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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

In re NETOPIA, INC. SECURITIES LITIGATION	Master File No. C-04-3364-RMW
	CLASS ACTION
This Document Relates To: ALL ACTIONS.	MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO ALL DEFENDANTS' MOTIONS TO DISMISS AND/OR STRIKE
	DATE: December 9, 2005 TIME: 9:00 a.m. COURTROOM: The Honorable Ronald M. Whyte

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SECONDARY AUTHORITY

Lead Plaintiffs James P. Levy and David M. Simon (collectively "Plaintiffs") hereby respond to Defendants' Notice of Motion and Motion to Dismiss, or in the Alternative to Strike Allegations from, Plaintiffs' Consolidated Amended Complaint ("Netopia Mem."), filed by Alan B. Lefkof ("Lefkof"), David A. Kadish ("Kadish") and Netopia, Inc. ("Netopia" or the "Company"), and joined by Thomas A. Skoulis ("Skoulis") and William D. Baker ("Baker") (collectively, "Defendants"). Plaintiffs also hereby respond to Defendant William D. Baker's (1) Notice of Joinder and Joinder to Defendants' Notice of Motion and Motion to Dismiss, or in the Alternative to Strike Allegations from, Plaintiffs' Consolidated Amended Complaint and (2) Notice of Motion and Motion to Dismiss Allegations from Plaintiffs' Consolidated Amended Complaint; Memorandum of Points and Authorities ("Baker Mem.").

I. INTRODUCTION

Defendants have actually conceded that Plaintiffs' Consolidated Amended Complaint (the "Complaint") states a valid claim for securities fraud. Despite boldly claiming that this "case is truly much ado about nothing," Defendants' motions are nothing more than a desperate attempt at "damage control" for their blatant securities fraud, described in painstaking factual detail in the Complaint. Significantly, none of the Defendants dispute that the Complaint properly alleges ***every*** element (*i.e.*, falsity, scienter, materiality, transactions causation, and loss causation) of a violation of §10(b) of the Securities and Exchange Act of 1934 ("Exchange Act"), with respect to the overstated revenue and earnings reported for the fourth quarter ended September 30, 2003 (first reported on November 5, 2003), attributable to a purported "transaction" between a Netopia customer (ICC) for the School District of Philadelphia ("Philadelphia"). ¶¶32-112; 119-124.[1]

Defendants' desperate attempts at "damage control" take several forms, each of which should be rejected. First, Defendants' argument that ***some*** of Plaintiffs' detailed "loss causation" allegations (*i.e.*, factual allegations concerning drops in the price of Netopia stock) do not satisfy the Supreme Court's decision in *Dura Pharms., Inc. v. Broudo*, 544 U.S. 588, 125 S. Ct. 1627 (2005), is not only

[1] All paragraph references ("¶__") refer to paragraphs in the Complaint, unless otherwise indicated.

completely without merit, but does not address other stock drops which clearly were causally related to the fraud. Significantly, Defendants do ***not*** dispute that the Complaint properly alleges "loss causation" under *Dura* with respect to the overstatement of Netopia's September 30, 2003 financial results, and do ***not*** dispute that the losses from the stock price drops beginning in July 2004 were causally related to the Philadelphia fraud. ¶¶108-112. Instead, Defendants merely, and erroneously, argue that ***other*** factual allegations describing stock drops in January, February and April 2004 (*i.e.*, the price drops before July 2004) do not satisfy *Dura* because these stock drops did not result from an express ***admission*** of fraud by Defendants. As discussed below, nothing in *Dura* (or the recent decision from the Ninth Circuit interpreting *Dura*, *In re Daou Sys., Inc.*, 411 F.3d 1006, 1026-27 (9th Cir. 2005)), even remotely suggests such a draconian "loss causation" pleading requirement. As the Complaint explains – in great factual detail – how the drops in the price of Netopia stock in January, February and April 2004 directly resulted from the overstated September 30, 2003 financial results, the Complaint more than amply satisfies the "loss causation" pleading standards under *Dura* and *Daou*.

Second, the Complaint properly alleges claims attributable to Defendants' misrepresentations about the reasons for Netopia's revenue from Swisscom (Netopia's largest customer) when Defendants reported Netopia's financial results for the first quarter ended December 31, 2003. As discussed below, Defendants affirmatively misrepresented that Swisscom's increased revenue and orders from Swisscom were due to "increased demand," when Defendants knew and concealed that the Swisscom revenue results were not due to "increased demand," but from stuffed sales channels that deceptively inflated revenues; indeed, Defendants concealed that Netopia had not shipped its products to Swisscom by air, as had been the normal practice, but instead placed the products "on a boat" for Swisscom in the last days of December 2003 in order to generate these revenues. Contrary to Defendants' arguments, the detailed factual allegations more than sufficiently show that Defendants' statements concerning Netopia's December 31, 2003 revenue from Swisscom were not only false when made, but were made knowingly or recklessly. Moreover, contrary to the arguments of Baker and Kadish, the Complaint more than amply attributes these misrepresentations concerning the Swisscom revenue to these Defendants.

Third, the Complaint properly alleges that Kadish is both primarily and secondarily liable for the material misrepresentations alleged. Kadish is primarily liable under §10(b) because the false statements are directly attributable to Kadish. As discussed below, Kadish is expressly alleged to have ***created*** the fraudulent purchase order from ICC in connection with Philadelphia, drafted the false press releases reporting the overstated financial results, drafted the scripts of the investor conference calls at issue in the Complaint, devised the attempted "cover-up" of the fraudulent transaction with ICC concerning Philadelphia, and significantly benefited from the fraud by selling 83% of his Netopia stock during the Class Period (his first sales in almost four years). Similarly, these facts vividly demonstrate that Kadish is the classic "control person" within the meaning of §20(a).

Finally, Defendants' attempt to conceal the extensive evidence of Defendants' previous use of ICC (*i.e.*, before the Class Period, November 6, 2003 through and including August 16, 2004) to fraudulently report overstated financial results should be rejected. Specifically, the Complaint alleges that Defendants had previously used a fraudulent "contingent sale" with ICC to supply Netopia's product to the Chicago Public Schools ("Chicago") to overstate Netopia's financial results for the third quarter ended June 30, 2002 (reported on July 23, 2002), and alleges that Defendants decided to use ICC, again, in connection with Philadelphia in order to report the overstated financial results during the Class Period. These factual allegations concerning Defendants' prior use of ICC (in relation to Chicago) to overstate Netopia's financial results prior to the Class Period should not be stricken, as they not only serve as important factual background to understanding Defendants' use of ICC to carry out the fraudulent overstatement of revenue and earnings reported during the Class Period with respect to Philadelphia, but they are additional evidence of Defendants' scienter. As the Complaint specifically alleges that Defendants knew from the Chicago transaction that ICC would not agree to issue a purchase order that contained an unconditional payment obligation, but, instead, required Netopia to agree that ICC would ***not*** have to pay Netopia ***unless and until*** the potential customer (*i.e.*, Chicago) paid ICC. These detailed allegations concerning Chicago further confirm that Defendants acted with scienter when they overstated the financial results issued during the Class Period through their use of the purported contingent sale with ICC for Philadelphia.

While Defendants may pretend that this case is "much ado about nothing," Defendants do not challenge the sufficiency of the allegations that they ***intentionally*** overstated Netopia's financial results. Moreover, others apparently take issue with Defendants' view: Netopia's auditors have resigned; Netopia and Lefkof have admitted to securities laws violations asserted by the United States Securities and Exchange Commission ("SEC"); the SEC has issued "Wells Notices" describing the SEC's intention to prosecute Baker and Skoulis for accounting fraud; and the United States Attorney is now conducting its own investigation. Baker and Skoulis have been fired, and other former employees have come forward with detailed evidence of the fraud, including e-mails and other evidence detailing the lurid story.

II. SUMMARY OF THE FACTUAL ALLEGATIONS IN THE COMPLAINT

A. The Class and Defendants

Plaintiffs brought this class action on behalf of all persons who purchased the common stock of Netopia during the Class Period. ¶1. The Defendants are: Netopia, a corporation based in Emeryville, California (¶7); Lefkof, the President, Chief Executive Officer ("CEO"), and a member of the Company's Board of Directors during the Class Period (¶8); Baker, the Senior Vice President and Chief Financial Officer ("CFO") of Netopia during the Class Period (¶9); Kadish, the Senior Vice President, General Counsel, and Secretary of Netopia during the Class Period (¶10); and Skoulis, the Senior Vice President and General Manager of Netopia during the Class Period (¶11).

B. The Chicago Transaction

In May 2002, ICC agreed to provide Netopia with a $1,593,000 "purchase order" for Netopia's products (the "Chicago Purchase Order"), which expressly provided that ICC would not have to pay for the products unless and until ICC was actually paid by Chicago. ¶¶27-28. Skoulis told Peter Frankl ("Frankl"), a Netopia sales person dealing with ICC, that Netopia would accept these "contingent" payment terms in mid-May 2002. ¶25.

On May 23, 2002, Lefkof and Skoulis received and reviewed a fax of the Chicago Purchase Order containing these contingent payment terms on May 23, 2002. ¶26. Lefkof and Skoulis then conducted a conference call on May 23, 2002, in which, *inter alia*, Lefkof specifically asked "how is the payment going to work" and was told by Frankl in response that "Netopia had agreed that ICC

would not have to pay Netopia unless and until ICC received payments from Chicago." ¶¶26-27. Despite knowing that ICC's obligation to pay Netopia was wholly contingent, Netopia improperly included all of the $1,593,000 under the Chicago Purchase Order in Netopia's reported financial results for the third quarter ended June 30, 2002 (reported to the public on July 23, 2002). ¶29. The $1,593,000 order from ICC was the largest single software order in Netopia's history, and constituted over 29% of Netopia's reported software revenue of $5.468 million for the quarter ended June 30, 2002. *Id.*

Netopia subsequently was forced to restate the recognition of the approximately $1.593 million in revenue recognized for the quarter ended June 30, 2002, after the resignation of Netopia's auditors and an internal investigation, because it constituted a "contingent sale" in violation of Generally Accepted Accounting Principles ("GAAP"). ¶31. As discussed below, the Defendants do not dispute that they knew that payment by ICC to Netopia under the Chicago Purchase Order was wholly contingent upon the payment from Chicago to ICC, when they overstated Netopia's June 30, 2002 financial results by including the $1,593,000 in revenue attributable to the Chicago Purchase Order with ICC for the quarter ended June 30, 2002.[2]

C. The Purported Philadelphia Transaction

In the spring of 2003, Frankl and ICC began working on another possible deal, this time to sell Netopia's products to Philadelphia, under which Philadelphia would purchase Netopia's products from ICC. ¶32.[3] Throughout the spring and summer of 2003, Frankl kept Lefkof, Skoulis, Kadish and Baker apprised of the attempts to convince Philadelphia to buy, and obtain governmental funding for, a purchase of Netopia's products from ICC. ¶¶33-34.

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[2] As discussed below, the Complaint does not allege that the overstatement of Netopia's June 30, 2002 financial results operated to inflate Netopia's stock price during the Class Period, and Plaintiffs do not seek recovery on behalf of the Class arising out of Defendants' overstatement of Netopia's revenue and net income for the quarter June 30, 2002.

[3] The possibility of doing business with Philadelphia was prompted by the fact that Philadelphia's CEO was a friend of David Andalcio ("Andalcio"), the head of ICC. *Id.*

On September 25, 2003 (five days before the end of the fourth quarter ended September 30, 2003), Lefkof and Skoulis called Frankl about the progress of the efforts by ICC to convince Philadelphia to purchase, and obtain funding for, Netopia's products. *Id.* In the call, Lefkof stated that an order from ICC for Philadelphia would be very important for Netopia's quarterly "numbers" and would help the Company "hit" Wall Street earnings estimates. ¶35. Lefkof then asked Frankl whether there "is any way you can get this deal before Tuesday [September 30, 2003]?" *Id.* When Frankl responded that Philadelphia did not currently have the money in its budget to purchase Netopia's products from ICC, and that Philadelphia would not likely obtain funding until March 2004, Lefkof (who obviously did not care whether Philadelphia could pay) then asked, "do you think the guys at ICC would be willing to place the order?" *Id.* Frankl said that ICC might agree to "purchase" Netopia's product as long as ICC did not have to pay for the product unless and until Philadelphia paid ICC (*i.e.*, the same terms as the earlier Chicago transaction). *Id.* Lefkof responded to Frankl that Netopia would accept an ICC order on those terms, and then asked Frankl to contact ICC to find out whether ICC would give Netopia a purchase order. *Id.*

Frankl then called ICC, stated to Andalcio (the head of ICC) that he had just spoken with Lefkof, explained that an order from Philadelphia was crucial for Netopia to "hit its numbers for the quarter," and that Lefkof wanted to know whether ICC would place an order "now." ¶36. Andalcio responded that he was "uncomfortable" giving Netopia a purchase order (due to the fact that Philadelphia had not given ICC a purchase order), but would be willing to give Netopia a purchase order by September 30, 2003 as long as Netopia agreed that ICC would not have to pay Netopia unless and until Philadelphia gave ICC an order and paid ICC for the Netopia products, and Netopia agreed to charge ICC a lower price for the products. *Id.* In response, Frankl told Andalcio that he would speak with Lefkof, and call him back. *Id.*

On September 25, 2003, after completing his call with Andalcio, Frankl called Skoulis, and Skoulis set up a "conference call" between Lefkof and Skoulis and Frankl. ¶37. During this conference call, Frankl reported to Lefkof and Skoulis that Andalcio said that ICC would issue a purchase order to Netopia, but that ICC would only do so if Netopia agreed that ICC would not have to pay Netopia for the products unless and until Philadelphia gave ICC an order for the products and

paid ICC for the products, and Netopia agreed to provide an additional discount. *Id.* Lefkof responded, "Well Peter, that's fine. Get the order." *Id.*

Lefkof and Skoulis then instructed Frankl to provide the terms and all of the information concerning the proposed transaction to Kadish because ***Kadish wanted to draft a purchase order for ICC***. ¶¶37, 39-40. Kadish then proceeded to create a purchase order that purported to come from ICC on his own word processing system (*i.e.*, one that looked like an authentic ICC purchase order), and called Frankl to assist him. ¶42. During this call, Frankl asked Kadish what he was going to write down as payment terms in the purchase order; Kadish abruptly responded: "Nothing." *Id.*[4] Shortly thereafter, Kadish sent Lefkof, Skoulis, and Frankl an e-mail, dated September 26, 2003, that read, "Here is the form of PO we will receive," and attached to this e-mail was a purchase order, dated September 29, 2003, from ICC to Netopia, in the amount of $750,400 (the "Philadelphia Purchase Order"); as Kadish had told Frankl, the Philadelphia Purchase Order did not contain ***any*** payment terms. ¶43. Lefkof and Skoulis then reviewed the purchase order drafted by Kadish, and ICC signed it on September 30, 2003. ¶¶43, 45.

In late-October 2003, ICC told Frankl that Philadelphia's CEO had informed ICC that Philadelphia had decided that it was not going to purchase any of Netopia's products; Philadelphia's CEO also explained that if ICC and Netopia wanted to sell Philadelphia in the future, they would have to begin a new sales effort to convince other Philadelphia employees to purchase the products and obtain budgetary funding for any such purchase. ¶51. Frankl immediately informed Skoulis of the fact that Philadelphia had decided that it was not going to purchase Netopia's products (including the $750,400 in products referenced in the Philadelphia Purchase Order), who then told Lefkof of these adverse facts. *Id.* Lefkof immediately ordered Netopia's highest ranking salesperson (Skoulis) and Netopia's highest ranking financial officer (Baker) to personally devote their time and effort to convince Philadelphia to purchase Netopia products at least equal to the $750,400 referenced in the

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[4] Netopia's internal accounting policy required all purchase orders received from customers to set forth the payment terms in order for the Company to recognize revenue, and Netopia's standard payment terms were "net 30." *Id.*

Philadelphia Purchase Order, including making personal visits to Philadelphia. ¶52. On November 4, 2003, Skoulis traveled to Philadelphia in furtherance of the new sales efforts to convince Philadelphia to purchase Netopia's products from ICC, but was unsuccessful. ¶53. Thus, as of November 5, 2003 (the date of the Netopia press release reporting the financial results for the fourth quarter ended September 30, 2003), Philadelphia had not agreed to purchase even $1 of Netopia product from ICC.

In early November 2003 (upon learning that Netopia had not received payment of the $750,400 from ICC within 30 days of the Philadelphia Purchase Order), representatives of KPMG questioned Defendants Baker, Kadish and Lefkof about whether it was appropriate to recognize the $750,400 attributable to the Philadelphia Purchase Order. ¶54. In November 2003, Percy Sanders ("Sanders"), Netopia's Collections Manager, called Frankl, and indicated that Netopia had not yet received any payment from ICC in connection with the Philadelphia Purchase Order. Frankl responded that Sanders should speak with Defendant Baker (Sanders' boss) concerning the transaction because there was "nothing due." ¶55. Shortly after the completion of the call with Sanders, Defendant Baker called Frankl to ask for contact information for ICC, and Frankl reminded Defendant Baker that Netopia was not entitled to be "paid a penny" by ICC until Philadelphia paid ICC. ¶55. Defendant Baker also told Frankl that he wanted to be included in upcoming visits to Philadelphia in order to gauge whether Philadelphia would move forward with a purchase. *Id.*

D. Defendants' Suspicious, Unusual and Substantial Stock Sales

On November 3 or 4, 2003, Lefkof conducted a Company-wide conference call with all Netopia employees in anticipation of the November 5, 2003 press release. ¶56. During that internal conference call, Lefkof told the employees that he expected a sharp increase in Netopia's stock price after the September 30, 2003 financial results were released on November 5, 2003, and Lefkof instructed the employees that they should not sell their Netopia shares, but, instead, they should hold their stock and even buy more. *Id.* Lefkof's prediction about Netopia's stock price came true. After reporting net income of $222,000 (or $0.01 per share) for the fourth quarter ended September 30, 2003 (the Company's first quarter with net income since the quarter ended June 30, 2000) (¶¶58-59),

on November 5, 2003, the price of Netopia stock increased from $12.10 per share to $19.90 per share. ¶59.[5]

On November 10, 2003 (just days after Lefkof issued instructions to employees to not sell their Netopia stock and just three trading days after the November 5 press release), Lefkof and all of the other Defendants began an avalanche of selling their own Netopia stock. ¶64. In the 30 trading days after the news was released, Lefkof, Baker, Kadish, and Skoulis ***sold over 228,000 Company shares for over $3.33 million*** in proceeds, and in total during the Class Period the four Individual Defendants sold over 329,000 shares for over $4.80 million in proceeds. ¶119. For the entire Class Period, all insiders sold over 668,000 Netopia shares for proceeds of over $9.75 million. ¶119.

Defendants' stock sales were suspicious in amount and timing, and were dramatically out of line with their prior sales of Netopia stock:

- Lefkof – after Class Period sales of 95,000 shares for over $1.38 million, Lefkof directly ***held no shares*** in Netopia; he ***sold no shares*** for 23 months prior to the Class Period. ¶120.
- Baker – after Class Period sales of 67,984 shares for over $944,000, Baker held only 1,516 shares in Netopia; he ***sold no shares*** in over 16 months prior to the Class Period. ¶121.
- Kadish – after Class Period sales of 118,850 shares for over $1.80 million, Kadish held only 24,015 shares in Netopia; he ***sold no shares*** in over 44 months prior to the Class Period. ¶122.
- Skoulis – after Class Period sales of 47,500 shares for over $668,000, Skoulis held only 2,015 shares in Netopia; he ***sold no shares*** in over 45 months prior to the Class Period. ¶123.

E. The Efforts to "Cover-Up" the Purported Philadelphia Transaction

Knowing that Philadelphia had not agreed to purchase any Netopia products by November 5, 2003, the Complaint details how Baker and Skoulis spent approximately the next six months (beginning with Defendant Skoulis' November 4, 2003 meeting) trying to convince Philadelphia to purchase Netopia's products (¶¶65(a)-(b), 66), including offering to pay $37,500 to a

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[5] Due to the very high profit margins of over 95% on Netopia's software sales, the $750,400 "sale" to ICC accounted for approximately $700,000 in income – much more than the entire $222,000 in net income for the quarter.

third party that already had a contract to sell computers to Philadelphia (Gateway), if Gateway could get Philadelphia to buy Netopia's products from Gateway. ¶66. By April 2004, as a result of the fact that Philadelphia had not given ICC any order (or obtained funding for a $750,400 order), Lefkof and Kadish were becoming extremely concerned about the fact that Netopia was still carrying the $750,400 as part of its reported accounts receivables. Indeed, by March 31, 2004, Netopia's Days Sales Outstanding ("DSO") (which measures the amount of time taken by Netopia to collect its outstanding accounts receivables) had materially increased from 58 to 63 (at least partly as a result of the failure to receive payment of the $750,400 attributable to the Philadelphia Purchase Order). ¶67.

As a result, and in order to purportedly justify Netopia's decision to continue carrying the $750,400 in accounts receivable attributable to the Philadelphia Purchase Order, Defendants devised a plan designed to convince Andalcio and ICC to provide Netopia with a writing that purported to confirm that ICC had agreed to enter into a "payment plan" with respect to the $750,400 attributable to the Philadelphia Purchase Order. ¶68. The Complaint proceeds to detail the numerous face-to-face meetings, e-mails, and telephone calls between Lefkof, Kadish, Baker, and Skoulis and Andalcio between April and early-July 2004, in which Defendants unsuccessfully sought to convince ICC to agree to go along with the "cover-up." ¶¶69-94. The plan to "cover-up" the fraud finally unraveled in early-July 2004, when ICC refused Kadish's demand that ICC sign a backdated document (backdated to June 30, 2004, the final day of Netopia's fiscal quarter). ¶¶93-94.

F. Defendants' False and Misleading Statements Concerning Sales to Swisscom, Netopia's Largest Customer

The Complaint also alleges material misrepresentations concerning Netopia's financial results for the first quarter ended December 31, 2003, January 20, 2004 and February 17, 2004, concerning the reasons underlying Netopia's $8.232 million in revenue from Swisscom, its largest customer. ¶¶113-118. In a January 20, 2004 press release and a January 20, 2004 conference call, as well as Netopia's February 17, 2004 quarterly SEC filing, Defendants reported excellent revenues for the quarter ended December 31, 2003 of $28.6 million – which Defendants represented was primarily attributable to $8.232 million in sales from Swisscom, constituting a 41% sequential

increase. ¶¶113-115. Defendants represented that the $8.232 million in sales from Swisscom was due to Swisscom's "increased demand" and Swisscom's successful year-end promotions. *Id.*

Unbeknownst to Class members, Defendants misrepresented the true circumstances underlying the $8.232 million in revenue from Swisscom. In a conference call on January 20, 2004 (the "January 20 Conference Call"), Lefkof said that the reason for the dramatic increase in Swisscom revenue was that "Swisscom had a very, very good year-end, as [Swisscom] ran a number of year-end promotions." ¶113. In the Company's Report on Form 10-Q for the quarter ended December 31, 2003 (filed on February 17, 2004), Defendants repeated the misrepresentation about the reason for the huge increase in Swisscom's purchase of Netopia products: "Volumes to Swisscom increased as their demand for our Internet equipment products increased for their residential broadband Internet services." ¶114. Lefkof also falsely represented that Netopia's Swisscom revenue for the quarter ended March 31, 2004 would be approximately the same as the $8.232 million reported from Swisscom in the December 31, 2003 quarter. ¶113.

What Defendants knew had occurred to obtain the $8.232 million in revenue from Swisscom first reported in January 2004 – and which would result in materially lower Swisscom revenue for the following quarter (*i.e.*, the second quarter ended March 31, 2004) – became apparent three months later, when Defendants disclosed Netopia's disastrous financial results for the quarter ended March 31, 2004 – a loss of $0.07 per share on revenues of $21.9 million (as compared to consensus earnings estimates of $0.05 per share and revenue of $28 million). ¶116. Defendants represented that these poor results were due, in part, to Netopia's Swisscom revenues, which had ***plummeted over 58%*** from Swisscom revenues for the previous quarter. *Id.*

During a conference call with analysts and investors on April 19, 2004 (the "April Conference Call"), Defendants acknowledged that the excellent revenue results attributable to Swisscom from the December 31, 2003 quarter had not been the result of "increased demand" from Swisscom, or a "very, very good year-end," but had instead only been realized through Netopia's early shipments of unneeded product to Swisscom. *Id.* Specifically, Defendants disclosed that the Swisscom revenue reported for the December 31, 2003 quarter included millions of dollars of "excess" product that had been placed on a "boat" in the final days of December 2003 (and thereby

booked as revenue for the December 31, 2003 quarter) for delivery to Swisscom during the first quarter of 2004. *Id.* These disclosures also confirmed that the representation on January 20, 2004 that Swisscom revenue for the quarter ended March 31, 2004 would be approximately the same as the $8.232 million reported from Swisscom in the December 31, 2003 quarter was grossly misleading, as Defendants knew that Swisscom did not have "increased demand" but, to the contrary, Defendants knew that there would be a substantial reduction in Swisscom orders during the quarter ended March 31, 2004. ¶¶116-117. Following the April Conference Call, the price of Netopia stock dropped significantly from $11.35 per share on April 19, 2004, to $7.17 per share on April 20, 2004. ¶116.

G. Defendants Are Forced to Make Disclosures Concerning the $750,400 in Revenue Recognized in the Fourth Quarter Ended September 30, 2003

In the beginning of July 2004, after the three month campaign of face-to-face meetings, e-mails, and telephone calls designed to bully ICC into signing a false confirmation of the $750,400 had failed, Defendants were forced to make disclosures concerning the $750,400 in revenue recognized for the fourth quarter ended September 30, 2003. ¶¶67-95. On July 6, 2004, Netopia issued a press release which "pre-announced" abysmal financial results for the third quarter ending June 30, 2004, including a quarterly net loss of $0.13 - $0.15 per share. ¶108. In the press release, the Company stated:

> Netopia also currently expects operating expenses for the third fiscal quarter to include a specific bad debt charge of approximately $750,000 relating to non-payment from a software reseller. The Company continues to work with the reseller to resolve the matter.

Id. During a July 7, 2004 conference call with analysts and investors (the "July 7 Conference Call"), Defendants misleadingly represented:

> [I]n the past they have come through, and it is just that their balance sheet has worsened, and therefore the conservative accounting was to take the bad-debt charge in June. As I mentioned to an earlier questioner, they are not in the Chapter 11. I do not expect them to go that route, and as a result, we continue to work with them.

Id. While Defendants informed the market that the $750,400 would be written off, Defendants failed to disclose any of the true facts concerning ICC and Philadelphia, including the fact that the

$750,400 in revenue was improperly recognized as revenue, and further misrepresented the non-payment was due to ICC's "balance sheet."

H. The Audit Committee Investigation, the SEC Investigation, and the Resignation of Netopia's Auditors

On July 22, 2004, Defendants disclosed that Netopia's audit committee was conducting an investigation of Netopia's accounting and reporting practices, including with respect to the revenue recognition of software licenses and fees in two transactions with a software reseller. ¶109. On August 17, 2004, Netopia disclosed that an SEC investigation had been commenced and that Netopia would not be able to file its 10-Q until the completion of the audit committee investigation. ¶110. On September 10, 2004, KPMG resigned as independent auditors, advising that Netopia's audited financial statements for the fiscal year ended September 30, 2003 should no longer be relied upon (¶111); six days later, when Netopia actually announced the resignation, Netopia disclosed that: (1) KPMG requested certain information from the audit committee and ***Netopia declined to provide that information***; (2) if Netopia had not provided all or some of the information requested, then KPMG would have issued an audit scope limitation with respect to that matter; and (3) if the information had been provided, it might (a) cause KPMG to be unwilling to rely on management's representations and (b) materially impact the fairness or reliability of its previously issued audit reports and the underlying financial statements. *Id.*

I. Skoulis and Baker Are Fired

On September 20, 2004, Netopia terminated Skoulis and Frankl due to the circumstances underlying the transaction with ICC and Philadelphia. ¶97. However, Kadish admitted to another Netopia employee (Mark Coumans, of Netopia's Netherlands office) that Frankl and Skoulis were fired as a "shield" for the conduct of Lefkof and Kadish concerning the problems with Swisscom. ¶97. On October 21, 2004, Netopia announced that Defendant Baker had resigned from the Company, but Baker was actually forced to resign. ¶98.

J. The Federal Investigations

Three federal investigations are currently being conducted with respect to the activities that occurred at Netopia during the Class Period. An SEC investigation was commenced in August 2004,

and was elevated to a formal investigation two months later. ¶124. Netopia and Lefkof recently admitted to securities laws violations asserted by the SEC, and Lefkof agreed to a resolution of those charges which includes monetary penalties; the SEC continues to pursue civil charges against Baker and Skoulis. The United States Attorney for the Northern District of California is conducting a criminal investigation concerning Netopia, following a referral from the SEC. *Id.* And, the Occupational Safety and Health Administration ("OSHA") is conducting an investigation concerning possible violations of the Sarbanes-Oxley Act of 2002, with respect to the improper manipulation of Netopia's stock price in connection with ICC and Philadelphia. ¶99.

III. THE STANDARD OF REVIEW

A. The Standard of Review on a Motion to Dismiss

It is well settled that "[a] complaint should not be dismissed unless it appears beyond doubt that the plaintiff cannot prove any set of facts that would entitle him or her to relief." *Nursing Home Pension Fund, Local 144 v. Oracle Corp.*, 380 F.3d 1226, 1229 (9th Cir. 2004). In considering Defendants' motion to dismiss, "[a]ll allegations of material fact made in the complaint are taken as true and construed in the light most favorable to the plaintiff." *No. 84 Employer-Teamster Joint Council Pension Trust Fund, v. America West Holding Corp.*, 320 F.3d 920, 931 (9th Cir. 2003), *cert. denied*, 540 U.S. 966 (2003).

Under the Private Securities Litigation Reform Act of 1995 ("PSLRA"), there are two pleading requirements for claims asserted under §10(b) of the Exchange Act. First, a complaint must identify each statement alleged to have been misleading and set forth the reason or reasons why the statement is misleading. 15 U.S.C. §78u-4(b)(1)(B). In order to satisfy this requirements of the PSLRA, the complaint need only allege a discrepancy between what the defendants publicly reported "and the allegedly true state of affairs" within the corporation. *Daou*, 411 F.3d at 1020-21 (district court's dismissal on grounds that "allegations lacked sufficient particularity to be actionable" under the PSLRA reversed).

Second, a complaint must allege "facts giving rise to a strong inference" that the defendant acted knowingly or recklessly when the misrepresentation was made. 15 U.S.C. §78u-4(b)(2). In evaluating whether the PSLRA's scienter pleading standard has been satisfied, the Court is required

to consider whether the totality of plaintiffs' allegations leads to a strong inference of scienter. *Daou*, 411 F.3d at 1022; *Oracle*, 380 F.3d at 1230 (same); *America West*, 320 F.3d at 938 (same). The Ninth Circuit has held that a strong inference of scienter may be shown by factual allegations showing significant GAAP violations (*Daou*, 411 F.3d at 1016, 1022), unusual or suspicious insider stock sales (*Oracle*, 380 F.3d at 1231-32; *Daou*, 411 F.3d at 1022, 1024), or direct involvement in the transactions underlying the misrepresentations (*Daou*, 411 F.3d at 1023; *America West*, 320 F.3d at 1234).[6]

B. The Standard of Review on a Motion to Strike

Motions to strike are generally viewed with disfavor and are not frequently granted. 2 James Wm. Moore, *Moore's Federal Practice & Procedure*, §12.37[l], at 12-93 (3d ed. 1997); *Naton v. Bank of Cal.*, 72 F.R.D. 550, 552 (N.D. Cal. 1976). The rationale for this standard is that "a case should be tried on the proofs rather than the pleadings." *Rennie & Laughlin, Inc. v. Chrysler Corp.*, 242 F.2d 208, 213 (9th Cir. 1957). Hence, motions to strike "'are generally not granted unless it is clear that the matter to be stricken could have no possible bearing on the subject matter of litigation.'" *Lazar v. Trans Union LLC*, 195 F.R.D. 665, 669 (C.D. Cal. 2000) (quoting *LeDuc v. Kentucky Cent. Life Ins. Co.*, 814 F. Supp. 820, 830 (N.D. Cal. 1992)).

IV. ARGUMENT

A. The Court Should Not Strike the Factual Allegations in the Complaint Concerning the Fraudulent Transaction Between Netopia and ICC Concerning Chicago

As discussed above, the Complaint specifically alleges that the Defendants first used ICC to report overstated financial results for the third quarter ended June 30, 2002, when Defendants fraudulently included revenue from a "contingent sale" with ICC to supply Netopia's products to Chicago. ¶¶21-29. Specifically, in May 2002, ICC agreed to provide Netopia with a $1,593,000 purchase order for Netopia's products (the "Chicago Purchase Order"), which expressly provided that ICC would not have to pay for the products unless and until ICC was actually paid by Chicago

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[6] As discussed below, allegations concerning "loss causation" are governed by Fed. R. Civ. P. 8. *Dura*, 125 S. Ct. at 1634.

for the products. *Id.* The Complaint alleges that Skoulis initially agreed that Netopia would accept these "contingent" payment terms in mid-May 2002, and that Lefkof and Skoulis received and reviewed a fax of the Chicago Purchase Order containing these contingent payment terms on May 23, 2002. ¶¶25-26. Lefkof and Skoulis then conducted a conference call on May 23, 2002 in which, *inter alia*, Lefkof specifically asked "how is the payment going to work," and was told by Frankl (the Netopia sales person) in response that "Netopia had agreed that ICC would not have to pay Netopia unless and until ICC received payments from Chicago." ¶¶26-27. Despite the fact that Lefkof and Skoulis knew that ICC's obligation to pay Netopia was wholly contingent upon payment by Chicago to ICC, Netopia improperly included all of the $1,593,000 under the Chicago Purchase Order in Netopia's reported financial results for the third quarter ended June 30, 2002 (reported to the public on July 23, 2002). ¶29.[7]

It is undisputed that Defendants' actions in recognizing the $1,593,000 in revenue from ICC were improper. There is no dispute that the inclusion of the $1,593,000 in revenue materially overstated Netopia's June 30, 2002 financial results; after the resignation of Netopia's auditors and an internal investigation, Netopia was forced to restate the $1,593,000 in revenue recognized for the quarter ended June 30, 2002 because it constituted a "contingent sale" in violation of GAAP. ¶31. Moreover, the Defendants knew that payment by ICC to Netopia under the Chicago Purchase Order was wholly contingent upon payment by Chicago to ICC when Netopia reported its financial results for the quarter ended June 30, 2002; indeed, in their motions to dismiss, none of the Defendants dispute that the Complaint properly alleges that the Defendants knowingly or recklessly overstated Netopia's June 30, 2002 financial results by including the $1,593,000 in revenue attributable to the Chicago Purchase Order with ICC. ¶¶24-28, 31.[8]

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[7] The $1,593,000 order from ICC was the largest single software order in Netopia's history, and constituted over 29% of Netopia's reported software revenue of $5.468 million for the quarter ended June 30, 2002. *Id.*

[8] Defendants seek dismissal of Plaintiffs' allegations concerning the Chicago Purchase Order under Rule 12(b)(6) on the ground that the improperly recognized revenue "could have no conceivable effect on Netopia's stock price" as of the commencement of the Class Period. Netopia Mem. at 9. However, the Complaint does ***not*** even allege that the overstatement of Netopia's

These detailed factual allegations describing Netopia's fraudulent use of ICC to report overstated financial results for the quarter ended June 30, 2002 should not be stricken from the Complaint. Contrary to Defendants' arguments, these factual allegations are not "redundant, immaterial, impertinent, or scandalous" under Rule 12(f). Not only do these allegation provide the factual "backdrop" for Defendants' fraudulent use of a purported "contingent sale" transaction with ICC in connection with Philadelphia to report overstated financial results during the Class Period, these allegations about the Chicago Purchase Order support a strong inference of fraudulent intent with respect to the similar Philadelphia Purchase Order and transaction which is at the heart of this case. From their knowledge of ICC in connection with the Chicago Purchase Order, Defendants knew that ICC would not agree to provide Netopia with a purchase order containing "unconditional" payment terms, and would only provide Netopia with a purchase order on the condition that ICC would not have to pay Netopia unless and until the potential customer (Chicago; Philadelphia) paid ICC. Accordingly, these allegations concerning Chicago are relevant to Plaintiffs' claims concerning Philadelphia because they further confirm Defendants' scienter with respect to the overstatement of Netopia's September 30, 2003 financial results to meet analysts' estimates.

Indeed, the Complaint expressly alleges that Lefkof (along with Skoulis) called Frankl on September 25, 2003 (five days before the end of the quarter) to find out whether Philadelphia was ready to give ICC an order for Netopia's products, explaining that such an order "would help Netopia 'hit' Wall Street earnings estimates." ¶35. When Frankl responded that ICC was not yet ready to place an order with ICC for Philadelphia (because Philadelphia did not have money in its budget to purchase Netopia's products, and would not likely have such money until March 2004),

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June 30, 2002 financial results operated to inflate Netopia's stock price during the Class Period, and ***expressly*** alleges that Plaintiffs ***only*** seek recovery on behalf of the Class arising out of Defendants' overstatement of Netopia's revenue and net income for the fourth quarter and year ended September 30, 2003 through the inclusion of $750,400 in revenue from the "contingent sale" with ICC with respect to Philadelphia and the Philadelphia Purchase Order, including the overstated accounts receivables reported for the quarters ended September 30, 2003, December 31, 2003, March 31, 2004, as a result of the improper inclusion of the improperly recognized (and uncollectible) $750,400 attributable to the Philadelphia Purchase Order. ¶¶100(a)-(e); 101-104. Indeed, the allegations concerning Chicago are included within a separate section of the Complaint entitled "Factual Background." ¶¶22-31.

Lefkof ***then*** asked "do you think the guys at ICC would be willing to place the order?" *Id.* When Frankl responded that ICC would not be willing to purchase the products from Netopia without an order from Philadelphia, but might be willing to make a "purchase" as long as ICC did not have to pay for it unless and until Philadelphia agreed to purchase the product and paid ICC, Lefkof stated that Netopia would accept an order from ICC under those conditions. *Id.* Similarly, the Complaint alleges that Kadish then used information from the Chicago Purchase Order itself to "create" a purchase order that looked like an authentic ICC purchase order, which – contrary to Netopia's internal accounting policy – did not contain ***any*** payment terms. ¶42.

As the allegations concerning Defendants' prior use of ICC to overstate Netopia's financial results prior to the Class Period are clearly pertinent and relevant to the allegations concerning Defendants' use of ICC to carry out the fraudulent overstatement of revenue and earnings reported during the Class Period with respect to ICC and Philadelphia, and their knowledge that ICC would not agree to pay Netopia unless and until ICC received payment from Philadelphia, they should not be stricken.

B. The Court Should Not Dismiss or Strike the Factual Allegations Showing that Losses from Stock Drops in January, February and April 2004 Were Caused by Defendants' Overstatement of Netopia's September 30, 2003 Financial Results

In ¶¶103-112 of the Complaint, Plaintiffs specifically allege and demonstrate – in great factual detail – how the Class suffered losses that were caused by Defendants' overstatement of Netopia's September 30, 2003 financial results attributable to the Philadelphia Purchase Order. In these paragraphs, Plaintiffs alleged and described how losses to Class members resulting from stock drops on January 21, 2004 (¶105), February 18-19, 2004 (¶106), April 20, 2004 (¶107), July 7, 2004 (¶108), July 23, 2004 (¶109), August 17, 2004 (¶110), September 16, 2004 (¶111), and February 1, 2005 (¶112) were caused by Defendants' overstatement of Netopia's September 30, 2003 financial results. Significantly, Defendants do not (and, indeed, cannot) dispute that the Complaint properly alleges that the losses of the Class were caused by Defendants' overstatement of Netopia's September 30, 2003 financial results, in accordance with the Supreme Court's ruling in *Dura*. ¶¶108-112; *see, e.g.*, Netopia Mem. at 14-16, and "Issues To Be Decided," Nos. 1(c), 2.

However, Defendants erroneously argue that the Court should dismiss or strike the factual allegations that demonstrate that losses from stock drops in January, February, and April 2004 were caused by Defendants' overstatement of Netopia's September 30, 2003 financial results. ¶¶105-107. Defendants' argument is ***solely*** that these stock drops are not alleged to have resulted from a ***specific disclosure that Netopia had engaged in fraudulent conduct*** with ICC concerning Philadelphia. *See*, *e.g.*, Netopia Mem. at 14-16. As discussed below, Defendants' argument is wholly without merit, and Plaintiffs' "loss causation" allegations in ¶¶105-107 amply satisfy the standards articulated in *Dura* and *Daou*.

1. The Principles Articulated in the *Dura* Decision

In *Dura*, the Supreme Court rejected the Ninth Circuit's pleading standard for loss causation (which required only that a plaintiff allege that he bought a security at artificially inflated prices), and held that a complaint must allege a causal connection between the misrepresentation and the loss suffered. 125 S. Ct. at 1634. While the Court explained that a plaintiff must ultimately "prove that the defendant's misrepresentation (or other fraudulent conduct) proximately caused the plaintiff's economic loss," the Court held that in order to properly allege "loss causation," a plaintiff need only plead a short, plain statement (under Fed. R. Civ. P. 8(a)(2)) that is sufficient "to provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind." *Dura*, 125 S. Ct. at 1633-34.[9] In holding that loss causation may be properly alleged in many ways, the Supreme Court in *Dura* ***refused*** to accept Defendants' argument here – that loss causation can only be shown by a stock drop that accompanies an admission or specific disclosure that prior statements were fraudulent.[10]

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[9] *See also In re Initial Pub. Offering Sec. Litig.*, No. MDL 1554 (SAS), 2005 U.S. Dist. LEXIS 12845, at *5 (S.D.N.Y. June 27, 2005) ("*Dura* did not establish what ***would*** be a sufficient loss causation pleading standard; it merely established what was ***not***.") (emphasis in original).

[10] As *Dura* author Justice Breyer noted at oral argument, the artificial inflation in the stock price "might come out in many different ways," not simply through an announcement by a corporate executive that "I'm a liar." *Dura Pharms., Inc. v. Broudo*, No. 03-932, 2005 U.S. TRANS LEXIS 4, at *37 (Jan. 12, 2005). Indeed, Justice Breyer specifically recognized the viability of a loss causation theory similar to that alleged here, where the corporate executive "doesn't say anything but it sort of oozes out as earnings reports come in, but it has to come out." *Id.*

Indeed, courts already applying *Dura* – including the Ninth Circuit Court of Appeals – have consistently held that there is no requirement that a complaint allege the stock price drop was caused by a specific admission that the prior statements were fraudulent. *See, e.g.*, *Daou*, 411 F.3d at 1026 (rejecting the district court's requirement of express "negative public statements, announcements or disclosures at the time the stock dropped that Defendants were engaged in improper accounting practices" to allege loss causation, the Court of Appeals held that it was sufficient under *Dura* to allege that stock drop was caused by reporting negative financial results which were the "direct result of prematurely recognizing revenue"); *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Inc.*, No. 05 Civ. 1898 (SAS), 2005 U.S. Dist. LEXIS 19506, at *58 (S.D.N.Y. Sept. 6, 2005) (court held that drop in value of securities that occurred when company reported decreased earnings expectations was sufficient to allege "loss causation" under *Dura*, where plaintiff alleged that the decreased earnings expectations were caused by the materialization of the concealed adverse facts; court rejected defendants' argument that a complaint must allege that a "corrective disclosure was revealed to the market"); *Sekuk Global Enters. v. KVH Indus. Inc.*, C.A. No. 04-306ML, 2005 U.S. Dist. LEXIS 16628, at **50-51 (D.R.I. Aug. 11, 2005) (loss causation properly alleged where stock price fell upon news of reduced quarterly revenues, even though company did not expressly attribute sales reduction to decreased sales of product alleged to be subject of scheme to manipulate revenues through channel stuffing, fictitious sales, and shipment of defective products); *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 510 (S.D.N.Y. 2005) (loss causation does not, as the defendants would have it, require a corrective disclosure followed by a decline in price); *Greater Pa. Carpenters Pension Fund v. Whitehall Jewelers, Inc.*, No. 04 C 1107, 2005 U.S. Dist. LEXIS 12971, at **15-17 (N.D. Ill. June 30, 2005) (no requirement that the complaint allege a specific direct disclosure or admission that prior financial statements were in fact false).

2. The "Loss Causation" Allegations in Paragraphs 105-107 Are Sufficient Under *Dura*

Plaintiffs' allegations that losses from stock drops on January 21, 204, February 18-19, 2004, and April 20, 2004 were caused by Defendants' overstatement of Netopia's September 30, 2003

financial results are more than sufficient under *Dura* and *Daou*. Specifically, ¶104 alleges as follows:

> Plaintiffs and other Class Members who purchased Netopia stock suffered losses caused by Defendants' overstatement of Netopia's financial results attributable to the Philadelphia Purchase Order. Through a series of reports and statements by Defendants beginning in January 2004, information was issued to the public that decreased and ultimately eliminated the artificial inflation caused by Defendants' overstatement of Netopia's financial results for the quarter ended September 30, 2003 in violation of GAAP due to the inclusion of the $750,400 fraudulently recognized as revenue from the "contingent sale" with ICC.

The Complaint then proceeds to describe how the stock drops on January 21, 2004, February 18 and 19, 2004, and April 20, 2004 were caused by reports by Defendants of adverse financial results that demonstrated that revenue expectations of securities analysts (set based upon Netopia's false and overstated September 30, 2003 financial results, first announced on November 5, 2003) would not be met. ¶¶105-107.

While it is true that these drops were not caused by direct ***admissions*** by Defendants that they had previously committed securities fraud with respect to ICC and Philadelphia, these drops were the direct result of the materialization of the overstated September 30, 2003 financial results, as the market recognized that Netopia's true financial condition was inconsistent and contrary to Netopia's reported (and overstated) September 30, 2003 financial results. ¶¶104-107. *Daou*, 411 F.3d at 1026. As these stock price decreases are specifically alleged to have removed some of the artificial inflation caused by the Defendants' overstatement of the September 30, 2003 financial results, Plaintiffs have more than adequately provided defendants with "some indication of the loss and the casual connection that the plaintiff has in mind" under *Dura, Daou*, and Fed. R. Civ. P. 8(a)(2).

C. The Complaint Properly Alleges Material Misrepresentations Concerning Netopia's December 31, 2003 Revenue from Swisscom

Plaintiffs have also properly alleged that Defendants made material misrepresentations concerning Netopia's revenue from Swisscom, Netopia's largest customer, for the first quarter ended December 31, 2003. ¶¶113-118. Specifically, in Netopia's January 20, 2004 press release, in the January 20, 2004 investor conference call, and in Netopia's Form 10-Q for the quarter ended December 31, 2003 (filed in February 2004), Defendants reported "excellent" quarterly revenues of

$28.6 million, which Defendants represented was primarily attributable to $8.232 million in sales to Swisscom (¶¶113-114). Defendants represented that the $8.232 million in Swisscom revenue was due to "increased demand" from Swisscom for Netopia's Internet equipment products and successful Swisscom promotions at year-end, and constituted a 41% sequential quarterly revenue increase. ¶¶113-115. Securities analysts regarded Netopia's strong revenue from Swisscom as a basis for recommending that investors purchase Netopia stock. ¶115. Unfortunately for Class members, Defendants' representations in January and February 2004 concerning the reasons for the $8.232 million in Swisscom revenue were false and misleading. ¶¶116-117.

On April 19, 2004, Defendants reported disastrous financial results for the second quarter ended March 31, 2004, consisting of a loss of $0.07 per share on revenues of $21.9 million (as compared to consensus earnings estimates of $0.05 per share and revenue of $28 million), and disclosed that these poor results were due, in part, to Netopia's Swisscom revenues for the second quarter, which had plummeted over 58% from the previous quarter. ¶116. During their April 19, 2004 conference call explaining these poor results, Defendants shocked investors by admitting that the $8.232 million Swisscom reported for the December 31, 2003 quarter had ***not*** been the result of "increased demand" from Swisscom or its successful promotions at year-end, but had actually been realized through Netopia's shipments of "excess" (*i.e.*, unnecessary and unneeded) product to Swisscom in the final days of December 2003 by "boat" (which would therefore be delivered when needed in 2004) rather than its normal delivery by plane. *Id.* Following the April Conference Call, the price of Netopia stock dropped significantly from $11.35 per share on April 19, 2004, to $7.17 per share on April 20, 2004. *Id.*

Plaintiffs' claims that Defendants made material misrepresentations concerning Netopia's December 31, 2003 revenue from Swisscom satisfy the PSLRA. First, the Complaint satisfies the PSLRA (15 U.S.C. §78u-4(b)(1)(B)) because it specifically identifies the statements on January 20, 2004 and February 17, 2004 concerning Netopia's $8.232 million in Swisscom revenue that are misleading (¶¶113-114), and explains in precise detail why these statements were misleading.

¶¶116-117. Nothing more is required to satisfy 15 U.S.C. §78u-4(b)(1)(B) of the PLSRA. *See, e.g.*, *Daou*, 411 F.3d at 1020-21.[11]

Second, Plaintiffs' factual allegations give rise to a strong inference of scienter under the PLSRA, as the allegations strongly infer that the misrepresentations were made knowingly or recklessly. Significantly, Defendants disclosed during the April Conference Call that the $8.232 million in Swisscom revenue reported was attributable to shipments of "excess" product (and not due to "increased demand" or promotions), and acknowledged that they ***knew*** that these shipments were "excess" when they placed the shipments on the boats rather than the normal method of shipment by air. ¶116. *See, e.g.*, *Daou*, 411 F.3d at 1023 (allegations of direct involvement sufficient to strongly infer scienter); *Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 948 (9th Cir. 2005) (in order to satisfy the PSLRA's scienter pleading standard, plaintiff need only allege that defendants knew their statements were false when made); *Oracle*, 380 F.3d at 1234 (public statements by defendants that they monitored the transaction underlying false representation sufficient to strongly infer scienter). Moreover, the Complaint alleges in detail that ***each*** of the Defendants obtained substantial financial benefits from these misrepresentations concerning Swisscom, by selling enormous amounts of Netopia stock that were "suspicious in timing and amount," immediately after making the misrepresentations on January 20, 2004 (and just before the

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[11] The Complaint also expressly – and properly – alleges that Defendants' misrepresentations concerning Swisscom caused Class members to suffer losses, in accordance with *Dura*. ¶116. As discussed above, the price of Netopia stock dropped from $11.35 per share on April 19, 2004 to $7.17 per share on April 20, 2004 as a result of Defendants' disclosures in the April Conference Call. *Id.* Indeed, while Defendants (erroneously) argue that Plaintiffs have not properly pled "loss causation" with respect to Defendants' (admitted) overstatement of Netopia's September 30, 2003 financial results, Defendants do not dispute in their motions to dismiss that the Complaint properly alleges "loss causation" under *Dura* with respect to the misrepresentations concerning Swisscom. Plaintiffs allege that the April 20, 2004 drop was caused by both the overstatement of Netopia's September 30, 2003 financial results attributable to ICC and Philadelphia, as well as the misrepresentations in January 2004 and February 2004 concerning Netopia's revenue from Swisscom. *See, e.g.*, ¶¶104, 107, 116, 137. At trial, experts will provide testimony concerning the portion of the April 20, 2004 loss that was caused by each misrepresentation. Defendants also do not (and cannot) argue that the misrepresentations concerning Swisscom were immaterial as a matter of law.

disclosures concerning Swisscom on April 19, 2004). ¶¶119-123; *see, e.g.*, *Daou,* 411 F.3d at 1022; *Oracle*, 380 F.3d at 1231-32.

Defendants' attempts to dismiss or strike these claims are wholly without merit. Contrary to Defendants' unsupported argument (Netopia Mem. at 11-12), it is wholly irrelevant whether Netopia "properly" recognized revenue for the product that it shipped by boat to Swisscom, because Plaintiffs seek to impose liability for Defendants' knowing or reckless misrepresentations of "present fact" concerning the reasons for Netopia's Swisscom revenue. The Complaint alleges that Defendants lied about the reasons for Netopia's purportedly positive financial results, by attributing the results to "strong demand" from Swisscom, while failing to disclose that the positive reported results were actually the result of Defendants' shipment of "excess" and unnecessary product. It is well-settled that the failure to disclose adverse facts concerning the reasons for a company's purportedly positive revenue results – regardless of whether the reported revenue was properly recognized – renders the financial results materially misleading. *In re Campbell Soup Co. Sec. Litig.*, 145 F. Supp. 2d 574, 588 (D.N.J. 2001) (failure to disclose "channel stuffing" rendered misleading defendants' statements concerning reasons for positive revenue results, regardless of whether revenue was appropriately recognized under GAAP; motion to dismiss denied); *see Carpenters Health & Welfare Fund v. Coca-Cola Co.*, 321 F. Supp. 2d 1342, 1351 (N.D. Ga. 2004) (failure to disclose that revenue results included revenue from shipments of excess product to bottlers rendered Coke's representations that increasing consumer demand had caused reported revenue growth materially false and misleading); *Friedman v. Rayovac Corp.*, 295 F. Supp. 2d 957, 988 (W.D. Wis. 2003) (failure to disclose that revenue results were attributable to channel stuffing rendered revenue results misleading; irrelevant whether that revenue results not alleged to have violated GAAP); *In re Scientific-Atlanta, Inc. Sec. Litig.*, 239 F. Supp. 2d 1351, 1363 (N.D. Ga. 2002) ("a company is obligated to reveal channel stuffing once sale[s], earnings and

growth projections were disclosed because such information could be important to a reasonable investor"), *aff'd sub nom.*, *Phillips v. Scientific-Atlanta, Inc.*, 374 F.3d 1015 (11th Cir. 2004).[12]

Contrary to Defendants' argument (Netopia Mem. at 10), Lefkof's statements concerning the revenue of Swisscom for the second quarter ended March 31, 2004 were not "accurate," and those statements are also actionable. During the January 20, 2004 conference call, Lefkof led reasonable investors to conclude Netopia would report Swisscom revenues for the second quarter ended March 31, 2004 that were approximately the same as the $8.232 million reported for the December 31, 2003 quarter when he stated

> what we observe Swisscom doing is finishing year-end strong. Maybe running for January/February – whatever – a few months without the aggressive promotions, you know, without the free modem here or the free Wi-Fi gateway there. And so, ***because we are conservative here at Netopia,*** we believe the rational thing to do is similar to what happened last year between December and March – we did not have sequential increase. ***We would at least – at today's date, expect a similar thing,*** but then a very nice rebound for June, September and December, accordingly.

¶113.[13] The Complaint specifically alleges that this representation by Lefkof was materially false and misleading because, as discussed above, Defendants knew as of the January 20, 2004 conference call that the results reported for Swisscom for December 31, 2003 included the "excess" shipments made and booked as revenue in December 2003; as Defendants knew that Swisscom did not need the "excess" Netopia products that were shipped by boat in the last days of December 2003, Defendants

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[12] It is well-settled under the federal securities laws that when a person makes a statement – regardless of whether the statement is voluntary or required – there is a duty to make the statement ***complete and accurate*** so as not to mislead potential investors. *See, e.g.*, *Lucia v. Prospect St. High Income Portfolio, Inc.*, 36 F.3d 170, 175-76 (1st Cir. 1994); *First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1313, 1317 (5th Cir. 1977) (under federal securities laws, "a duty to speak the full truth arises when a defendant undertakes to say anything"; where defendant has revealed some relevant, material information, defendant "may not deal in half-truths").

[13] It is well-settled that, on a motion to dismiss, whether a statement is misleading is determined by whether the statement could have misled a reasonable investor; as a result, a dispute over how reasonable investors understood Defendants' statements is a factual inquiry which cannot be determined on a motion to dismiss. *Hunt v. Alliance N. Am. Gov't Income Trust, Inc.*, 159 F.3d 723, 728 (2d Cir. 1998); *McMahan & Co. v. Wherehouse Entm't, Inc.*, 900 F.2d 576, 579-80 (2d Cir. 1990); *Angres v. Smallworldwide PLC*, 94 F. Supp. 2d 1167, 1174 (D. Colo. 2000); *In re MCI Worldcom, Inc. Sec. Litig.*, 93 F. Supp. 2d 276 (E.D.N.Y. 2000); *In re Fidelity/Micron Sec. Litig.*, 964 F. Supp. 539, 547-48 (D. Mass. 1997); *In re ValueVision Int'l, Inc. Sec. Litig.*, 896 F. Supp. 434, 443 (E.D. Pa. 1995); *In re Par Pharm. Sec. Litig.*, 733 F. Supp. 668, 677 (S.D.N.Y. 1990).

knew that there would be a substantial reduction in Swisscom orders during the quarter ended March 31, 2004. ¶117. Accordingly, there was nothing "accurate" about Lefkof's statements.

Finally, and contrary to Baker's arguments (Baker Mem. at 4-5), the allegations in the Complaint strongly infer Baker's scienter with respect to the misrepresentations concerning the revenue from Swisscom.[14] Indeed, Baker does not – and cannot – dispute that the allegations describing his suspicious and unusual insider stock sales ***immediately following*** January 20, 2004 are sufficient to strongly infer his scienter with respect to misrepresentations on January 20, 2004; after January 20, 2004, Baker again went on a selling spree, unloading an additional 28,000 shares, virtually eliminating his entire holdings in Netopia. ¶¶119, 121. Moreover, Baker (Netopia's CFO) was listed as Netopia's "contact person" in the January 20, 2004 press release with respect to any inquiries seeking information concerning Netopia's December 31, 2003 financial results (¶100); under these circumstances, it is "patently incredible," and even "absurd," to infer that Baker would not know the circumstances underlying the revenue reported from the Company's transactions with its largest customer. *America West*, 320 F.3d at 943 n.21.

D. The Court Should Not Dismiss the Claims Against Kadish

1. The Complaint Properly Alleges that Kadish Is Primarily Liable

Contrary to his arguments (Netopia Mem. at 2, 17-18), the Complaint properly alleges that the false statements are attributable to Kadish. First, Plaintiffs' detailed allegations more than amply satisfy the "group publication doctrine." The Complaint expressly alleges that Kadish drafted the Netopia press releases at issue, drafted the scripts of the investor conference calls at issue, and drafted the SEC filings at issue. ¶¶100(a)-(e), 129. In addition to alleging his role in connection with each of the misrepresentations, the Complaint alleges that the false statements were the collective action of the small group consisting of Kadish, Lefkof, Baker and Skoulis, Netopia's senior executives. As a result, it is reasonable to presume that the false statements made were a

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[14] As discussed above, Baker does not contest that the Complaint properly alleges his scienter in connection with the overstatement of Netopia's September 30, 2003 financial results during the Class Period with respect to ICC and Philadelphia.

collective action under the "group publication doctrine"(¶129), and it is irrelevant that Kadish was never "quoted" in, or signed, Netopia's press releases and SEC filings.[15] Moreover, Kadish's argument that the "group pleading" doctrine is no longer valid under the PSLRA has been repeatedly rejected.[16]

Even assuming, *arguendo,* that the misrepresentations during the Class Period were not deemed to have been made by Kadish, Kadish is nonetheless liable based upon his participation in the fraudulent scheme and his sales of Netopia stock. Rule 10b-5(a) and (c) imposes liability against any person who "directly or indirectly" employs "any device, scheme, or artifice to defraud" or engages "in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 C.F.R.

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[15] The doctrine, described in *Wool v. Tandem Computers, Inc*., 818 F.2d 1433 (9th Cir. 1987), provides that it is appropriate to infer that a company's false statements are attributable to the members of the small group of senior officers within a company:

> In cases of corporate fraud where the false and misleading information is conveyed in prospectuses, registration statements, annual reports, press releases or other "group-published information," it is reasonable to presume that these are the collective actions of the officers. Under such circumstances, a plaintiff fulfills the particularity requirement of Rule 9(b) by pleading the misrepresentations with particularity and where possible the roles of the individual defendants in the misrepresentations.

Id. at 1440.

[16] *See, e.g.*, *In re Adaptive Broadband Sec. Litig*., No. C 01-1092 SC, 2002 U.S. Dist. LEXIS 5887 (D. Cal. Apr. 2, 2002); *In re Secure Computing Corp. Sec. Litig.*, 120 F. Supp. 2d 810, 821 (N.D. Cal. 2000) (the "majority of the district courts in the Ninth Circuit that have addressed the issue have concluded that the group published information presumption survives the PSLRA"); *see also In re Silicon Graphics Sec. Litig.*, 970 F. Supp. 746, 759 (N.D. Cal. 1997) (applying group pleading doctrine); *Schlagel v. Learning Tree Int'l*, Case No. CV 98-6384 ABC (Ex), 1998 U.S. Dist. LEXIS 20306, at **17-18 (C.D. Cal. Dec. 23, 1998) ("Several courts, including even the *Silicon Graphics* court, have not contested that this [group publishing] doctrine survives the Reform Act. . . . Until the Ninth Circuit speaks otherwise, the Court finds the rationale behind the group-pleading doctrine sound and will not disturb it."); *J.F. Lehman & Co. v. Treinen,* No. CV 99-13046-WJR (JWJx), 2000 U.S. Dist. LEXIS 10329, at *20 (C.D. Cal. June 9, 2000) (noting that the group-published information doctrine "indeed" applied to post-PSLRA cases); *In re Imperial Credit Indus. Sec. Litig.*, CV 98-8842 SVW, 2000 U.S. Dist. LEXIS 2340, at **15-16 (C.D. Cal. Feb. 22, 2000) (applying group pleading doctrine); *In re Stratosphere Corp. Sec. Litig.*, 1 F. Supp. 2d 1096, 1108 (D. Nev. 1998) ("even in *In re Silicon Graphics*, which established the most stringent of pleading standards under the PSLRA, the Court did not question whether group pleading was still viable post-PSLRA . . . and this Court declines to adopt such a proposition [abolishing the group pleading doctrine after the PSLRA]").

§240.10b-5(a), (c). Under Rule 10b-5, there is no requirement that the defendant directly make a false statement. *See*, *e.g.*, *SEC v. Zandford*, 535 U.S. 813, 820 (2002) ("neither the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security in order to run afoul of the Act"); *America West*, 320 F.3d 920 ("the fact that neither [defendant] made any of the allegedly misleading statements does not shield them from liability"); *In re Enron Corp. Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 577-99 (S.D. Tex. 2002). Given the specific factual allegations in the Complaint showing Kadish's extensive knowledge of, and participation in the fraud (as well as the attempted "cover-up"), as well as the fact that he sold 118,850 shares of Netopia stock (almost his entire holdings, and more than any other Defendant) while in possession of material non-public information, the Complaint sufficiently alleges that Kadish is liable under Rule 10b-5 (a) and (c). *See America West*, 320 F.3d 920 (citing *United States v. O'Hagan*, 521 U.S. 642, 652 (1997)) (trading on material non public information is a deceptive device under §10(b) "because a relationship of trust and confidence [exists] between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation"); *Enron*, 235 F. Supp. 2d at 577-99, 704-05 (sustaining claims against outside law firm, Vinson & Elkins, for violations of Rule 10b-5(a) or (c)).

2. The Complaint Properly Alleges that Kadish Acted with Scienter

Contrary to his argument (Netopia Mem. at 19-22), the allegations in the Complaint strongly infer that Kadish acted with scienter, as the Complaint contains specific factual allegations that show that Kadish had direct knowledge concerning the contingent nature of the Philadelphia Purchase Order, as well as the true nature of the "excess" shipments to Swisscom for the December 31, 2003 quarter.

First, the Complaint expressly alleges that Kadish knew about the contingent payment terms of the Philadelphia transaction, and further alleges that he ***drafted and created*** the Philadelphia Purchase Order himself, and ***told*** Frankl that he was not going to put ***any*** payment terms down (despite the fact that Netopia's payments terms were "net 30"). ¶¶42-43. Second, the Complaint expressly alleges that Kadish (along with Lefkof and Baker) devised a scheme to "cover-up" the

fraud, and was actively involved in attempting to carry the out the "cover-up" (¶¶67-95), even whispering the responses in the ear of the Netopia employee who had to respond to ICC's protestations about Netopia's attempted "cover-up." ¶88. Indeed, both Skoulis and Baker admitted that Kadish (along with Lefkof) was the driving force behind the "cover-up. ¶¶73-77.[17] Third, the Complaint expressly alleges that Kadish was assigned by Lefkof to act as ***the*** "salesperson" with respect to Swisscom during the quarter ended December 31, 2003, the same quarter in which Netopia reported revenue from "excess" shipments to Swisscom, as discussed above. ¶117.

Finally, the suspicious circumstances of Kadish's insider stock sales strongly – and overwhelmingly – infer scienter. The amount and percentage of shares sold by Kadish infers that he acted with scienter, as he sold 118,850 shares, or 83% of his holdings, during the Class Period for over $1.8 million in insider trading proceeds. ¶122. (No other Defendant sold more stock than Kadish.) The ***timing*** of Kadish's stock sales is equally suspicious; Kadish dumped 91,350 shares, or 63% of his holdings, in just ***15 days*** following the November 5, 2003 press release (¶119), and again went on a selling spree, dumping an additional 27,500 shares, after January 20, 2004 (but before the April 20, 2004 stock drop). Moreover, Kadish's sales were inconsistent with his prior trading history, as Kadish sold ***zero*** shares of Netopia stock in the preceding 44-month period. ¶122. *See America West*, 320 F.3d at 940-41 ("the sudden flurry of massive insider trading over this [short] period of time, after an extended period of inactivity, appears unusual"). Whether viewed individually or collectively, the factual allegations in the Complaint give rise to a strong inference of scienter with respect to Kadish.

3. Kadish Is Liable as a "Control Person" Under Section 20(a)

In order to allege a *prima facie* claim under §20(a), a complaint must allege that the defendant had the power to exercise control over the primary violator. *See Howard v. Everex Sys.*,

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[17] Skoulis made numerous statements about Kadish's knowledge of the fraudulent ICC transaction. ¶¶31, 97. Skoulis used phrases such as "everyone" and "they" to refer to defendants, including Kadish. While Defendants assert that they do not know exactly "who 'everyone' is and what they knew" (Netopia Mem. at 20), examination of paragraphs 31 and 97 of the Complaint explains exactly who (Lefkof, Kadish and Baker) the Complaint is referring to and what those Defendants knew.

228 F.3d 1057, 1065 (9th Cir. 2000). It is well-settled in the Ninth Circuit that the defendant need not be a "culpable participant" in the alleged fraud. *Id.*; *America West*, 320 F.3d at 945; *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1575 (9th Cir. 1990). Instead, allegations that the defendant, based upon his position within the company, possessed the power to control the company, are sufficient.[18] The determination whether a person is a control person "is an intensely factual question," and therefore inappropriate for resolution on a motion to dismiss. *America West*, 320 F.3d at 945.

The Complaint properly alleges that Kadish is liable as a "control person" under §20(a) of the Exchange Act. Not only was Kadish alleged to be one of the most senior officers of the Company, but Plaintiffs' specific allegations that Kadish drafted the press releases, conference call scripts and SEC filings at issue (not to mention the specific allegations concerning his role in drafting the Philadelphia Purchase Order, in overseeing the Swisscom sales during the December 31, 2003 quarter, and devising the "cover-up"), and attended "Executive Staff" meetings with Lefkof, Baker and Skoulis, more than amply allege at this stage of the litigation that Kadish had the power to exercise control over Netopia within the meaning of §20(a), and place Kadish at the center of control within Netopia. ¶¶24, 39, 42-44, 67-95, 117-118; *see America West*, 320 F.3d at 945-46.[19]

Finally, Kadish's argument (Netopia Mem. at 23-24) that the "control person" claims against him should be dismissed because he "acted in good faith" is not only procedurally improper, but contrary to express allegations in the Complaint. As a matter of law, this assertion of contested fact

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[18] *See In re Network Assocs., Inc. II Sec. Litig.*, No. C 00-4849 MJJ, 2003 U.S. Dist. LEXIS 14442, at *49 (N.D. Cal. Mar. 25, 2003) ("the fact that the named individual defendants held important positions in the company is sufficient at the pleadings stage to state a claim that the defendant was a control person under Section 20(a) of the Exchange Act") (citations omitted); *In re Cylink Sec. Litig.*, 178 F. Supp. 2d 1077, 1089 (N.D. Cal. 2001) ("'by virtue of their executive and managerial positions [defendants] had the power to control and influence [the company], which they exercised'") (citation omitted); *In re Secure Computing Corp. Sec. Litig.,* 184 F. Supp. 2d 980, 983 (N.D. Cal. 2001) (company's top six officers and executive committee members were controlling persons); *In re Nuko Info. Sys., Sec. Litig.*, 199 F.R.D. 338, 345 (N.D. Cal. 2000) (top officers are controlling persons).

[19] While Kadish is incorrect (Netopia Mem. at 22-23) that Plaintiffs are required to allege facts showing that he "exercised control over the alleged misstatements" to allege a *prima facie* claim under §20(a), the argument blatantly ignores the specific allegations in the Complaint.

pertaining to Kadish's affirmative defense cannot be considered in support of defendants' motion to dismiss. *America West*, 320 F.3d at 931. Far from alleging that Kadish was carrying out innocent "collection efforts," the Complaint specifically alleges that Kadish knew that the Philadelphia Purchase Order was "contingent" from the outset and that Kadish devised, and attempted to carry-out, a "cover up" of the fraud during the Class Period by attempting to get ICC to agree, in writing, that the $750,400 Philadelphia Purchase Order was legitimate from the outset and had no contingencies. ¶¶42-43, 46, 67-69, 71, 77, 80, 84, 87-88, 93-94. Ironically, the "final straw" occurred when ICC refused to accede to Kadish's demand that ICC sign a "backdated" agreement (backdated to June 30, 2004, the final day of Netopia's third quarter), which, *inter alia*, falsely described ICC's liability to Netopia. ¶¶93-94. That Kadish could seek to characterize his conduct alleged in the Complaint as proof of his "good faith" borders on the frivolous.[20]

V. CONCLUSION

For all of the above reasons, Plaintiffs' Complaint should be upheld in its entirety. If this Court determines that any part of the Complaint should be dismissed, Plaintiffs respectfully request leave to amend pursuant to Rule 15(a). Leave to amend should be "freely given." Fed. R. Civ. P. 15(a); *see Foman v. Davis*, 371 U.S. 178, 182 (1962). Plaintiffs have done, and continue to do, considerable investigation, and believe they could amend the Complaint to address any pleading deficiencies identified by the Court.

DATED: October 13, 2005

Respectfully submitted,

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[20] Lefkof, Baker and Skoulis do not argue that Plaintiffs have failed to properly allege that they were "control persons" within the meaning of §20(a).

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I, Reed R. Kathrein, am the ECF User whose ID and password are being used to file this MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO ALL DEFENDANTS' MOTIONS TO DISMISS AND/OR STRIKE. In compliance with General Order 45, X.B., I hereby attest that Michael D. Bruan has concurred in this filing.

/s/Reed R. Kathrein
REED R. KATHREIN

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DECLARATION OF SERVICE BY MAIL AND FASCIMILE
PURSUANT TO NORTHERN DISTRICT LOCAL RULE 23-2(c)(2)

I, the undersigned, declare:

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and employed in the City and County of San Francisco, over the age of 18 years, and not a party to or interested party in the within action; that declarant's business address is 100 Pine Street, 26th Floor, San Francisco, California 94111.

2. That on October 13, 2005, declarant served the MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO ALL DEFENDANTS' MOTIONS TO DISMISS AND/OR STRIKE by depositing a true copy thereof in a United States mailbox at San Francisco, California in a sealed envelope with postage thereon fully prepaid and addressed to the parties listed on the attached Service List and this document was forwarded to the following designated Internet site at:

http://securities.lerachlaw.com/

3. That there is a regular communication by mail between the place of mailing and the places so addressed. Declarant also caused a true copy of the above-entitled document to be served via facsimile upon all parties listed on the Service List.

I declare under penalty of perjury that the foregoing is true and correct. Executed this 13th day of February, 2005, at San Francisco, California.

/s/ Ruth A. Cameron
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