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UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

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

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Plaintiffs respectfully submit this opposition to the Underwriter Defendants' motion to dismiss the §11 claim against them in the Consolidated Complaint for Violation of the Federal Securities Laws (the "Complaint").[1]

I. INTRODUCTION

This is a securities class action on behalf of all persons who purchased the common stock of SureBeam Corporation ("SureBeam" or the "Company") in the Initial Public Offering ("IPO") of SureBeam stock, effective March 16, 2001, and thereafter until August 27, 2003 (the "Class Period").

As to the Underwriter Defendants, the Complaint alleges only violations of §11 of the Securities Act of 1933 ("Securities Act"). It does not allege any violations of §10(b) of the Securities Exchange Act of 1934 and there is no allegation of fraud or scienter, which are not elements of a violation of §11. Section 11 imposes liability on securities issuers, underwriters and others, if the Registration Statement "contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading." 15 U.S.C. §77k(a).

Here, the Complaint alleges that the Registration Statement and the Prospectus (together, the "Prospectus") issued in connection with the IPO contained untrue statements and omitted material facts. More particularly, while misstating that SureBeam had entered into a joint venture with Tech Ion Industrial Brazil ("Tech Ion") to irradiate food throughout Brazil and that the venture had generated $15.5 million in revenue for SureBeam in 2000 (more than 61% of its revenues for the year) and would generate $55 million in revenue (more revenue than the Company had generated in its entire history) over three years, the Underwriter Defendants failed to disclose that the Tech Ion joint venture had not generated revenue for SureBeam before the IPO and could not generate revenue for SureBeam after the IPO because neither joint venture entity (SureBeam Brasil) nor Tech

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[1] The Underwriter Defendants include defendants Merrill Lynch, Pierce, Fenner & Smith Incorporated, Credit Suisse First Boston LLC and Wachovia Capital Markets LLC (formerly known as First Union Securities, Inc.). ¶¶78-80. All "¶_" and "¶¶__" references are to the Complaint, unless otherwise noted. Emphasis is added and citations are omitted, unless otherwise noted.

Ion (which had only $418,000 of current assets and $1,753 of "available" assets before the IPO) had the ability to pay for SureBeam's irradiation systems without substantial outside funding, which fell through four days before the IPO. ¶¶4, 22-23, 38-40.

The Underwriter Defendants also misstated in the Prospectus that SureBeam/Titan had "acquired a 19.9% equity interest in SureBeam Brasil without charge at the time of [the] signing the agreement to establish SureBeam Brasil" and that SureBeam Brasil was created "with no initial capital contribution from either party." ¶40. In fact, however, defendant The Titan Corporation ("Titan") had contributed $5 million to Tech Ion (under the guise of a loan with no repayment provision) to get the venture off the ground. *Id.*

Unable to rebut plaintiffs' allegations, the Underwriter Defendants argue that the Complaint is grounded in fraud and is subject to dismissal under Fed. R. Civ. P. Rule 9(b)'s fraud pleading requirements. However, the Complaint does not contain any allegations of fraud against the Underwriter Defendants. Indeed, the only two paragraphs of the Complaint which the Underwriter Defendants claim apply to them – ¶¶40 and 86 – do not contain any allegation of fraud whatsoever – but rather only negligence. *See* ¶40 (alleging the Prospectus contained "untrue statements") and ¶86 (alleging the Prospectus' statements were "untrue and omitted material facts"). As such, the Complaint's §11 claim is subject to simple notice-pleading standards under Rule 8(a) and cannot be dismissed under Rule 9(b), as the Underwriter Defendants erroneously contend.

The Underwriter Defendants also argue that the untrue statements and omitted material facts contained in the Prospectus were adequately disclosed and, therefore, protected under the "bespeaks caution" doctrine. Unfortunately for the Underwriter Defendants, however, the adequacy of disclosure is an intensely factual issue which is inappropriate for resolution at the pleading stage. Likewise, the "bespeaks caution" doctrine, by definition, cannot apply to the alleged omissions of material facts contained in the Prospectus. And, contrary to the Underwriter Defendants' arguments, the boilerplate and generic disclaimers contained in the Prospectus were themselves false and misleading for failing to disclose the true nature of SureBeam's dire financial situation as of the effective date of the IPO, and did not contain sufficient meaningful cautionary language to trigger the bespeaks caution defense.

Taken as true, the detailed factual allegations of the Complaint state a claim for violation of §11 against the Underwriter Defendants and, accordingly, the Underwriter Defendants' motion to dismiss should be denied in its entirety. This is especially true here since the Underwriter Defendants do not contest that they were aware of SureBeam's infirmed financial condition on the eve of the IPO, as detailed in the Complaint, but instead argue only they disclosed all of the material facts to investors in the Prospectus, which they did not.

II. THE FACTUAL ALLEGATIONS OF THE COMPLAINT

On the date of SureBeam's IPO, defendant Titan was in tremendous financial straits. Titan had incurred extraordinary losses beginning in the first quarter of 2000 and had dramatically increased its debt levels. ¶15.

Among Titan's money-losing enterprises was its SureBeam subsidiary. ¶¶13-15, 91, 99, 102. Since 1997, SureBeam was in the business of building irradiators that scanned electron beams across various products, including food items, to destroy or prevent the reproduction of organisms that cause infestation, contamination, spoilage or disease. ¶14. Titan did not want to keep funding SureBeam's business and looked to the IPO in March 2001 to provide necessary funding for SureBeam. ¶15. However, SureBeam could not successfully complete an offering unless it appeared that the business was successful and generating revenue.

The material misstatements and omissions that form the core of this case against the Underwriter Defendants stem from a joint venture which Titan arranged for SureBeam in May 2000 with Tech Ion, a Brazilian company. The joint venture was to create a new company, SureBeam Brasil, which would provide irradiation services to food producers who were storing their product in Rio de Janeiro's CEASA, a large distribution warehouse that provided most of the produce for Rio de Janeiro's ten million residents. ¶¶2, 28, 30.

Most importantly, SureBeam (Titan) was able to show revenues on its financial statements for the year ending December 31, 2000, issued to the public in connection with the IPO, based on SureBeam's "sale" of 11 irradiators to Tech Ion for use by SureBeam Brasil (the joint venture). ¶¶2, 20, 38. As a result, SureBeam's financial statements for fiscal 2000 showed food irradiation revenue of $25.2 million, of which $15.5 million (*i.e.*, 61%) was from the Tech Ion "sale" and accounts

receivable of $17.678 million, of which $15.5 million was from the Tech Ion "sale." ¶38. However, as the Underwriter Defendants knew or should have known, Tech Ion was insolvent – it had only $1,753 in available assets and $2.2 million in liabilities. ¶22. Therefore, the joint venture agreement recognized that SureBeam Brasil would pay for the irradiators, but only if and when SureBeam Brasil obtained outside funding sufficient to pay for the irradiators, as well as for its initial day-to-day operating expenses. ¶¶20-22.

However, by December 2000, the date of SureBeam's financial statements, and March 2001, the date of the IPO, all of the attempts to obtain outside funding for the joint venture had failed. Although potential lenders told SureBeam in 2000 that funding would not be possible without "assurances that there will be customers to generate revenue to pay the debt" and required "letters of interest from potential customers, alliances, etc.," SureBeam recognized that there would be no customers because the fundamental economic premise of SureBeam Brasil's business plan was fatally flawed. ¶¶25-27. As Jose Francisco Medeiros ("Medeiros"), a Tech Ion executive, reported to defendants in December 2000, SureBeam's accelerators could not profitably operate at the prices SureBeam Brasil would be forced to charge to attract customers. ¶30.

As SureBeam now had no reasonable basis for recognizing the revenue from the "sale" of the irradiators, the joint venture thereafter took desperate measures by seeking financing from SUDAM, a Brazilian government agency established to fund development in the Amazon, which required shipment of the irradiators to a warehouse in Manaus in the Amazon, nearly 2,000 miles from Rio de Janeiro, even though: (i) the transportation and storage could cause the irradiators to deteriorate; and (ii) SureBeam had to mislead the government to even qualify for SUDAM funding by falsely marking the irradiator invoices as "prepaid." ¶¶25, 32, 34. However, on March 12, 2001, one week before the IPO, SUDAM suddenly collapsed as a result of a probe into government corruption. ¶37. Thus, as of the IPO, SureBeam's prospects for collecting on its sale to Tech Ion were still negligible – and the joint venture itself likely doomed.

Nevertheless, on March 19, 2001, the Underwriter Defendants issued the Prospectus, which materially misled the investment community. ¶¶38-39. The Underwriter Defendants did not disclose that SureBeam Brasil's entire business plan had proved invalid in late 2000. The

Underwriter Defendants did not disclose that SureBeam Brasil's anticipated funding source had collapsed one week before the IPO or that SureBeam Brasil had no funding for operations (much less to pay for the irradiators). The Underwriter Defendants also allowed SureBeam to improperly recognize the $15.5 million from the "sale" of the irradiators as revenue and as an account receivable in its financial statements issued in the Prospectus even though collection was not reasonably assured as of December 2000 – and did not disclose the impairment to that revenue and receivable as of the IPO. Indeed, in the "Management Discussion & Analysis" portion of the Prospectus, the Underwriter Defendants continued to emphasize the viability of the SureBeam Brasil joint venture with Tech Ion and the importance of the revenue recognized from the "sale," stating:

> 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. 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.

¶38. SureBeam Brasil never obtained the financing and, in April 2002, SureBeam wrote off all $22.4 million in trade receivables it had booked to that point from the "sale" to Tech Ion. ¶¶44-45. SureBeam subsequently filed for bankruptcy. ¶64.

At all times material to the IPO process, the Underwriter Defendants knew or should have known about the adverse, non-public material facts set forth above. Yet, they failed to correct the untrue statements and material omissions contained in the Prospectus before the IPO. As a result, plaintiffs and the class suffered millions in damages.

III. THE UNDERWRITER DEFENDANTS' MOTION TO DISMISS SHOULD BE DENIED

A. The Applicable Standards on a Motion to Dismiss

A motion to dismiss for "failure to state a claim" upon which relief can be granted pursuant to Fed. R. Civ. P. 12(b)(6) should be granted only if it "appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957). On a motion to dismiss, the factual allegations of a complaint must be taken as true, and the court must draw all reasonable inferences in favor of the non-movant. *No. 84 Employers-Teamster Joint Council Petition Trust Fund v. Am. West Holding Corp.*, 320 F.3d 920,

931 (9th Cir. 2003), *cert. denied*, 2003 U.S. LEXIS 7727 (2003) ("All allegations of material fact made in the complaint are taken as true and construed in the light most favorable to the plaintiff."); *Gila River Indian Community v. Waddell*, 967 F.2d 1404, 1413 (9th Cir. 1992). The issue is not whether plaintiffs will ultimately prevail, but whether they are entitled to put forth evidence in support of their claims. *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974).

B. The Complaint Adequately Alleges §11 Liability Against the Underwriter Defendants

To recover under §11 of the Securities Act, plaintiffs need allege and prove only (i) that they purchased a security that was part of a registered offering, and (ii) that the Registration Statement contained a material misstatement or omission. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983). The statute imposes strict liability; *i.e.*, there is no requirement that plaintiffs prove reliance, knowledge or scienter, even as to defendants other than the issuer. *Id.*; *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 200 (1976) (underlying congressional policy was to create express liability regardless of fault); *Kaplan v. Rose*, 49 F.3d 1363, 1371 (9th Cir. 1994) (under §11, "defendants will be liable for innocent or negligent material misstatements"); *In re Westinghouse Sec. Litig.*, No. 91-354, 1998 U.S. Dist. LEXIS 3033, at *26 (W.D. Pa. Mar. 12, 1998) (scienter not required for §11 claim, mere negligence or innocent misrepresentations are actionable).

Here, the Complaint alleges the Underwriter Defendants made numerous untrue statements and omitted several material facts in the Prospectus. For example, the Complaint alleges in detail how the Underwriter Defendants told investors in the Prospectus that SureBeam and Titan had entered into a joint venture with Tech Ion to irradiate food throughout Brazil and that the venture had generated $15.5 million in revenue for SureBeam in 2000, or more than 61% of its revenues for the year, and would generate $55 million in revenue, or more revenue than the Company had generated in its entire existence, over three years. ¶38.

The Complaint also details how the Underwriter Defendants used the Prospectus to give the venture an appearance of economic substance by claiming that SureBeam/Titan had "acquired a 19.9% equity interest in SureBeam Brasil without charge at the time of our signing the agreement to establish SureBeam Brasil" and that SureBeam Brasil was created "with no initial capital

contribution from either party." ¶40. These positive but untrue statements generated excitement about SureBeam and allowed the Underwriter Defendants to complete SureBeam's IPO – selling 6.7 million shares of SureBeam stock at $10 per share for net proceeds of $62 million. ¶¶2, 38, 84-85.

Unfortunately for investors, the Underwriter Defendants' statements about the Tech Ion joint venture and the revenue recognized (and to be generated) from the venture were untrue when made. ¶¶39, 40, 86. Contrary to the Underwriter 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. Both SureBeam Brasil and Tech Ion were new operations, and Tech Ion, even more than SureBeam Brasil, was in dire financial straits. ¶¶18-40. Not only had its assets collapsed in a single year (leaving it with $1,753 in "available assets" in the bank) but it also "[had] no recorded historical revenues or profits that could be displayed at this time" as it had "just opened it [sic] first cobalt irradiation facility in Manaus."[2] ¶¶4, 22. In fact, contrary to the Underwriter Defendants' claim in the Prospectus that the venture was created with no capital contributions from SureBeam/Titan, Titan donated $5 million to Tech Ion (under the guise of a loan with no provision for repayment) just to get the venture off the ground. ¶¶22, 40.

As a result of the financial position of SureBeam's joint venture partner, the Underwriter Defendants knew from their pre-IPO investigation that the joint venture would not collect any revenue from the Brazilian operation without substantial outside funding. ¶4. And internal documents, which the Underwriter Defendants reviewed as a part of their pre-IPO investigation, showed that SureBeam's top insider knew as early as November 21, 2000 (nearly three months before the IPO) 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

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[2] From 1998 to 1999, Tech Ion's current assets had collapsed from $3.9 million to just $418,000, its "Available" assets had plummeted from $3.6 million to just $1,753.00 and its current liabilities had skyrocketed from $579,000 to an extraordinary $2.2 million in a single year. ¶22.

(an Amazonian developmental agency called "SUDAM") had collapsed only four days before the IPO. ¶¶22-38. The Underwriter Defendants knew or should have known, therefore, that Tech Ion and SureBeam Brasil would be incapable of paying SureBeam for its irradiators.

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 documents reviewed by the Underwriter Defendants, Delphos was unable to secure the funding for the SureBeam joint venture because the World Bank had rejected SureBeam's "Field of Dreams" business plan because its "customer base [was] not well-defined and established enough to provide comfort." ¶25. The documents themselves (which the Underwriter Defendants reviewed before the IPO) demonstrate that SureBeam's Brazilian joint venture was dead on arrival:

> As we discussed, the meetings at the IIC and IFC 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.

Id.

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" and for "as many specifics on the construction of the project as possible," the SureBeam defendants came up short. ¶27. In fact, as the Underwriter Defendants found out before the IPO, the SureBeam defendants knew by December 2000, that funding from the World Bank was virtually impossible because, as Medeiros – the head of Tech Ion and President of SureBeam Brasil – put it in a letter to defendants Lawrence A. Oberkfell and Kevin K. 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":

> I am sending this email to both of you in advance of that phone call because Delphos' material needs enormous rewriting and deep changes in the concept and

> numbers. There are problems of discrepancy of numbers, etc. As 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. I am ready with my team to rewrite the document in order to meet Delphos's schedulles [sic]. We are ready to work overnight, etc., if we agree on the changes of concept.

¶¶5, 28-29.

Neither the World Bank or any other lender provided funding and the Tech Ion joint 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. ¶37. Thus, the Prospectus, which omitted these material facts, and its representations about the amount of revenue that the venture had generated (and would generate) were, therefore, untrue and/or materially misleading when made.

Ignoring these detailed allegations contained in the Complaint, the Underwriter Defendants contend that all material facts were "clearly and fully disclosed" in the Prospectus. *See* Memorandum of Points and Authorities in Support of the Underwriter Defendants' Motion to Dismiss the Section 11 Claim Against Them in Plaintiffs' Consolidated Complaint ("Underwriter Defendants' Mem.") at 3-4. This is plainly false. Nowhere in the Prospectus did the Underwriter Defendants disclose that the revenue attributed to the Brazilian venture was improperly recognized because the very foundation of the joint venture was based on entities with no proven track record, no customer base and which had no ability to pay anywhere near $55 million (or any amount for that matter) for SureBeam's irradiators. ¶¶18-23, 25-39, 86.

Likewise, the Underwriter Defendants' contention that their generic description of the Brazilian joint venture as a "start up" company in the Prospectus was sufficient to adequately informed investors of severity of the foregoing adverse, material nonpublic facts is nonsensical. No reasonable investor would have concluded that the joint venture was in such dire financial straits and unable to obtain absolutely essential outside funding on the eve of the IPO based on the Underwriter Defendants' description of the venture as "start up" company. On the contrary, reasonable investors could have concluded exactly the opposite, *i.e.*, that the joint venture was a small company with bright prospects.

In any event, whether the shaky nature of the venture was adequately disclosed is an intensely factual issue which cannot be properly decided on a motion to dismiss. *See Durning v.*

First Boston Corp., 815 F.2d 1265, 1268 (9th Cir. 1987) (adequacy of disclosure, like materiality, is normally a jury question which cannot be determined on a motion to dismiss).

The Underwriter Defendants' attempt to escape liability by arguing that the details of Titan's $5 million loan to SureBeam was fully disclosed also fails. Again, the Underwriter Defendants misread the allegations in the Complaint and overlook the fact that Tech Ion was in dire financial straits at the inception of the venture (possessing on $1,753 in current assets) and both Tech Ion and SureBeam Brasil desperately needed an infusion of capital to get the project off the ground. They also ignore the fact that, although the Prospectus stated that the parties formed the Brazilian venture "without charge" and "with no initial capital contribution from either party," a contribution of $5 million to the venture was necessary to get the venture off the ground and to enable Tech Ion to begin constructing the facility that would enable SureBeam Brasil to operate. ¶¶22, 40. While this contribution was structured and announced as a "loan," defendants made no provision for repayment. These misrepresentations and omission also undermine the Underwriter Defendants contention that all material facts were somehow adequately disclosed.[3] Since the Complaint sufficiently alleges material misstatements and omissions under §11 against the Underwriter Defendants, their motions to dismiss plaintiffs' §11 claims should be denied.

C. The "Bespeaks Caution" Doctrine Does Not Immunize the Underwriter Defendants' False and Misleading Statements

The "bespeaks caution" doctrine is "nothing more than 'the unremarkable proposition that statements must be analyzed in context,'" and justifies granting a motion to dismiss only in rare

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[3] The Underwriter Defendants attempt to avoid liability by claiming that the Prospectus specifically cautions that the success of SureBeam's international operations in Brazil is "subject to several inherent risks ... including ... changes in [Brazil's] political or economic conditions" is disingenuous. Underwriter Defendants' Mem. at 4. As explained in detail below, the Underwriter Defendants cannot escape liability by attempting to disclaim something that has already happened. *In re Convergent Technologies Sec. Litig.*, 948 F.2d 507, 515 (9th Cir. 1991) ("'To warn that the untoward may occur when the event is contingent is prudent; to caution that it is only possible for the unfavorable events to happen when they have already occurred is deceit.'"); *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1115 (9th Cir. 1989) ("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 ....").

circumstances. *Fecht v. Price Co.*, 70 F.3d 1078, 1082 (9th Cir. 1995).[4] This defense may 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." *Id.* (original emphasis omitted). The inclusion of only "some" cautionary language in a document cannot support a finding, as a matter of law, that the statements were not misleading. *Id.*; *Warshaw v. Xoma Corp.*, 74 F.3d 955, 957, 959 (9th Cir. 1996).[5] Blanket warnings of general risk are insufficient to invoke the bespeaks caution doctrine. *Fecht*, 70 F.3d at 1082.[6]

Here, the Underwriter Defendants' boilerplate disclosures regarding the SureBeam-Tech Ion joint venture do not immunize their false and misleading statements. The unremarkable statement in the Prospectus that, like any company, the success of the joint venture depended upon product demand, the availability of capital, and management of general economic and geopolitical risks, failed to disclose the actual problems SureBeam was experiences at the time of the IPO. Despite their awareness of the dire financial condition of SureBeam, the Underwriter Defendants failed to disclose, among other things, that: (i) the very foundation of the SureBeam joint venture was based on entities with no proven track record, no customer base and which had no ability to pay anywhere near $55 million (or any amount for that matter) for SureBeam's' irradiator systems but instead were relying on outside funds as a source of capital; (ii) before the IPO, Tech Ion had failed in its attempt

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[4] This is so because the Underwriter Defendants must "prove that the information that was withheld or misrepresented" in specific documents was "'transmitted to the public with a degree of intensity and credibility sufficient to effectively counterbalance any misleading impression created by insider's one-sided representations.'" *Provenz v. Miller*, 102 F.3d 1478, 1492-93 (9th Cir. 1996), *cert. denied*, 1997 U.S. LEXIS 4598 (1997).

[5] The "bespeaks caution" doctrine defense is applicable only to forward-looking statements and cannot result in the dismissal of the past or present tense misstatements alleged in the Complaint. *Gray v. First Winthrop Corp.*, 82 F.3d 877, 883 (9th Cir. 1996); *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1413 (9th Cir. 1994).

[6] *See also Cherednichenko v. Quarterdeck Corp.*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶90,108, at 90,141 (C.D. Cal. 1997) (boilerplate disclaimers did not "bespeak caution"); *Powers v. Eichen*, 977 F. Supp. 1031, 1043-44 (S.D. Cal. 1997) (bespeaks caution doctrine inapplicable where "cautionary" language did not directly address delays the company was having with its products).

to secure funding from the World Bank (or any other lender) because SureBeam Brasil's business plan was flawed and could not satisfy lenders that the venture could be successful; and (iii) in fact, defendants ultimately failed in their attempt to secure funding and saw their last chance for funding disappear when SUDAM collapsed amid political scandal just days before the IPO. ¶86. The Underwriter Defendants' generic description of SureBeam as a "start up" company failed to address the actual problems SureBeam was then experiencing with its electronic food irradiation business and joint venture, which were having an adverse material effect on SureBeam's business, financial condition and future prospects.

The Complaint also alleges that at the time of the IPO, the Underwriter Defendants knew certain adverse information that rendered the statements and purported disclosures in the Prospectus false and misleading themselves. ¶¶18-40. *See In re Prudential Sec. Ltd. P'ships Litig.*, 930 F. Supp. 68, 72 (S.D.N.Y. 1996) ("The doctrine of bespeaks caution provides no protection to someone who warns his hiking companion to walk slowly because there might be a ditch ahead when he knows with near certainty that the Grand Canyon lies one foot away.").

D. The Complaint Pleads Securities Violations and Not Corporate Mismanagement

The Underwriter Defendants also seek to immunize their misstatements about SureBeam's business, finances and prospects for future success by labeling plaintiffs' allegations as nothing more than mere "corporate mismanagement." Underwriter Defendants' Mem. at 7. This is incorrect.

Although defendants' alleged misconduct may also amount to mismanagement, the Complaint alleges that the Underwriter Defendants made material misstatements and omitted material facts in the Prospectus. This is a violation of the securities laws. As the Ninth Circuit reaffirmed in *In re Wells Fargo Sec. Litig.*, 12 F.3d 922 (9th Cir. 1993), victims of securities violations do not lose their securities claims because the misstatements at issue were made by corporate officials whose misconduct could also form the basis for separate claims for mismanagement.

> Well Fargo's principal contention is that the shareholders' allegations amount to non-actionable mismanagement, not actionable securities fraud. It relies on [*Santa Fee Indus. v. Green*, 430 U.S. 462 (1977)], in which the Court held that "Congress by §10(b) did not seek to regulate transactions which constitute no more than internal

> corporate mismanagement." *Id.* at 479[,] [97 S. Ct. at 1304]. Characterizing the shareholders' Amended Complaint as one which challenges the timing of Wells Fargo's disclosure or some other "material deficiency in the administration of the loan loss reserve," Wells Fargo emphasizes that the calculation of reverses is an uncertain, "dynamic" process, and necessarily is based in large part on the judgment and discretion of corporate management. ***While the setting of loan loss reserves is, by all accounts, an "art and not a science," 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....***

Id. at 927; *Gross v. Metaphis Corp.*, 977 F. Supp. 1463, 1473 (N.D. Ga. 1997) ("if a defendant makes certain statements while that defendant knows that existing mismanagement makes those statements false or misleading, then the statements are actionable" under the federal securities laws). Thus, "violators of [the federal securities laws] are not immunized from civil liability for their unlawful acts," as the Underwriter Defendants contend, "merely because these acts were committed as part of a broader scheme of corporate mismanagement." *Herpich v. Wallace*, 430 F.2d 792, 808 (5th Cir. 1970); *Pellman v. Cinerama, Inc.*, 503 F. Supp. 107, 109 (S.D.N.Y. 1980) ("*Santa Fe* never intended to oust from the federal courts a case in which valid allegations of deception were made, simply because the actions also involved fiduciary breaches. Otherwise, officers and directors would be immune from federal liability whenever their misconduct also happened to violate state-law fiduciary duties."). Accordingly, the Underwriter Defendants' "corporate mismanagement" defense must fail.

E. The Complaint's §11 Claim Is Not Subject to Rule 9(b)

The Underwriter Defendants also incorrectly argue that plaintiffs' §11 claims fail to satisfy the particularity requirements of Rule 9(b). Underwriter Defendants' Mem. at 8. Under controlling Ninth Circuit authority, plaintiffs need not plead their §11 claims with particularity because such claims are based on negligence and not fraud. *Vess v. Ciba-Geigy Corp.*, 317 F.3d 1097, 1104-05 (9th Cir. 2003); *In re Calpine Corp. Sec. Litig.*, 288 F. Supp. 2d 1054, 1077-78 (N.D. Cal. 2003);

Lone Star Ladies Inv. Club v. Schlotzsky's, Inc., 238 F.3d 363, 369 (5th Cir. 2001); *In re NationsMart Corp. Sec. Litig.*, 130 F.3d 309, 318-19 (8th Cir. 1997).[7]

Here, in their §11 claim against the Underwriter Defendants, the plaintiffs expressly disclaim and exclude any allegations that could be construed as based on intentional or reckless conduct or fraud. *See* ¶¶176-181 (asserting a negligence claim under §11 against the Underwriter Defendants). Moreover, and perhaps as importantly, the only two paragraphs of the Complaint which the Underwriter Defendants claim in their motion to dismiss that have anything whatsoever to do with them, are devoid of any allegations of intentional or reckless misconduct or fraud. *See* Underwriter Defendants' Mem. at 1 ("[w]ith respect to the Underwriters and not based on any legal merit, the two statements from SureBeam's Registration Statement that are alleged to contain misrepresentations are [in ¶¶40 and 86]").

Neither ¶¶40 nor 86 contains the words "fraud," "deceit," "misrepresentation," or any other phrase or term charging the Underwriter Defendants with intentional or reckless misconduct. On the contrary, in ¶40, the Complaint alleges that defendants made "untrue statements" about the formation of the SureBeam Brasil joint venture. While in ¶86, the Complaint alleges in the language of §11 itself that the defendants' statements attributing revenue to the Tech Ion venture were "untrue and omitted material facts necessary to make defendants' statements not misleading." Thus, the Underwriter Defendants' argument that plaintiffs' §11 claim is a fraud claim, and, therefore, subject to Rule 9(b)'s particularity requirement, must be rejected as inconsistent with not only the actual allegations of the Complaint, but also controlling Ninth Circuit law.

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[7] Numerous other decisions are in accord. *See, e.g., In re Initial Pub. Offering Sec. Litig.*, 241 F. Supp. 2d 281, 296 (S.D.N.Y. 2003) (holding that because plaintiffs' §11 claim "is not a fraud claim, ***Rule 8(a)*** applies," and not Rule 9(b)) (emphasis in original); *Kensington Capital Mgmt. v. Oakley, Inc.*, [1999 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶90,411, at 91,854-55 (C.D. Cal. 1999); *see also Neuberger v. Shapiro*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶90,261, at 91,155 (E.D. Pa. 1998) (Rule 9(b) not applicable to claim under §11 where complaint "ma[de] no mention of intentional or reckless violations of the securities laws"); *Degulis v. LXR Biotechnology*, 928 F. Supp. 1301, 1310 (S.D.N.Y. 1996) (Rule 9(b) inapplicable to §§11 and 12(2) claims even where §10(b) fraud claims were also alleged); *In re In-Store Advertising Sec. Litig.*, 878 F. Supp. 645, 650 (S.D.N.Y. 1995); *Nelson v. Paramount Communs.*, 872 F. Supp. 1242, 1246 (S.D.N.Y. 1994); *In re AnnTaylor Stores Sec. Litig.*, 807 F. Supp. 990, 1003 (S.D.N.Y. 1992); *In re Consumers Power Co. Sec. Litig.*, 105 F.R.D. 583, 594 (E.D. Mich. 1995).

The Underwriter Defendants try to overcome this fatal defect in their argument by directing the Court's attention to other paragraphs in the Complaint that contain allegations which the Underwriter Defendants claim sound in fraud. However, this misdirection play must fail. As a threshold matter, according to the Underwriter Defendants, none of the allegations in the Complaint apply to them, except for those contained in ¶¶40 and 86, and as demonstrated above, those allegations state negligence, not fraud, claims.

Moreover, under controlling Ninth Circuit law, when plaintiffs base their §11 claim entirely on a unified course of fraudulent conduct that is inadequately pled under Rule 9(b), the district court should disregard the averments of fraud and examine the remaining allegations to determine if they state a claim under §11, bearing in mind that allegation of the non-fraudulent conduct need only satisfy the ordinary notice pleading of Rule 8(a). *See Vess*, 317 F.3d at 1104-05 ("[I]f particular averments of fraud are insufficiently pled under Rule 9(b), a district court should "disregard" those averments, or 'strip' them from the claim. The court should then examine the allegations that remain to determine whether they state a claim.").[8] Under this test, the Complaint clearly states a claim for relief under §11 and the Underwriter Defendants' motion to dismiss should be denied.[9]

F. The Complaint Need Not Allege Reliance in Connection with the Alleged Class Period after May 15, 2002

Lastly, the Underwriter Defendants' argument that the portion of the §11 claim representing shareholders who purchased their SureBeam stock after May 15, 2002 should be dismissed for the

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[8] *See also Lone Star Ladies Inv. Club*, 238 F.3d at 368 ("Where averments of fraud are made in a claim in which fraud is not an element, an inadequate averment of fraud does not mean that no claim has been stated. The proper route is to ***disregard*** averments of fraud not meeting Rule 9(b)'s standards and then ask whether a claim has been stated."); *NationsMart*, 130 F.3d at 315 ("The only consequence of a holding that Rule 9(b) is violated with respect to a §11 claim would be that any allegation of fraud would be ***stripped from the claim***. The allegations of innocent negligent misrepresentation, which are at the heart of a §11 claim, would survive.").

[9] *In re Stac Elecs. Sec. Litig.*, 89 F.3d 1399 (9th Cir. 1996), *cert. denied*, 1997 U.S. LEXIS 1494 (1997), upon which the Underwriter Defendants rely, actually supports plaintiffs' position here. In *Stac*, the Ninth Circuit held that Rule 9(b)'s particularity pleading requirements "apply to claims brought under Section 11" only when "they are grounded in fraud." *Id.* at 1404-05. *Stac* confirms that Rule 9(b) is inapplicable to §11 claims that are grounded in negligence. *Id.* As the court acknowledged, "the scienter requirement of Rule 9(b) does not apply to Section 11 claims, as such claims may be based on negligent or innocent misstatements or omissions." *Id.* at 1405 n.3.

Complaint's failure to plead reliance must also fail. Underwriter Defendants' Mem. at 11-12. Under §11, plaintiffs need not plead reliance in order to state a claim for relief, unless the plaintiffs acquired their shares after the issuer has generally made available to purchasers an earnings statement covering a period of at least 12 months after the effective date of the IPO. *See* 15 U.S.C. §77k(a).

Here, by ignoring the plain language of the statute and cobbling together two separate earning statements, the Underwriter Defendants contend that the 12 month period envisioned by §11 expired on May 15, 2002. In fact, however, SureBeam did not issue a ***single*** financial statement covering a 12-month period after the effective date of the IPO until March 31, 2003. Accordingly, the Underwriter Defendants improper and premature attempt to limit the length of the Class Period should be rejected and their motion to dismiss denied.

IV. CONCLUSION

For all of the foregoing reasons, the Underwriter Defendants' motion to dismiss the §11 claim against them in the Complaint should be denied. In the alternative, plaintiffs respectfully request leave to amend. *See Partington v. Bugliosi*, 56 F.3d 1147, 1162 (9th Cir. 1995) (leave to amend "shall be freely given when justice so requires").

DATED: July 29, 2004

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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 THE UNDERWRITER DEFENDANTS' MOTION TO DISMISS THE §11 CLAIM AGAINST THEM IN THE 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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