84.
- "We began construction of these systems in July 2000, and have ***recorded revenues of $15.5 million under the percentage-of-completion method for the year ended December 31, 2000***." *Id.*
- "***Our accounting policies comply with the provisions of SAB 101***." ¶85.
- "[W]e acquired a 19.9% equity interest in SureBeam Brasil ***without charge*** at the time of our signing the agreement to establish SureBeam Brasil." ¶40.
- SureBeam Brasil was created "***with no initial capital contribution from either party***." *Id.*

¶¶2, 38, 40.[7]

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[6] Defendants' attack on the group published doctrine is misguided. Defs.' Mem. at 4-5. Unlike *Allison v. Brooktree Corp.*, 999 F. Supp. 1342 (S.D. Cal. 1998), cited by defendants, plaintiffs here point to specific statements made by specific defendants. *See, e.g.*, ¶¶82, 84, 97, 101-108, 112-115, 124. In fact, defendant Oberkfell is quoted in the very press releases from which he now attempts to distance himself, and both Oberkfell and Claudio signed SureBeam's Prospectus and its SEC filings during the Class Period. They are liable, therefore, for SureBeam's false and misleading financial results. *Howard v. Everex Sys.*, 228 F.3d 1057, 1061 (9th Cir. 2000) ("a director who has the requisite level of scienter and signs a fraudulent Form 10-K can be liable as a primary violator of §10(b) for making a false statement").

[7] Contrary to defendants' contentions their road show statements are not forward-looking statements protected by the safe-harbor. Defs.' Mem. at 22. Defendants' statement that demand "was increasing" is clearly a present tense statement about existing demand. ¶82. And their statement about expected revenue from Tech Ion is an explanation of the existing terms of the joint venture. Both statements are, therefore, actionable. *See Am. West*, 320 F.3d at 937 (statements about the effect of existing facts on a company are not forward-looking statements protected by the safe-harbor).

These statements were false when made because the entities that formed the joint venture could not pay for SureBeam's systems independently and had two significant sources of funding eliminated before the IPO. ¶¶5, 25-33, 37. As detailed above, Tech Ion was in dire financial straits and was desperately in search of funding to get the project off the ground – which it failed to do because of a flawed business plan and political corruption in Brazil. ¶¶4, 22, 86. SureBeam Brasil (the joint venture entity) fared no better. It was designed as a start-up operation that would have no ability to pay for SureBeam's systems unless it too received financing. ¶¶19-23. In fact, both entities were in such a precarious financial position that Titan contributed (in the form of a purported loan) $5M just to get the operation off the ground. ¶16. SureBeam's recognition of $15.5M in revenue before the IPO was, therefore, improper and did not comply with SAB No. 101. ¶93. And defendants certainly had no expectation that these entities would pay SureBeam $55M over three years. ¶¶139-146, 148. Indeed, the facility was not even close to being constructed after nearly two years of purported construction. ¶¶43-45.

Defendants' statements about SureBeam's equity interest in SureBeam Brasil and the cost of that interest were also false and created the impression that the entities were appropriately capitalized – at least to the extent necessary to pay for SureBeam's systems. Contrary to defendants' claims that the parties formed the venture "without charge" and "with no initial capital contribution from either party," Titan contributed $5M to the venture to enable Tech Ion to begin constructing the facility that would enable SureBeam Brasil to operate. ¶¶22, 40. And while Titan structured the contribution as a "loan," defendants made no provision for repayment. In fact, a project manager for the venture explained that SureBeam would not get paid unless Medeiros secured funding and SureBeam's Form 10-K acknowledged that Tech Ion had not made a single payment to repay the "loan" at anytime prior to the IPO. ¶¶33, 40, 43, 44. This was true up until November 2001 – when SureBeam bought-out Tech Ion's interest and forgave the balance on the purported loan.[8] ¶44.

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[8] Defendants assert that their statements about their capital contribution were not false because it was Titan (and not SureBeam) that made the contribution. Defs.' Mem. at 25. Defendants' distinction is meaningless given that Titan controlled 100% of SureBeam (and had overlapping officers) at the time of the contribution and retained 80% control of SureBeam after the IPO.

2. Defendants' Statements About the Tech Ion Joint Venture After the IPO Were False When Made

Following SureBeam's IPO, defendants continued to mislead investors regarding SureBeam's venture and the revenue attributed to the venture. ¶¶3, 4, 7, 41-45. In the six months following the IPO, SureBeam announced revenues of $7.7M and attributed those revenues to systems sales to Tech Ion. ¶¶91-92, 100, 102, 104. Defendants also issued misleading statements regarding the nature and progress of the joint venture and the effect the venture would have on SureBeam's international marketshare. SureBeam's press releases, which quoted defendant Oberkfell, claimed that SureBeam's "joint venture, SureBeam Brazil, will be supporting the new Food Irradiation Center of Excellence being instituted in the State of Rio de Janeiro" and that "[t]he joint venture between SureBeam Corporation and Tech Ion ... expands our revolutionary, patented SureBeam(R) technology into one of the largest and most diversified food markets in the world." ¶¶97-98. These statements were false when made.

Defendants' recognition of revenue was undermined by serious delays in the project. At the same time that Oberkfell was expressing frustration to SureBeam consultants about not being able to "liberate" SureBeam's irradiators from Manaus and when he was receiving updates from his project managers complaining that Medeiros and Tech Ion were not spending Titan's "contribution" on the construction of the facility, SureBeam continued to recognize revenue as though it expected to receive payment. Revenue recognition under these circumstances was inappropriate and violated Generally Accepted Accounting Principles ("GAAP").

These facts not only undermined SureBeam's revenue recognition, but they also belie defendants' statement about SureBeam's "Center of Excellence." *Id.* The Medeiros e-mail suggested to Oberkfell and Claudio that they create this "Center of Excellence" to justify the existence of SureBeam's irradiators in Rio de Janeiro because of its problems. Far from "expand[ing] [SureBeam's] revolutionary, patented SureBeam(R) technology," the "Center of Excellence" confirms that defendants adopted Medeiros's conclusions. ¶¶3, 97. Defendants' omissions of these important facts rendered SureBeam's statements about the venture false and misleading when made.

3. Defendants' Statements About Its RESAL Joint Venture in Saudi Arabia Were False When Made

Beyond the Tech Ion joint venture, defendants announced a similar joint venture on June 25, 2001 with RESAL in Saudi Arabia. ¶¶8, 46. And much like the Tech Ion joint venture, defendants represented that they expected the venture to generate sales to SureBeam of $53M through the sale of 10 SureBeam irradiators. ¶96. Defendants then improperly recognized $18.2M in revenue from the venture over the next two years. ¶48. Defendants caused SureBeam to begin recognizing these revenues just six months after announcing the venture and six months before the first facility was even scheduled to begin operating. ¶48.

Defendants also disseminated false statements regarding the nature and progress of the RESAL venture through conference calls with analysts and investors. ¶¶112, 126. On April 25, 2002, defendants Oberkfell and Rane repeated SureBeam's false financial results for the first quarter of 2002, including the revenue recognized from SureBeam's RESAL joint venture – announcing that SureBeam had already recognized $13.3M in revenue from the RESAL joint venture, of which $1.1M was recognized in the quarter ending March 31, 2002. ¶¶112-113. Defendants Oberkfell and Rane also stated on the call that they anticipated "collect[ing]" all $58 million in unbilled receivables that it was owed in 2003 (which would include payments from RESAL) and that they expected to make a shipment every quarter until the end of the contract. ¶¶112, 126.

These statements were false when made. SureBeam's revenue recognition was improper under GAAP as defendants recognized the revenue based on its own manufacturing process despite the fact that defendants knew that payment for the systems was contingent upon RESAL securing funding. ¶48. Since payment was based upon the operations of the venture, SureBeam could not be assured that the venture would generate sufficient profits to pay for the systems. ¶49. Indeed, significant delays in the construction of the facilities and RESAL's inability to obtain financing prohibited SureBeam from shipping a single system to Saudi Arabia until July 2003 – two years after SureBeam announced the venture. And defendant Rane negotiated multiple payment extensions with RESAL so that it was not obligated to pay for SureBeam's systems before receiving funding. SureBeam's revenue recognition under these circumstances was inappropriate and rendered

SureBeam's 2001-2003 financial results materially false and misleading. These facts also rendered misleading defendants' statements that they anticipated "collect[ing]" all $58M in unbilled receivables that it was owed in 2003 and that they expected to make a shipment every quarter until the end of the RESAL contract. ¶¶49, 50, 112, 126.

4. Defendants' Statements About Domestic Demand Were False When Made

Defendants made positive but untrue statements about the level of customer demand for SureBeam's services. ¶¶10, 51. And contrary to defendants' claims that all of defendants' statements about demand were forward looking, they were, in fact, talking about ***existing*** demand for SureBeam irradiated meat. Defs.' Mem. at 19-20. Defendants claimed that "the availability of SureBeam [irradiated] ground beef had expanded '***rapidly***,' reflecting '***growing customer demand***'" and even stated that "'***[c]onsumer demand is obviously growing***, as folks ***are*** embracing this as an added measure of food safety in the products they purchase for their families.'" ¶¶52, 96. The PSLRA's safe-harbor does not protect these statements. *Am. West*, 320 F.3d at 937. And even when they were speaking about future demand, defendants lead investors to believe that future demand was, in fact, a reflection of existing demand.

These statements were false and misleading when made. Demand for irradiated beef was ***not*** "obviously growing," as defendants represented, but was in fact virtually nonexistent. ¶¶52, 124. Contrary to defendants' statements, SureBeam was only utilizing 2%-3% of its capacity Company-wide during the Class Period and had seen its product withdrawn from grocery stores because of poor sales. ¶¶11, 54, 140. Project engineers and other insiders throughout the Company confirmed this non-existent demand, which caused SureBeam's facilities nationwide, which had very few paying customers, to service large producers for free or at deep discounts. ¶11, 56. These facts, which defendants concealed from investors, rendered their statements false and misleading when made. Defendants' contention otherwise simply ignores plaintiffs' allegations. Defs.' Mem. at 2-3.

C. The Complaint Pleads a Strong Inference of Defendants' Scienter

The Ninth Circuit requires plaintiffs to plead facts giving rise to a strong inference that the defendants "acted with the required state of mind." 15 U.S.C. §78u-4(b)(2). In this Circuit, the

required state of mind is one of deliberate or conscious recklessness. *Am. West*, 320 F.3d at 931 (citing *In re Silicon Graphics Sec. Litig.*, 183 F.3d 970, 979 (9th Cir. 1999)). The Ninth Circuit in *Am. West* recently held that courts must "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." 320 F.3d at 938. Courts recognize that "[s]cienter may be proven and pled by reference to circumstantial evidence, for it is rare that perpetrators of a fraud would confess outright." *In re PeopleSoft, Inc., Sec. Litig.*, No. C 99-00472 WHA, 2000 U.S. Dist. LEXIS 10953, at *9 (N.D. Cal. May 25, 2000); *see In re Hi/fn, Inc. Sec. Litig.*, No. C 99-4531 SI, 2000 U.S. Dist. LEXIS 11631, at *22 (N.D. Cal. Aug. 9, 2000). This means investors must plead not direct evidence, but "facts that constitute strong circumstantial evidence of deliberately reckless or conscious misconduct." *Silicon*, 183 F.3d at 974.

1. Defendants Knew that SureBeam's Offshore Joint Ventures Would Not Pay SureBeam for Its Systems

Defendants knew that SureBeam's financial results were materially false and misleading when made. The largest component of SureBeam's revenues throughout the Class Period was attributed to its off-shore joint ventures with Tech Ion in Brazil and RESAL in Saudi Arabia. *See, e.g.*, ¶9. Both ventures were subject to serious contingencies that rendered SureBeam's revenue recognition inappropriate under GAAP. Indeed, for both ventures, SureBeam tied payment for its irradiators to financing that was designed to pay for SureBeam's systems or for the construction of facilities that would enable the venture to generate sales to pay for the irradiators. ¶¶19-22, 46. Defendants knew that SureBeam's off-shore joint ventures did not meet the financing contingencies at any time during the Class Period. *See, e.g.*, ¶¶93, 105, 120, 139-148.

For the Tech Ion joint venture, both defendants Oberkfell and Claudio knew that the venture was unable to secure the necessary financing prior to the IPO. In fact, internal correspondence shows that both defendants saw the World Bank reject its flawed business plan, and that they knew ***no*** lender would finance the joint venture because SureBeam Brasil had no paying customers and Medeiros himself told both defendants that SureBeam's irradiators were "financially inadequate" to adequately service Brazil's food supply. Defendants Oberkfell and Claudio then worked with

Medeiros to attempt to secure funding from the SUDAM despite the fact that SureBeam's irradiators were not going to be utilized in the Amazonian region of Brazil. Both defendants were involved in corresponding with Medeiros where they agreed to increase the purchase price of SureBeam's irradiators (and mark them as "prepaid") just to secure additional funding. When the SUDAM collapsed just four days before the IPO, both defendants knew that SureBeam would not be paid for its irradiators.

Both defendants also knew that Tech Ion was not fulfilling its end of the obligation. According to internal sources, defendants knew that SureBeam would not get paid if Medeiros did not secure funding and that Tech Ion was not utilizing the $5M "contribution" to construct the facility in Brazil. Indeed, plaintiffs' sources spoke with Oberkfell himself and sent e-mails, letters and pictures to Oberkfell and Claudio describing exactly what was happening with the project. ¶¶41-43, 142, 145. Because of the information, defendants terminated SureBeam's venture with Tech Ion and hired a new construction firm to complete the construction. ¶43. Defendants did not disclose any of these facts to investors. Instead, they merely stated that construction was delayed because of "time needed to obtain regulatory permits and licensing." ¶115.

The same is true for SureBeam's joint venture with RESAL who, like Tech Ion, could not (and would not) pay for SureBeam's irradiators without the appropriate funding. ¶¶4, 46-48, 50. Defendants set up the venture that way. Although the joint venture agreement obligated RESAL to place a purchase order for 10 SureBeam systems, it expressly permitted RESAL to transfer the obligation to pay for SureBeam's systems to the joint venture entity once RESAL had secured the funding necessary to finance the project. ¶8. Defendants knew, therefore, that RESAL intended to finance the operation through external funding. And according to internal sources, defendants knew that RESAL was severely delayed (for more than two years) because RESAL could not secure that funding. Defendants' scienter is supported by the fact that they knew about RESAL's delays, agreed to extend RESAL's payment obligation under the invoice during those delays (defendant Rane traveled to Saudi Arabia to renegotiate this payment obligation), and recognized revenue despite the delays. Had RESAL truly intended (and had the ability) to pay for SureBeam's systems on its own,

these significant delays would not have occurred and the payment extensions would have been unnecessary.[9]

2. Defendants Knew that Domestic Demand for SureBeam's Irradiated Meat Was Non-Existent

Defendants knew that the statements made regarding SureBeam's domestic demand were false and misleading when made. Demand for irradiated meat encompassed virtually 100% of SureBeam's domestic operations and were critical to SureBeam's viability in the United States. Defendant Rane was intimately familiar with the almost complete lack of demand for SureBeam's service (and its anemic processing rate) through weekly sales report that he received from SureBeam's Marketing Director, which detailed the volume of product being processed by each of SureBeam's domestic irradiation facilities. ¶147. Rane's knowledge is confirmed by his own statements when, not out of ignorance, but out of "company policy," he refused to answer a question relating to the tonnage of meat processed in SureBeam's facilities and the average price and rate per pound that SureBeam was charging for that service. ¶147.

Along the same lines, defendant Oberkfell repeatedly discussed the state of SureBeam's domestic demand through SureBeam's press releases. He told investors that "[c]onsumer demand is obviously growing" and made repeated statements about SureBeam expanding its pasteurization capacity to meet demand. *See, e.g.*, ¶¶10, 52, 96, 124, 131. In fact, Oberkfell himself made a number of references to roll-outs by grocery retailers because of consumer acceptance of SureBeam's processed products. ¶¶52, 108, 124. These statements demonstrate that Oberkfell was thoroughly familiar with the demand (or lack thereof) for his Company's products.

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[9] Defendants' sole challenge to plaintiffs' allegation that defendant Rane extended RESAL's payment schedule is to plaintiffs' use of an "unnamed" source. Defs.' Mem. at 15. The Ninth Circuit has never required plaintiffs to name the source of their allegations as defendants suggest. *In re Adaptive Broadband Sec. Litig.*, No. C 01-1092 SC, 2002 U.S. Dist. LEXIS 5887, at *34 (N.D. Cal. Apr. 2, 2002) ("a plaintiff need only 'mention ... the sources of [plaintiff's] information'") (citation omitted). It is sufficient, as plaintiffs have done here, to allege facts showing that the allegations are reliable. *In re Seebeyond Techs. Corp. Sec. Litig.*, 266 F. Supp. 2d 1150, 1159 (C.D. Cal. 2003). And there is nothing more reliable than a percipient witness, which is the source that plaintiffs have here. ¶50.

Each defendant was, in fact, intimately familiar with the lack of demand for SureBeam's irradiated meat given that it amounted to virtually 100% of SureBeam's domestic operations. ¶¶143, 146-148. Indeed, while SureBeam chose to sell its systems to its off-shore joint venture partners and recognize revenue from the purported sale of those systems, defendants decided against that business plan and, instead, chose to charge a per pound processing fee for every pound of meat that SureBeam processed in the United States. ¶51. The demand for irradiated meat was, therefore, critical to SureBeam's business plan and the success (or failure) of its domestic operations, which each defendant discussed during their daily management meetings in Claudio's office. ¶¶139-148. Defendants' claims that they did not know that their statements about demand were false is unavailing. Defs.' Mem. at 2.[10]

Defendants contend that SureBeam's actions of expanding its manufacturing capabilities demonstrates that they actually believed that demand would increase. Defs.' Mem. at 3, 20. Defendants are misguided for two reasons. First, what defendants hoped would happen in the future is irrelevant to determining whether defendants knew that their statements about ***existing*** demand were false. Second, defendants were concealing adverse information about SureBeam and had to create the appearance that its business was growing in order to raise capital to keep operating. They knew that SureBeam was operating at an anemic processing capacity, they saw the roll-out of irradiated meat withdrawn from grocery stores because of "poor sales," and they had to go to great lengths to get processors to use their product. ¶¶55, 95, 121, 140. These facts undermine

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[10] Defendants claim that they did not know about the major problems facing SureBeam's domestic operations and that it had few paying customers is simply unbelievable. Defs.' Mem. at 20-21. Like the directors in *Am. West*, it is "patently incredible" that defendants would not know about "major problems" facing their entire domestic operation. *Am. West*, 320 F.3d at 943 n.21. This is especially true given that the problems faced directly impacted SureBeam's revenues and its bottom line from its domestic operations. Defendants' contention that plaintiffs must plead that each witness identified in the Complaint discussed each allegation with each defendant is simply unrealistic. 320 F.3d at 946 ("In this era of corporate scandal ... we are cautious to raise the bar of the PSLRA any higher than that which is required under its mandates."). The Complaint outlines disastrous problems facing SureBeam's domestic operations and cites former SureBeam employees who, contrary to defendants' contention, had personal knowledge of the facts attributed to them. ¶¶53-54, 56-57. Plaintiffs' allegations are plead with sufficient particularity and combined with defendants' knowledge and motivations, give rise to a strong inference of scienter.

defendants' claim that existing demand was growing and demonstrate that their expectation for future demand – especially at the 20% rates claimed by defendant Rane – had no basis.[11] *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1113 (9th Cir. 1989) ("projections and general expressions of optimism may be actionable under the federal securities laws" when there is no reasonable basis for that belief); *In re Terayon Communications Sys.*, No. C 00-01967 MHP, 2002 U.S. Dist. LEXIS 5502, at *32 (N.D. Cal. Mar. 29, 2002) (scienter found where "defendants' statements were made without a reasonable basis"); ¶115.

3. SureBeam's IPO Raises a Strong Inference of Scienter

Oberkfell and Claudio's scienter is also bolstered by the fact that defendants' misrepresentations enabled SureBeam to obtain $63M from sales of its stock in its IPO. ¶¶2, 65, 71-72, 149, 178. As courts recognize, scienter may be inferred from evidence suggesting that defendants may have disseminated false and misleading statements to the public in an effort to protect public offerings. *In re Amylin Pharms., Inc. Sec. Litig.*, No. 01cv1455 BTM(NLS), 2002 U.S. Dist. LEXIS 19481, at *10 (S.D. Cal. Oct. 9, 2002) (motive to raise financing is relevant to scienter). Indeed, allegations of non-disclosures that would jeopardize an IPO are routinely held to be significant to establishing scienter. *In re Res. Am. Sec. Litig.*, No. 98-5446, 2000 U.S. Dist. LEXIS 10640 (E.D. Pa. July 26, 2000) (motive to complete secondary offering sufficient to allege scienter).

In this case, the Complaint pleads specific facts establishing that defendants concealed serious problems with the Tech Ion joint venture in order to complete the IPO. ¶¶53-58, 95. The IPO itself enabled SureBeam to raise over $60M in capital and its secondary offering on December 2, 2002 contributed another $25M. ¶¶62, 118, 123. Without question, these facts provided defendants with ample motive to commit the acts alleged in the Complaint. When combined with

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[11] Defendants' attempt to hid behind the PSLRA's safe-harbor for their statements about demand is misguided. Defs.' Mem. at 19. Beyond the fact that defendants' statements were present-tense statements that conveyed information about "existing" demand, defendants had actual knowledge that demand for SureBeam's irradiated meat was non-existent. *See* Discussion, *supra* at §III.C.2.

failed joint venture and the defendants' actual knowledge of these problems, SureBeam's fraudulent IPO more than adequately raise a strong inference of defendants' scienter. *Am. West*, 320 F.3d at 938 (Court should 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.'") (citation omitted).

4. Combined with the Complaint's Allegations of Actual Knowledge, Defendants' Stock Sales Raise a Strong Inference of Scienter

Defendants argue that their Class Period stock sales do not raise a strong inference of scienter. Citing *Ronconi v. Larkin*, 253 F.3d 423 (9th Cir. 2001), defendants argue that "allegations that corporate officers sold stock does not raise a strong inference of scienter unless plaintiffs also allege specific facts showing that the stock sales were 'dramatically out of line with prior trading practices at times calculated to maximize the personal benefit from undisclosed inside information.'" *See* Defs.' Mem. at 17. This, plaintiffs have done. Plaintiffs have alleged that Oberkfell sold 37.51% of his stock and that Claudio's sales totaled 65.63%. ¶¶106, 110. And the circumstances behind these sales show that they were intended to maximize defendants' personal benefit since defendants sold these shares as soon as they were able and after SureBeam's stock had fallen from its Class Period high of $19.45. In fact, Claudio's first sale of $1.1M occurred when SureBeam's stock price was near the highest point once he was able to sell and his second sale (along with all of Oberkfell's sales) occurred just before the stock began its decent from around $6.00 to $1.62 at the end of the Class Period. ¶¶1, 4, 110.

Defendants argue that because the stock sales were made below the peak price for SureBeam stock during the Class Period, their stock sales cannot be used to show scienter. Defs.' Mem. at 3, 17, 18. Defendants are misguided. The price of the stock when sold is not dispositive as defendants suggest. *Id.* It is the circumstances that dictate whether defendants sold to maximize their personal benefit. In both *Ranconi* and *Vantive*, cited by defendants, the sales of stock below the peak did not raise a strong inference of scienter because the share price increased dramatically following the insiders' sales. *In re Vantive Corp. Sec. Litig.*, 283 F.3d 1079, 1093-94 (9th Cir. 2002); *Ronconi*, 253 F.3d at 435. While these cases state that defendants "miss[ed] the boat" by selling at low prices

when the stock price ultimately increased, the defendants here sold their shares ***to avoid a sinking ship***. Following defendants' sales at prices from $5.70-$6.20, SureBeam's Class Period stock price never closed above $6.82. In fact, defendants' reference to the peak share price during the Class Period is misleading since defendants' options had not vested until after SureBeam's stock had dropped significantly from the Class Period high of $19.45. Under these circumstances, defendants' sales were designed to maximize their personal benefit.[12]

5. Defendants' Financial Fraud Raises a Strong Inference of Scienter

Because plaintiffs have alleged how the defendants distorted and inflated SureBeam's revenues and earnings, what defendants' unreasonable accounting practices were, and the impact on SureBeam's financial results, they have properly alleged a claim for accounting fraud and have adequately alleged scienter. *Aldridge v. A.T. Cross Corp.*, 284 F.3d 72, 83 (1st Cir. 2002) ("'accounting shenanigans'" may be evidence of scienter); *see also STI Classic Fund v. Bollinger Indus.*, No. 3-96-CV-823-R, 1996 U.S. Dist. LEXIS 21553, at *7 (N.D. Tex. Oct. 25, 1996) ("Based upon their respective positions with the company, a strong inference may be drawn that [defendants] were knowledgeable about the methods and billing practices utilized by [the company] which led to the over-stated sales and revenues reported in SEC filings signed by them."). *In re Miller Indus. Sec. Litig.*, 12 F. Supp. 2d 1323, 1332 (N.D. Ga. 1998) (allegations that defendants "engaged in a number of accounting practices to artificially inflate and support Miller Industries' stock price notwithstanding the downturn in its core business" pleaded "***conscious behavior*** under the more stringent Silicon standard").

Defendants argue that the Complaint fails to allege defendants' "knowledge of accounting errors" and contend that plaintiffs are required to allege that defendants were capable of understanding complex accounting rules before the complaint can give rise to scienter. Defs.' Mem.

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[12] Defendants' attempt to use Rane's lack of sales to show that he lacked scienter is misplaced. Defs.' Mem. at 3, 18. The Ninth Circuit specifically rejected this argument in *Am. West* when it held that "[s]cienter can be established even if the officers who made the misleading statements did not sell stock during the class period." 320 F.3d at 944. *Nathenson v. Zonagen Inc.*, 267 F.3d 400 (5th Cir. 2001), relied upon by defendants, has no precedential value. Defs.' Mem. at 18.

at 7. Defendants even go so far as to argue that only those responsible for SureBeam's revenue recognition policy can be liable for SureBeam's false financial results. Defs.' Mem. at 8. Wrong. Under the circumstances here, defendants knew that revenue recognition was improper regardless of the accounting principles used because neither joint venture entity was capable of paying for SureBeam's systems. Defendants' own authority establishes that "'an inference of scienter becomes more probable as the violations become more obvious.'" Defs.' Mem. at 10 (citing *In re MicroStrategy Inc. Sec. Litig.*, 115 F. Supp. 2d 620 (E.D. Va. 2000)).

The violations here were obvious. The Complaint is replete with "red flags" establishing that defendants knew that SureBeam's revenue recognition from the Tech Ion venture was improper. The most critical "red flags" are the correspondence that the defendants received months before IPO informing them that SureBeam's systems could not service Brazil's CEASAs and that the World Bank had rejected its request for funding. *Chalverus v. Pegasystems, Inc.*, 59 F. Supp. 2d 226, 234-36 (D. Mass. 1999) (violations of GAAP, coupled with the significant overstatements of revenue and other factors were more than sufficient to satisfy scienter requirement). Far from relying on mere job titles, plaintiffs provide quotations from documents to and from defendants showing that they knew that SureBeam would not be paid for its systems. *See, e.g.*, ¶¶5, 23, 25-33. These facts establish defendants' fraudulent intent to mislead investors. *See City of Philadelphia v. Fleming Cos.*, 264 F.3d 1245, 1261 (10th Cir. 2001) (GAAP violations are sufficient to state a claim "where such allegations are coupled with evidence that the violations or irregularities were the result of the defendant's fraudulent intent to mislead investors").[13]

Defendants argue that because SureBeam's third auditor "questioned precisely the same accounting" that was passed off by Arthur Andersen and KPMG, SureBeam's improper accounting cannot give rise to a strong inference of scienter. Defs.' Mem. at 9, 16-18. Plaintiffs do not,

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[13] *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407 (9th Cir. 1994), the case cited by defendants for the proposition that "even a deliberate violation of GAAP, without more, does not amount to fraud" is unpersuasive and misplaced. Defs.' Brf. at 9. Defendants, again ignoring ***motion to dismiss*** standards have cited a ***summary judgment*** opinion where the court, after analyzing evidence (including expert declarations) found that the plaintiffs had failed to establish scienter with the respect to the defendant auditor. *Wonder*, 35 F.3d at 1426.

however, rely on Deloitte's rejection as a basis for defendants' scienter. Instead, they rely on defendants' own internal documentation showing that they knew that SureBeam was improperly recognizing revenue from the Tech Ion joint venture. *See* ¶¶5, 23, 25-33. Deloitte's reaction to the accounting improprieties is further support that defendants' financials were false when made.

D. Defendants Violated §11 of the Securities Act of 1933

Section 11 of the Securities Act of 1933 ("Securities Act") allows purchasers of registered securities to recover from the issuer, every person who signed the Registration Statement, and every director of the issuer if the Registration Statement contained an untrue material fact or omitted to state a required material fact. 15 U.S.C. §77k; *See Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1204 (1st Cir. 1996). By alleging that SureBeam's Prospectus was materially false and misleading when issued, the Complaint adequately pleads all of the necessary elements of a cause of action under §11 of the Securities Act. *See* Discussion, *supra* at §II.B.1. Plaintiffs also incorporate herein all of the arguments made in Plaintiffs' Opposition to Defendants The Titan Corporation, Dr. Gene W. Ray and Susan Golding's Motion to Dismiss. Plaintiffs have adequately pled a §11 claim against defendants Oberkfell and Claudio. Plaintiffs have not alleged a §11 claim against defendant Rane as he joined SureBeam after the IPO. ¶¶175-181.

IV. CONCLUSION

Accordingly, defendants' motion should be denied, or plaintiffs should be granted leave to amend. *See Partington v. Bugliosi*, 56 F.3d 1147, 1162 (9th Cir. 1995).

DATED: July 29, 2004

Respectfully submitted,

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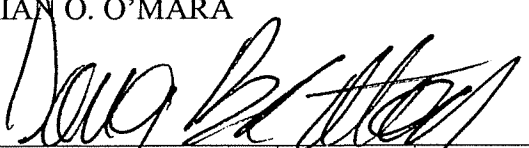

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DECLARATION OF SERVICE BY FEDERAL EXPRESS DELIVERY

I, the undersigned, declare:

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and a resident of the County of San Diego, over the age of 18 years, and not a party to or interest in the within action; that declarant's business address is 401 B Street, Suite 1700, San Diego, California 92101.

2. That on July 29, 2004, declarant served by FedEx, next day delivery, the PLAINTIFFS' OPPOSITION TO DEFENDANTS OBERKFELL, CLAUDIO AND RANE'S MOTION TO DISMISS CONSOLIDATED COMPLAINT to the parties listed on the attached Service List. Declarant also served the parties by facsimile.

I declare under penalty of perjury that the foregoing is true and correct. Executed this 29th day of July, 2004, at San Diego, California.

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