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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN JOSE DIVISION

IN RE NETOPIA, INC. SECURITIES LITIGATION	Case No.: C 04-3364 RMW And Related Cases
This Document Relates to: All Actions	**NOTICE OF MOTION AND MOTION TO DISMISS, OR IN THE ALTERNATIVE TO STRIKE ALLEGATIONS FROM, PLAINTIFFS' CONSOLIDATED AMENDED COMPLAINT** Judge: Ronald M. Whyte Date: December 9, 2005 Time: 9:00 a.m. Courtroom: 6, Fourth Floor

NOTICE OF MOTION AND MOTION TO DISMISS AND/OR IN THE ALTERNATIVE TO STRIKE ALLEGATIONS FROM PLAINTIFFS' CONSOLIDATED AMENDED COMPLAINT

TO ALL PARTIES AND THEIR COUNSEL OF RECORD:

PLEASE TAKE NOTICE THAT: On December 9, 2005 at 9:00 a.m., or as soon thereafter as the matter may be heard by the Court in the Courtroom of the Honorable Ronald M. Whyte, Courtroom 6, Fourth Floor, United States District Court, 280 South First Street, San Jose, California 95113, defendants Netopia, Inc. ("Netopia"), Alan B. Lefkof, and David A. Kadish will, and hereby do, move the Court, pursuant to Federal Rules of Civil Procedure Rules 12(b)(6) and 12(f), for an order dismissing with prejudice, or in the alternative striking, allegations in plaintiffs' Consolidated Amended Complaint concerning a transaction with the Chicago public schools, Netopia's revenue received from its customer Swisscom AG, and alleged losses caused by Netopia's public statements on January 20, 2004, February 17, 2004 and April 19, 2004. Defendants seek dismissal of these allegations on the grounds that they each fail to state a claim upon which relief can be granted. In the alternative, Defendants seek to strike these allegations on the grounds that they are impertinent and immaterial.

In addition, Mr. Kadish will, and hereby does move the Court, pursuant to Federal Rules of Civil Procedure Rule 12(b)(6) for an order dismissing with prejudice the claims against him on the grounds that the allegations, and each claim upon which they are based, fail to state a claim upon which relief can be granted.

These Motions are based on this Notice of Motion; the attached Memorandum of Points and Authorities in Support of the Motion; the Request for Judicial Notice in Support of Netopia, Inc., Alan B. Lefkof, and David A. Kadish's Motion to Dismiss, or in the Alternative to Strike Allegations from, the Consolidated Amended Complaint; the other pleadings and papers comprising the record in this Action; and such other matters and arguments as may come before the Court, including in connection with reply briefing and argument of the Defendants' Motions.

ISSUES TO BE DECIDED (Local Rule 7-4(a)(3))

1. Whether plaintiffs fail, as a matter of law, to state a claim against Defendants Netopia, Inc. ("Netopia" or the "Company"), Alan Lefkof, and David Kadish in the Consolidated Amended Complaint (the "CAC") for:

a. Alleged misstatements about Netopia's sale of software and maintenance to software reseller Interface Computer Company ("ICC") for resale to the Chicago public school system in 2002 (the "Chicago Transaction) because all revenue from the transaction was received and recorded more than a year after the November 2003 commencement of plaintiffs' purported class period?

b. Alleged misstatements about the revenue Netopia received from its customer Swisscom AG in the fiscal quarter ended December 2003, because Netopia's statements concerning this revenue were accurate and Netopia properly recognized revenue according to generally accepted accounting principles?

c. Alleged losses from the decline in Netopia's stock price following Netopia's public statements about its earnings on January 20, February 17, and April 19, 2004 because those statements have no connection to alleged misstatements about the ICC transactions?

2. Whether, in the alternative, this Court should strike the allegations in the CAC concerning the Chicago Transaction (CAC ¶¶ 22-31), Swisscom revenue (CAC ¶¶ 113-118), and Netopia's stock price drops following its public statements on January 20, February 17, and April 19, 2004 (CAC ¶¶ 105-107), where these allegations do not contribute to any cause of action and would distract this Court and defendants from identifying the factual basis, if any, for plaintiffs' claims?

3. Whether plaintiffs' claims in the CAC fail as a matter of law against defendant David Kadish because plaintiffs have failed to allege that Mr. Kadish:

a. Made any actionable statement?

b. Acted with scienter with respect to any of the alleged misstatements

about revenue from Netopia's two transactions with ICC?

c. Had control over a primary violator, or that Mr. Kadish did not act in good faith?

Table of Contents

Page

Table of Authorities

Page

Cases

Statutes

Rules

Other Authorities

MEMORANDUM OF POINTS & AUTHORITIES

Defendants Netopia, Alan B. Lefkof, and David A. Kadish[1] respectfully submit this Memorandum of Points and Authorities in support of their Motion to Dismiss, or in the Alternative to Strike Allegations from, the Consolidated Amended Complaint ("CAC").

INTRODUCTION

This case is truly much ado about nothing. The announcement of an investigation by the audit committee of Netopia's board of directors (the "Audit Committee Investigation") triggered the inevitable filing of several putative class action lawsuits before the results of the investigation were even known. In fact, when the investigation was completed, the restatement of Netopia's previously-issued financial statements confirmed that the transactions in question were of real economic substance, and required little more than the shifting of some revenue between fiscal periods.

Plaintiffs have attempted to distract the Court from these fundamental facts by filling their CAC with irrelevant allegations and innuendo. *First*, plaintiffs dedicate many pages of the CAC to a May 2002 transaction in which Netopia sold software to a reseller, Interface Computer Corporation ("ICC"), that ICC intended to resell to the Chicago Public Schools (the "Chicago Transaction"). While a portion of the revenue from the Chicago Transaction was ultimately deemed prematurely recorded, plaintiffs gloss over the fact that Netopia received all of the revenue from the Chicago Transaction by September 2002 — before the close of Netopia's 2002 fiscal year, and over a year before the November 2003 commencement of plaintiffs' purported class period.[2] *Second*, plaintiffs have invented a fraud relating to Netopia's sales to Swisscom AG ("Swisscom"), claiming that (a) Netopia prematurely recognized Swisscom revenue in the December 2003 quarter, even though the Company indisputably shipped all of Swisscom's order before the end of the quarter; and (b) Mr. Lefkof falsely suggested, in January 2004, that sales to Swisscom in the March 2004

[1] Alan Lefkof is Netopia's President and David Kadish is its General Counsel. Plaintiffs have also sued William Baker, who was the Chief Financial Officer during the purported class period, and Tom Skoulis, who was the Vice President of Sales.

[2] Netopia's fiscal year runs from October 1 to September 30.

quarter would not decline from the previous quarter, when in fact Mr. Lefkof pointedly noted that December 2003 sales to Swisscom had benefited from certain unique year-end promotions. In trumping up their Swisscom allegations, plaintiffs also ignore the fact that none of this revenue was restated. *Third*, many of the CAC's loss causation allegations pay no heed to the Supreme Court's holding in *Dura Pharmaceuticals, Inc. v. Broudo*, __ U.S. __, 125 S. Ct. 1627 (2005), as plaintiffs improperly attribute their purported losses from stock price declines over the class period to events that have no conceivable connection to the supposed misstatements alleged in the CAC. Because these parts of the CAC do not give rise to any cause of action and are immaterial to the CAC, the Court should dismiss, or in the alternative strike, these allegations.

Finally, plaintiffs' claims against Mr. Kadish simply have no basis in fact or law. They are factually deficient because, as plaintiffs themselves allege, Mr. Kadish's actions are consistent with those of an officer who not only had no idea about the alleged fraud, but who actually worked to uncover it — continually pressing ICC for payment of a receivable from another sale of software and maintenance to ICC for resale to the Philadelphia school system (the "Philadelphia Transaction"), and ultimately triggering the Audit Committee Investigation. Plaintiffs' securities fraud allegations against Mr. Kadish are legally deficient because plaintiffs have not even alleged that he made an actionable statement, let alone with the requisite scienter. And their control person allegations fail because, even by the CAC's own terms, Mr. Kadish was not a control person over any alleged primary violator with respect to the alleged misstatements, and because he acted in good faith and without scienter. In sum, plaintiffs have failed to plead any of the elements of a securities fraud claim against Mr. Kadish, and the Court should dismiss all the claims against him.

FACTUAL BACKGROUND & PROCEDURAL HISTORY

I. FACTUAL BACKGROUND

A. Netopia Is A Provider Of Wireless Products And Services.

Based in Emeryville, California, Netopia develops, markets and supports broadband wireless products and services. CAC ¶ 20. Netopia sells both hardware and software. *Id.*

Netopia's hardware business accounts for approximately 85% of the Company's annual revenue; in the fiscal year ended September 30, 2004, Netopia's hardware revenues were $85.7 million out of total revenue of $101.3 million. *Id.*; *see* Request for Judicial Notice ("RJN"), filed concurrently, Ex. 1 at 22.[3] The remaining 15% comes from the Company's software sales. CAC ¶ 20; RJN, Ex. 1 at 22.

B. Netopia Announced The Audit Committee Investigation, Which Eventually Led To The Restatement.

On July 22, 2004, Netopia announced that the audit committee of its board of directors had initiated an investigation into the circumstances surrounding a transaction between the Company and ICC, a software reseller, in which ICC was to resell Netopia's products to the Philadelphia public schools. CAC ¶ 96. The Audit Committee Investigation was initiated following receipt of information provided by ICC's counsel in response to vigorous collection efforts by Netopia. At the conclusion of the investigation, after expanding its scope to include another transaction with ICC, Netopia restated its prior reported financial results to adjust the treatment of a portion of the revenue from the two transactions. CAC ¶ 112; RJN, Ex. 1 at 19, 59-60.

The overall effect of restating the ICC transactions on Netopia's previously-announced financial results was minute, and to a substantial extent involved simply shifting portions of the ICC revenue into later quarters. Of the approximately $2.3 million originally recorded as revenue from ICC, Netopia eventually collected (and recognized) all but $150,000. RJN, Ex. 1 at 19, 60. Specifically, on February 1, 2005 Netopia announced that its restated results would:

- move $632,000 of software license revenue (of the approximately $1.5 million originally recorded from the Chicago Transaction in the June 30, 2002 quarter) to the quarter ended September 30, 2002 to reflect the proceeds received during the later quarter;
- recognize $118,000 of maintenance revenue from the Chicago Transaction

[3] The Court may properly consider material that has been submitted as part of the CAC, as well as documents that are not expressly incorporated, but "upon which the plaintiff's complaint necessarily relies." *Parrino v. FHP, Inc.*, 146 F.3d 699, 706 (9th Cir. 1998); *In re Silicon Graphics, Inc. Sec. Litig.*, 183 F.3d 970, 986 (9th Cir. 1999) (SEC filings properly considered on motion to dismiss).

ratably over four quarters beginning with the September 30, 2003 quarter, during which periods the maintenance revenues were earned;

- move $273,000 of software license, maintenance, and deferred revenue originally recorded in the quarter ended September 30, 2003 (of the $750,000 originally recognized from the Philadelphia Transaction) to the quarter ended September 30, 2004 to reflect proceeds received during the quarter;
- move $262,500 of software license revenue originally recorded in the quarter ended September 30, 2003 to the quarter ended December 31, 2004, to reflect additional proceeds received during that quarter; and
- recognize $64,000 of maintenance ratably over the five quarters beginning with the September 30, 2004 quarter.[4]

CAC ¶ 112; RJN, Ex. 1 at 19.

C. Netopia's Efforts To Collect The Receivable Due From ICC For The Philadelphia Transaction Triggered The Audit Committee Investigation.

Throughout the first half of 2004, Netopia was engaged in efforts to collect on the $750,400 purchase order issued to ICC to consummate the Philadelphia Transaction. *See generally* CAC ¶¶ 45, 52, 66, 67, 72, 82, 84. Netopia personnel had many conversations with ICC representatives — none of whom ever told Messrs. Lefkof or Kadish that ICC's obligation to pay Netopia was contingent upon receipt of funds by ICC from the Philadelphia schools. When these collection efforts proved unsuccessful, Netopia sent ICC's president, David Andalcio, a June 17, 2004 demand letter seeking confirmation that ICC would comply with a previously negotiated payment schedule and pay the amount owed on the Philadelphia purchase order. *Id.* ¶ 87. Netopia continued its efforts to collect at least some of the original receivable, which was beginning to look like a bad debt, during

[4] As part of the restatement, Netopia determined that it also needed to make other adjustments, unrelated to the ICC transactions, to certain revenue and expense line items. The majority of these additional small adjustments actually reduced various expenses previously recorded. For example, Netopia determined that it had misrecorded certain expenses relating to a rental obligation that required reversing approximately $180,000 in operating expenses during the restatement period. In addition, Netopia reduced its income tax expense by $200,000 for the fiscal quarter ended June 30, 2002.

The overall effect of the restatement on Netopia's earnings per share highlights the insignificance of these adjustments. For the fiscal quarter ended June 30, 2002 (the quarter in which the full amount of the Chicago Transaction was originally recorded), Netopia initially recorded a loss of $0.26 per share; the restated loss was $0.28 per share. For the fiscal quarter ended September 30, 2003 (the quarter in which the full amount of the Philadelphia Transaction was originally recorded), Netopia previously recorded earnings of $0.01 per share; restated its earnings were $0.00 per share.

the last two weeks of June. *Id.* ¶¶ 89-93. On July 1, 2004, Mr. Kadish sent a draft agreement to ICC memorializing further discussions concerning ICC's payment obligations. *Id.* at ¶ 93. Finally, on July 2, 2004 (after months of negotiations), Mr. Andalcio informed Netopia's executives that ICC believed it did not owe Netopia any money until ICC received a purchase order from the Philadelphia school system. *Id.* ¶ 94. Shortly thereafter, this revelation triggered the Audit Committee Investigation. *See id.* ¶ 96.

D. The Audit Committee Investigation Turned Up A Prior Transaction with ICC, And Uncovered the Hidden Terms Of Both ICC Transactions.

The Chicago Transaction. While investigating the circumstances surrounding the Philadelphia Transaction, the audit committee also learned of an earlier software transaction between Netopia and ICC. That sale of a similar software and maintenance package, resold by ICC to the Chicago public school system, was negotiated for Netopia by plaintiffs' star witness, Peter Frankl. CAC ¶¶ 23-25. Netopia received a purchase order from ICC on May 23, 2002 — in the middle of Netopia's third quarter for fiscal year 2002. *Id.* ¶¶ 23, 26. Mr. Frankl and John Deckard (another sales representative based, like Mr. Frankl, in Netopia's small Dallas, Texas sales office) altered the original ICC purchase order to conceal the fact that, per ICC's agreement with Frankl and Deckard, ICC did not have to pay Netopia until ICC was paid by the Chicago public schools. *Id.* ¶ 28. Still, ICC paid Netopia for approximately half of the Chicago Transaction within 30 days (before the end of the third quarter of fiscal 2002), and the remaining balance before the September 30 end of fiscal 2002. *Id.* ¶ 112; *see* RJN, Ex. 1 at 19, 59. Although plaintiffs spend pages discussing this 2002 transaction, CAC ¶¶ 21-31, their purported class period does not begin until November 2003, more than a year later, *id.* ¶ 1, and they make no attempt to link the Chicago Transaction with any damages allegedly suffered by the putative class.

The Philadelphia Transaction. On September 30, 2003, ICC signed, and Netopia received, a purchase order for $750,400 of Netopia software and maintenance for resale to the Philadelphia public schools. CAC ¶ 45. The Audit Committee Investigation uncovered that on October 7, 2003, ICC sent Mr. Frankl a "side letter" stating that ICC had no

obligation to pay Netopia unless and until it was paid by the Philadelphia public schools.[5] *Id.* ¶ 49. Nevertheless, by November 1, 2004, Netopia had collected all but $150,000 of the full amount on the Philadelphia purchase order. RJN, Ex. 1 at 19, 60. The $150,000 reflected a negotiated reduction in the amount owed Netopia. *Id.* Plaintiffs do not allege that these transactions were fabricated — they were sales of real economic substance that resulted in the receipt of revenue by Netopia. *E.g.*, CAC ¶ 30, 81, 112; RJN, Ex. 1 at 19, 59-60.

E. Plaintiffs' Swisscom Allegations Describe Events Relating To Revenue That Was Not Affected By The Restatement.

In an apparent effort to sweep in and account for a decline in the price of Netopia's stock unrelated to the ICC transactions during the CAC's lengthy purported class period (November 2003 through August 2004), plaintiffs also allege that Netopia made false statements about, and prematurely recognized revenue from, transactions with Swisscom. CAC ¶¶ 113-119. Plaintiffs point to a January 20, 2004 conference call, during which Mr. Lefkof described Netopia's robust sales to Swisscom during the quarter just ended. *Id.* As the transcript of the January 20 conference call reveals, Mr. Lefkof carefully explained that Netopia did not expect its revenue from Swisscom for the March quarter to equal the December quarter's Swisscom revenue:

> We had a very strong December quarter in Europe as Swisscom remained our largest customer…. Swisscom and Bluewin marketing programs are succeeding across multiple fronts…. *Clearly, we've benefited in the December quarter from year-end promotions implemented by Swisscom and Bluewin. They are currently taking a breather from such promotions.*

RJN, Ex. 2 at 3 (emphasis added) (quoted at CAC ¶ 113). In the same conference call, Mr. Lefkof cautioned analysts not to draw too many conclusions from one quarter's results:

> We have delivered a very nice growth pattern in six month increments over the past year and a half and we plan to continue doing that. *Similar to last year, we do not currently expect sequential revenue growth for the March quarter.* However, this outlook does not reflect any loss of business momentum.

[5] There is no evidence — and plaintiffs do not allege — that Messrs. Lefkof or Kadish were aware of the "side letter" before July 2004.

Id. at 5 (emphasis added). Mr. Lefkof's prediction was accurate, as revenue from Swisscom fell the following quarter. *Id.* ¶ 116.

Plaintiffs also allege that Netopia inflated its Swisscom-related revenue during the December 2003 quarter by improperly pulling in revenue from "'excess' product that had been placed on a 'boat' for delivery to Swisscom in the final days of December 2003." *Id.* In fact, as Mr. Lefkof explained in an April 19, 2004 conference call, specific terms of Netopia's contract with Swisscom provided that ownership of the Netopia hardware transferred to Swisscom upon delivery to Swisscom's freight carrier in Bangkok. *See* RJN, Ex. 3 (April 19, 2004 transcript of conference call) (quoted at CAC ¶ 116). Because the contract is "FOB origin," Netopia was required to recognize the revenue when the freight forwarder picked up the hardware from Netopia's warehouse. *See* RJN, Ex. 4 (Securities Exchange Commission Staff Accounting Bulletin ("SAB") Topic 13-A.3(a) (2003)).

II. PROCEDURAL HISTORY

On August 17, 2004, just after Netopia announced its intention to restate some prior-reported revenue, plaintiffs filed the first of a series of putative securities class action suits, alleging violations of Section 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "1934 Act"). Over the next several weeks, three additional purported class actions were filed. On December 3, 2004, this Court consolidated the putative securities class action complaints in this action, and appointed the Levy Group, represented by Schatz & Nobel and The Law Office of Michael Braun, as lead plaintiff and counsel, respectively. Because of delays in filing the restated financial statements (the restatement was filed on February 1, 2005), and an effort at mediation, lead plaintiffs filed the CAC on June 29, 2005.[6]

[6] In addition, two state shareholder derivative actions and two federal derivative actions were filed. The state derivative actions were consolidated, and the parties agreed to stay discovery and the filing of a response to the consolidated amended derivative complaint until defendants file an answer in these consolidated actions, or they are dismissed. The federal shareholder derivative plaintiffs agreed to stay their actions in favor of the two state shareholder derivative actions. Beyond the civil litigation, two other private actions are proceeding against Netopia, both instituted by Messrs. Frankl and Deckard after Netopia terminated their employment, on September 20, 2004, for their roles in negotiating and hiding from Netopia executives the contingent terms in the ICC contracts. Specifically, Messrs. Frankl and Deckard have brought: (1) a "whistleblower" action pursuant to Section 806 of Sarbanes-Oxley, currently pending before the Department of Labor

(Footnote continued)

ARGUMENT

I. THE COURT SHOULD DISMISS PLAINTIFFS' ALLEGATIONS ABOUT THE CHICAGO TRANSACTION, SWISSCOM, AND CERTAIN LOSS CAUSATION ALLEGATIONS BECAUSE THEY DO NOT ALLEGE FACTS UPON WHICH A CLAIM FOR RELIEF CAN BE BASED.

To state a claim for violation of Section 10(b) of the 1934 Act, plaintiffs must allege, in connection with the purchase or sale of a security, that defendants (1) made a false or misleading statement; (2) concerning a material fact; and (3) acted with scienter, a mental state that in this circuit constitutes at least deliberate recklessness. *DSAM Global Value Fund v. Altris Software, Inc.*, 288 F.3d 385, 388 (9th Cir. 2002). Plaintiffs must also allege that they (4) relied on the statement(s); and (5) sustained damages as a result. *Id.* To avoid dismissal, a complaint must comply with the stringent, fact-based pleading requirements of the Private Securities Litigation Reform Act (the "PSLRA"). *See* 15 U.S.C. § 78u-4(b)(3)(A). The PSLRA contains three distinct fact-based pleading requirements, two of which are relevant here. First, plaintiffs are required to specify, for each challenged statement, the "reason or reasons why the statement is misleading." 15 U.S.C. § 78u-4(b)(1). Second, for each challenged statement, plaintiffs must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(1).

In deciding a Rule 12(b)(6) motion to dismiss, while the Court must accept the complaint's well-pleaded allegations as true and construe them in the light most favorable to the pleader, *In re Silicon Graphics, Inc. Sec. Litig.*, 183 F.3d 970, 978 (9th Cir. 1999), it need not accept conclusory allegations of law and unsupported inferences of fact. *In re Verifone Sec. Litig.*, 11 F.3d 865, 868 (9th Cir. 1993).

Office of the Administrative Law Judge; and (2) a wrongful termination action filed in Texas state court, which Netopia removed to federal court in Texas. Frankl and Deckard have agreed to dismiss both these actions without prejudice.

Finally, the Securities and Exchange Commission ("SEC") conducted an investigation, which Netopia and Mr. Lefkof have agreed to resolve by submitting to negligence-based offers of settlement. The SEC has not initiated any action against Mr. Kadish.

A. Plaintiffs Have Failed To Allege Damages Related To The Chicago Transaction.

Plaintiffs devote many pages of the CAC purporting to describe (and attempting to create an aura of nefariousness about) the Chicago Transaction, alleging that Netopia and ICC signed a purchase order consummating the deal in May 2002, and that Netopia recognized revenue from the transaction during the quarter ended June 30, 2002. CAC ¶¶ 23-29. Netopia eventually determined that, because the revenue was contingent upon payment by the Chicago public schools to ICC, revenue recognition rules required that revenue be recognized upon payment to Netopia. Accordingly, because Netopia received a partial payment before the end of June and the remaining license revenue before the end of September, approximately half of the revenue from the Chicago Transaction was transferred forward one quarter, to the quarter ended September 30, 2002.[7] *Id.* ¶ 31, 112.

Because all the license revenue (both as originally reported, and as restated) from the Chicago Transaction was recorded and received by the end of Netopia's fiscal 2002, it could have had no conceivable effect on Netopia's stock price as of November 6, 2003 — the beginning of plaintiffs' purported class period and more than one fiscal year later. *See DeMarco v. DepoTech Corp.*, 149 F. Supp. 2d 1212, 1223 n.6 (S.D. Cal. 2001) (noting that statements made before class period are not actionable). Any contemporaneous picture of the Company's finances on which a purchaser of Netopia stock on or after November 6, 2003 could have relied could not have contained any inaccuracy as a result of the Chicago Transaction. Indeed, plaintiffs have admitted as much. *See* CAC ¶ 103 (alleging only that statements "in connection with the Philadelphia Purchase Order caused the price of Netopia common stock to be artificially inflated beginning November 2003"). Accordingly, the allegations relating to the Chicago Transaction should be dismissed.

B. Plaintiffs Have Failed To Allege Fraud Relating To Swisscom.

Plaintiffs' allegations about Netopia's December 2003 revenue from Swisscom fare

[7] Small amounts of revenue attributable to maintenance were recognized ratably over the maintenance period. RJN, Ex. 1 at 19.

no better. Plaintiffs appear to have trumped up this "interim fraud" to avoid some (but not all) of the loss causation problems caused by declines in Netopia's stock price that cannot be attributed to the Philadelphia Transaction. *See infra* Section C. However, the Swisscom allegations are lacking many of the elements of securities fraud that plaintiffs must plead under Section 10(b) — in particular falsity, scienter and reliance. *See DSAM Global Value Fund*, 288 F.3d at 388.

1. Netopia's Statements About Swisscom Revenue Were Accurate.

Plaintiffs allege that Netopia misrepresented in a January 20, 2004 conference call that revenue from Swisscom for the quarter ended March 31, 2004 would be approximately the same as Swisscom revenue for the prior quarter. CAC ¶ 113. In fact, the opposite is true: Netopia's statements about previous and projected Swisscom revenues accurately noted that December sales to Swisscom were uniquely robust, and were not likely to remain as high in ensuing periods.

Specifically, Mr. Lefkof explained in the January 20, 2004 conference call that revenue from Swisscom for the December 2003 quarter was particularly strong in part because of certain promotions Swisscom ran to attract broadband customers that quarter, and that Netopia did *not* expect these promotions to continue in the next quarter. RJN, Ex. 2 at 3 ("we've benefited in the December quarter from year-end promotions implemented by Swisscom and Bluewin. They are currently taking a breather from such promotions"). Mr. Lefkof also repeatedly emphasized that the securities market should *not* expect Netopia's revenue from Swisscom *in the March 31, 2004 quarter to match the revenue growth in the December 31, 2003 quarter*. *Id.* at 5 ("Similar to last year, we do not currently expect sequential revenue growth for the March quarter"). Netopia's financial results for the quarter ended March 31, 2004, which "were due, in part, to the fact that Netopia's Swisscom revenues had plummeted by $4.8 million," CAC ¶ 116, were therefore entirely *consistent* with Mr. Lefkof's statements in the January 20 conference call. *See* RJN, Ex. 3 at 3. Plaintiffs allegations to the contrary are pure fabrication.

2. Netopia Properly Recognized Revenue For Product Sold To Swisscom In The December 2003 Quarter.

In the absence of a misstatement or omission, plaintiffs have also invented a story about the supposedly "true nature" of the Swisscom revenue earned in the December 2003 quarter. CAC ¶ 116. Plaintiffs allege that Netopia reported revenue from "'excess' product that had been placed on a 'boat' for delivery to Swisscom in the final days of December 2003," *id.*, and that the Company's financial statements for that quarter "were artificially inflated by the excess shipments made and booked as revenue in December 2003, and those shipments would likely lead to decreased orders from Swisscom in the March 2004 Quarter," *id.* ¶ 117.

But there is nothing suspicious or improper about shipping product by "boat." The hardware Netopia sells to Swisscom is manufactured in Thailand. According to the terms of the contract between Netopia and Swisscom, title to the product transfers to Swisscom upon delivery to Swisscom's freight carrier in Bangkok. *See* CAC ¶ 116 (quoting April 19, 2004 Conference Call that explained Netopia's contract with Swisscom is "FOB origin"). *How* Swisscom elects to transport the product has no impact on *when* Netopia recognizes the revenue from the sale: because the contract is FOB origin, Netopia *must* recognize revenue at the time the freight forwarder picks up Netopia's product from its warehouse. SAB Topic 13-A.3(a). As Mr. Lefkof explained to analysts and investors, "We [Netopia] didn't have a choice, if it shipped FOB origin in December we have to record the revenue." CAC ¶ 116 (quoting April 19, 2004 Conference Call); RJN, Ex. 3 at 13.

In sum, the premise of plaintiffs' Swisscom allegations is fundamentally flawed. Whether Netopia's sales to Swisscom fell during the March quarter because Swisscom did not continue year-end promotions to its customers, because it ordered sufficient quantities of product in the December 2003 quarter to last through part of the March 2004 quarter, or because of some other factor, is irrelevant and pure speculation. Netopia accurately represented that it expected no growth in Swisscom revenue in the March 2004 quarter.

There was no misstatement, and no securities fraud.[8] 15 U.S.C. § 78u-4(b)(1).

C. Plaintiffs Have Not Alleged Loss Causation For The Majority Of The Alleged Class Period.

Plaintiffs face serious difficulties in establishing loss causation for all of the downward movement in Netopia's stock price from November 2003 through August 2004, the length of their purported class period. *See Dura*, 125 S. Ct. at 1634 (securities class action plaintiff must plead a causal connection between the alleged misrepresentation and the claimed loss). Plaintiffs do describe in the CAC several instances where Netopia has made a public announcement and its stock price fell. But they are unable to connect these drops to the misrepresentations alleged in the CAC.

1. *Dura* Changed The Law In This Circuit For Pleading Loss Causation.

The PSLRA requires plaintiffs to show that "the act or omission of the defendant … caused the loss for which the plaintiff seeks to recover damages." 15 U.S.C. § 78u-4(b)(4). In this circuit, prior to *Dura*, to allege "loss causation" a plaintiff only had to allege that the price of the stock at issue was inflated on the date of purchase because of the alleged misrepresentations. 125 S. Ct. at 1631. The Supreme Court rejected that standard, explaining that once a price is inflated "the logical link between the inflated share purchase price and any later economic loss is not invariably strong." *Id*. Because stock prices fluctuate for reasons unrelated to the alleged fraud, plaintiffs may lose money on those stocks for other reasons. Rejecting the notion that a purchaser who sells inflated shares after a corrective disclosure has *inevitably* suffered a loss related to the alleged fraud, the Supreme Court stated that:

> When the purchaser subsequently resells such shares, even at a lower price, that lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific

[8] Plaintiffs' remaining Swisscom allegations add nothing to the CAC, except innuendo. For instance, plaintiffs allege that, after a salesperson on the Swisscom account was terminated, Mr. Kadish assumed responsibility for the account. CAC ¶ 117. They further allege that Swisscom was dissatisfied with Mr. Kadish, and requested that other Netopia personnel work on the account. *Id.* ¶ 118. None of these allegations (even if true) contribute in any way to claims of securities fraud.

> facts, conditions, or other events, which taken separately or together account for some or all of that lower price.

Id. at 1632. It follows that "the longer the time between purchase and sale, the more likely that … the other factors caused the loss." *Id.* Similarly, the longer between the alleged misrepresentation and the corrective disclosure, the more likely that other factors have operated on the stock price. *See id.* Emphasizing that the purpose of the federal securities statutes is not "to provide investors with broad insurance against market losses," the Court concluded that plaintiffs must show that alleged misrepresentation proximately caused the losses they seek to recover. *Id.* at 1633.

2. Loss Causation Following *Dura* Requires A Showing Of Proximate Cause.

Since *Dura*, courts have recognized that they must scrutinize the connection between an alleged misrepresentation or omission and a subsequent drop in stock price. To survive a motion to dismiss, the plaintiff must establish that the drop was proximately caused by a corrective disclosure or event. The fact that the stock fell during the class period, even in response to some disclosure by the company, does not establish loss causation, unless that disclosure reveals the alleged misrepresentation or omission.

For example, in *In re Initial Public Offering Securities Litigation* ("*IPO*"), No. MDL 1554, 21 MC 92, 04 Civ. 3757, 2005 WL 1162445, at *3 (S.D.N.Y. May 16, 2005), the court applied the Second Circuit's standard for loss causation,[9] which requires a plaintiff to "allege that the subject of the fraudulent statement or omission was the cause of the actual loss suffered, *i.e.*, that the misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security" (internal quotations and emphasis omitted). The *IPO* plaintiffs alleged that the defendants intentionally deflated earnings statements to take advantage of the expected rise in stock price when the companies beat those depressed estimates. *Id.* at *3. The plaintiffs attempted to plead loss causation based on stock price drops following announcements of quarterly revenues that

[9] The court determined that the Second Circuit's inquiry for loss causation was unaltered by *Dura Pharmaceuticals*. *IPO Sec. Litig.*, 2005 WL 1162445, at *3 n.23.

failed to exceed forecasts. The court held that the plaintiffs had failed to establish loss causation because:

> a failure to meet earnings forecasts or a statement foreshadowing such a failure … does not mean that the event disclosed the alleged scheme to the market. In other words, a failure to meet earnings forecasts has a *negative* effect on stock prices, but not a *corrective* effect. Such a failure does not imply that defendants concealed a scheme … therefore it cannot correct the artificial inflation caused by the scheme.

Id. (emphasis in original, quotations omitted). Similarly, in *In re Tellum Inc., Securities Litigation*, No. Civ. A. 02CV5878, 2005 WL 1677467, at *27 (D.N.J. June 30, 2005), the plaintiffs alleged that Tellum's share price fell on several occasions following major disclosures by the company about customer prospects, quarterly financial results, and significant personnel actions. The court held that these allegations alone do not establish that plaintiffs' economic loss was proximately caused by the defendants' misrepresentations, as opposed to other market related factors, and dismissed the case. *Id.*

3. Plaintiffs Fail To Meet The *Dura* Standard Of Proximate Cause.

Plaintiffs' loss causation allegations are inadequate under *Dura*. Plaintiffs' approach is flawed for precisely the same reasons the loss allegations were rejected in the *IPO* and *Tellum* cases. That is, plaintiffs alleged, starting with the January 20, 2004 conference call, a series of announcements or events followed by a drop in the price of Netopia stock, without explaining how the alleged misrepresentations that are the subject of the CAC proximately caused these stock drops. But the January 20, February 17 and April 19, 2004 statements were not corrective disclosures of anything at all. None of the share price declines that followed can be attributed to the alleged ICC-related misrepresentations. Accordingly, plaintiffs' purported loss due to those price movements cannot, under *Dura*, have been caused by these alleged false statements.

Plaintiffs allege that the price of Netopia's stock dropped following the January 20 announcement of Netopia's results for the December 31, 2003 quarter. CAC ¶ 105. They claim that the price of Netopia's stock declined after the January 20 conference call because the Company revealed that the "revenue expectations of analysts (set based upon

predictions from the results announced on November 5, 2003) would not be met." *Id.* But plaintiffs do not allege that the January 20 conference call contained any corrective disclosure about ICC. Nor do they allege any connection between the ICC transactions and the Company's February 17, 2004 filing of its Report on Form 10-Q for the December 2003 quarter, which was followed by another decline in Netopia's share price. *Id.* ¶ 106. Indeed, plaintiffs do not (and cannot) allege that defendants made any representations concerning the ICC transactions in the December 31, 2003 quarter, or in the subsequent earnings releases. The fact that Netopia's stock price declined after the January conference call and the February 10-Q filing does not establish a causal connection with defendants' alleged misrepresentations about the Philadelphia Transaction.[10] *IPO Sec. Litig.*, 2005 WL 1162445, at *3 ("a failure to meet earnings forecasts has a negative effect on stock prices, but not a corrective effect. Such a failure does not imply that defendants concealed a scheme" to misrepresent earnings) (emphasis omitted).

Plaintiffs repeat their error a third time when they allege that they suffered damages from Netopia's April 19, 2004 earnings call. CAC ¶ 107. Again, plaintiffs do not allege that the conference call contained a corrective disclosure, or in any way released information concerning the ICC Transactions.[11] *See id.* Plaintiffs continually ignore *Dura*'s guidance: just because Netopia announced information to the market, and its stock price subsequently dropped, it does not follow that the drop was proximately caused by defendants' alleged misrepresentations. 125 S. Ct. at 1632 (a stock's "lower price may reflect, not the earlier misrepresentation, but changed … circumstances"). Accordingly, plaintiffs have failed to plead loss causation for the stock price drops following the January 20, February 17, and April 19 statements, and can state no claims based on those

[10] Indeed, the insinuation runs counter to one of plaintiffs' alternative theories: that the results of the December 31, 2003 quarter were artificially inflated by the Company's artificial acceleration of Swisscom revenue.

[11] Plaintiffs appear desperate to establish loss causation for the April 19 disclosure because Netopia's stock price declined "significant[ly]" following the announcement. CAC ¶ 107. This may explain their ill-fated flirtation with the Swisscom allegations. *See supra* Section B.

allegations.

II. IN THE ALTERNATIVE, THE COURT SHOULD STRIKE THE ALLEGATIONS RELATING TO THE CHICAGO TRANSACTION, SWISSCOM, AND CERTAIN LOSS CAUSATION ALLEGATIONS BECAUSE THEY ARE IMPERTINENT AND IMMATERIAL.

To the extent the Court is not inclined to dismiss completely the causes of action based on the allegations about the Chicago Transaction (at CAC ¶¶ 22-31), Swisscom (CAC ¶¶ 113-118), and loss causation (CAC ¶¶ 105-107), it should strike these allegations, as they do not contribute to any potential cause of action. *See* Fed. R. Civ. P. 12(f) (court "may order stricken from any pleading … any redundant, immaterial, impertinent, or scandalous matter"). The purpose of Rule 12(f) is "to avoid the expenditure of time and money that must arise from litigating spurious issues by dispensing with those issues prior to trial." *Sidney-Vinstein v. A.H. Robins Co.*, 697 F.2d 880, 885 (9th Cir. 1983). "Impertinent" or "immaterial" matter is not necessary to issues in the case or has no essential relationship to the claims. *Fantasy Inc. v. Fogerty*, 984 F.2d 1524, 1527 (9th Cir. 1993), *rev'd on other grounds*, *Fogerty v. Fantasy, Inc.*, 510 U.S. 517 (1994). "Superfluous historical allegations are a proper subject of a motion to strike." *Id.* In this case, the allegations defendants seek to strike are immaterial and impertinent, and should therefore be stricken.

The allegations relating to the Chicago Transaction are simply irrelevant to plaintiffs' claims. Whatever plaintiffs allege in connection with the sale to ICC in May 2002, it happened so long before the start of the purported class period that it could have had no effect on Netopia's stock price. Accordingly, these allegations have no place in the CAC. *In re Clearly Canadian Sec. Litig.*, 875 F. Supp. 1410, 1420 (N.D. Cal. 1995) (striking allegations describing alleged misstatement that occurred before the purported class period). Similarly, the Swisscom allegations do not allege a fraud. Rather they impertinently cast aspersions on Mr. Kadish, and "place[] an unnecessary burden on defendants and the court to sift through the irrelevant matter to identify the basis of plaintiffs' claims." *Id.* Finally, the loss causation allegations about stock price declines following the January 20, February 17, and April 19, 2004 public statements are likewise

not tied to plaintiffs' alleged fraud, and they, too, serve no purpose. Because they will not be a part of any issue litigated in this case, these allegations should be stricken. *See id.* at 1416 (noting that "[o]ften a pleader will be unable to match the misstatement … with price behavior;" if "the news that rocked the security price was of disappointing earnings, then the pleader must find a misstatement about [those] earnings").

III. THE COURT SHOULD DISMISS ALL CLAIMS AGAINST DAVID KADISH BECAUSE THEY FAIL TO STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED.

A. The CAC Fails To State A Section 10(b) Claim Against Mr. Kadish Because It Does Not Plead That He Made A False Statement, Let Alone With The Requisite Scienter.

Plaintiffs' Section 10(b) claim against Mr. Kadish fails because they have not pled each of the elements of securities fraud. First, plaintiffs cannot identify a misleading statement by Mr. Kadish, who did not participate in conference calls or sign SEC filings. Second, plaintiffs cannot allege scienter. They do not allege that Mr. Kadish knew about — or recklessly disregarded — the alleged schemes involving the Chicago or Philadelphia Transactions. Indeed, plaintiffs allege that other actors *concealed* the true nature of those transactions from Mr. Kadish, and that he acted inconsistently with the purported goals of the alleged fraudulent scheme.[12] *See* CAC ¶¶ 28, 46-47, 75-76. Plaintiffs are left with Mr. Kadish's stock transactions, which are in themselves insufficient to create a strong inference of scienter. *In re Vantive Corp. Sec. Litig.*, 283 F.3d 1079, 1093 (9th Cir. 2002).

1. Plaintiffs Have Not Alleged A Misstatement Attributable To Mr. Kadish.

Plaintiffs' Section 10(b) claim against Mr. Kadish fails to get off the ground because they have not alleged that he made any statement or omission. Mr. Kadish did not sign any relevant SEC filings. He did not participate in conference calls. Nor does the CAC establish that Mr. Kadish was responsible for the Netopia press releases. Quite simply, Mr.

[12] As discussed above, *see supra* Sections I.A & B, plaintiffs cannot even allege that the Chicago Transaction is at all relevant to the causes of action in the CAC, or that the statements about Swisscom were misleading. Aside from these failings, plaintiffs allege *no* facts to demonstrate Mr. Kadish acted with scienter regarding any Swisscom-related revenue recognition decisions. CAC ¶¶ 113-18.

Kadish did not speak to the market. *Medimatch, Inc. v. Lucent Tech., Inc.*, 120 F. Supp. 2d 842, 856 (N.D. Cal. 2000) (dismissing § 10(b) claim where plaintiff "failed to allege any misstatement" made by defendant).

Absent any allegations about Mr. Kadish speaking directly, plaintiffs try to rely on the "group pleading" doctrine. *See* CAC ¶ 129. This does not allow them to escape the stringent fact-based pleading requirements of the PSLRA, *see* 15 U.S.C. § 78u-4(b)(1), to say nothing of the basic fraud pleading standards of Rule 9(b).[13] *See In re Ramp Networks, Inc. Sec.*, 201 F. Supp. 2d 1051, 1078 (N.D. Cal. 2002) (plaintiffs must plead the roles of the individual defendants in the alleged misstatements with particularity to satisfy the requirements of Rule 9(b)). Allegations that an undifferentiated mass of "Individual Defendants" "participated in" the drafting of statements, CAC ¶¶ 100(a)-(e), are insufficient to allege that Mr. Kadish made such statements. *See In re Splash Tech. Holdings, Inc. Sec. Litig.*, No. C 99-00109, 2000 WL 1727405, at *14 (N.D. Cal. Sept. 29, 2000) ("conclusory comment" that "'defendants' participated in the drafting and reviewing of the misleading statements" failed to meet the requirements of 9(b) and the PSLRA); *see also In re Network Assoc., Inc., Sec. Litig.*, No. C 99-01729, 2000 WL 33376577, at * 13 (N.D. Cal. Sept. 5, 2000) (plaintiffs have "not present[ed] facts indicating that [defendant] had any knowledge of or involvement with the accounting or marketing side of the business").

2. Plaintiffs Do Not Allege That Mr. Kadish Acted With The Requisite Scienter.

The PSLRA also requires plaintiffs to "state with particularity facts giving rise to a 'strong inference that the defendant acted with the required state of mind.'" *Wenger v. Lumisys, Inc.*, 2 F. Supp. 2d 1231, 1250 (N.D. Cal. 1998), quoting 15 U.S.C. § 78a-4(b)(2).

[13] Moreover, it is doubtful that the group pleading doctrine survived the PSLRA. *Southland Sec. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353,363-65 (5th Cir. 2004) (rejecting group pleading doctrine and holding that "corporate officers may not be held responsible for unattributed corporate statements solely on the basis of their titles, even if their general level of day-to-day involvement in the corporation's affairs is pleaded"); *In re Immune Response Sec. Litig.*, 375 F. Supp. 2d 983, 1030 (S.D. Cal. 2005); *In re Syncor Int'l. Corp. Sec. Litig.*, 327 F. Supp. 2d 1149, 1172 (C.D. Cal. 2004); *but see In re Secure Computing Corp. Sec. Litig.*, 120 F. Supp. 2d 810, 821-22 (N.D. Cal. 2000).

The "required state of mind" in the Ninth Circuit is "deliberately reckless or conscious misconduct." *Silicon Graphics*, 183 F.3d at 974-75. In evaluating scienter allegations, a court "must consider all reasonable inferences to be drawn from the allegations, including inferences unfavorable to the plaintiffs." *Gompper v. VISX, Inc.*, 298 F.3d 893, 897 (9th Cir. 2002) (Rule 12(b)(6) standard has been, in this respect, fundamentally altered by the PSLRA).

a. Plaintiffs have not alleged that Mr. Kadish knew about the alleged contingent nature of the ICC transactions.

Plaintiffs describe in detail conversations and actions purportedly comprising the alleged premature revenue recognition schemes in the Chicago and Philadelphia Transactions. Conspicuously absent from these discussions is any allegation that Mr. Kadish actually took part in, or was informed of, these schemes.

Even if all that plaintiffs allege about the ICC Transactions occurred, they have not established that Mr. Kadish knew about the allegedly contingent payment terms. For example, plaintiffs do not allege that Mr. Kadish ever saw the original, unaltered version of the Chicago purchase order; indeed, plaintiffs allege that Mr. Deckard used white-out to conceal the contingent terms in ICC's purchase order before submitting it to Netopia's headquarters. *See* CAC ¶ 28. Furthermore, although plaintiffs allege that Mr. Frankl communicated the contingent terms of the Chicago Transaction to certain Netopia personnel, they do not allege that anybody told Mr. Kadish. *Id.* ¶¶ 25-28.

Similarly, plaintiffs do not allege that Mr. Kadish was aware of the hidden terms of the Philadelphia Transaction. According to plaintiffs, it was clear to Mr. Frankl and others that ICC did not intend to pay on the Netopia purchase order until it received payment from the Philadelphia school system. CAC ¶ 37. But, although the allegations concerning the Philadelphia Transaction cover more than fifteen pages of the CAC, plaintiffs have not alleged a single fact demonstrating that Mr. Kadish was aware of how Mr. Frankl had structured the transaction.

To the contrary, the CAC alleges that Mr. Kadish acted inconsistently with one who was aware of the alleged fraud. For example, plaintiffs allege that by April 2004, Mr.

Kadish was "extremely concerned" that ICC still had not paid on the Philadelphia purchase order. CAC ¶ 67. And, it was Mr. Kadish who drafted the June 17, 2004 demand letter seeking payment from ICC. *See id*. ¶ 84. Plaintiffs even allege that Mr. Kadish's efforts were detrimental to the furtherance of the alleged fraud. *Id.* ¶¶ 71, 73, 74.

Plaintiffs attempt to gloss over this failure, implying that Mr. Kadish somehow just "knew" of the contingent nature of the ICC Transactions because "everyone" allegedly knew. For instance, when Mr. Skoulis allegedly told Mr. Frankl that Mr. Deckard had been fired because he "whited-out" the conditional payment language in the original Chicago purchase order, Mr. Frankl allegedly responded, "that is ridiculous, because everyone knew." CAC ¶ 31. In another example, plaintiffs allege that Mr. Skoulis told Mr. Frankl that they had been fired because of the October 7 side letter from ICC, which plaintiffs allege Mr. Skoulis characterized as "BS" because "they … always knew" about it. *Id.* ¶ 97. Exactly who "everyone" is and what they "knew" is not alleged in the CAC; this is insufficient under the PSLRA. *Wietschner v. Monterey Pasta Co.*, 294 F. Supp. 2d 1102, 1115 (N.D. Cal. 2003) (rejecting "blanket statements" that defendant "knew" or "should have known" without alleging specifically what information defendant did have); *In re U.S. Aggregates, Inc. Sec. Litig.*, 235 F. Supp. 2d 1063, 1075 (N.D. Cal. 2002) (hearsay assertion of what defendant stated to another party insufficient to plead scienter). Certainly there are no facts to establish that Mr. Kadish was part of the unspecified group "everyone."

Such conclusory statements, without additional facts to show the basis of the defendant's knowledge, are insufficient to create a strong inference of scienter.[14] *See In re Read-Rite Corp.*, 335 F.3d 843, 848 (9th Cir. 2003) (affirming dismissal of complaint where plaintiffs failed to allege specific particularized facts that defendants knew of the alleged

[14] Because they cannot allege that Mr. Kadish knew, or should have known, of the alleged misstatements, plaintiffs resort to inferring scienter from a collection of mundane facts. *See* CAC ¶¶ 24 (alleging second-hand accounts of staff meetings), 34 (alleging deal status update requests), 44 (alleging purchase order form was emailed instead of faxed). Such "pejorative allegations" about ordinary conduct do not meet the PSLRA's pleading requirements. *See In re Bristol-Myers Squibb Sec. Litig.*, 312 F. Supp. 2d 549, 560 (S.D.N.Y. 2004) (plaintiff's "pejorative characterization of … ordinary corporate desires" insufficient to plead scienter).

misstatements); *U.S. Aggregates*, 235 F. Supp. 2d at 1074-75 (no strong inference of scienter where allegations did not demonstrate how defendants knew of allegedly improper accounting practices).

b. Allegations about Mr. Kadish's stock transactions are insufficient to plead scienter.

In the absence of any factual allegations of scienter, plaintiffs are left to rely on Mr. Kadish's sales of Netopia's stock. *See* CAC ¶ 64, 119. But plaintiffs' allegations about Mr. Kadish's stock transactions do not create any inference, let alone a strong one, of scienter. First, plaintiffs cannot meet their PSLRA-mandated pleading burden by pleading about stock sales in a vacuum: it is a bedrock principle of securities fraud litigation in this circuit that allegations of motive, standing alone, cannot serve as a proxy for scienter. *See Silicon Graphics*, 183 F.3d at 974 (in enacting the PSLRA, "Congress intended to elevate the pleading requirement;" prior standard "requir[ed] plaintiffs merely to provide facts showing … a motive to commit fraud and opportunity to do so"). Even allegations of sales of "large numbers [and percentages] do not necessarily create a strong inference of fraud." *Vantive*, 283 F.3d at 1093 (upholding dismissal of complaint in part because plaintiffs' stock sale allegations were insufficient to plead scienter). That Mr. Kadish sold stock during the class period, without more, is "not inherently suspicious," and is insufficient to allege scienter. *Id.* at 1092; *In re Syncor Int'l Corp. Sec. Litig.*, 327 F. Supp. 2d 1149, 1164-65 (C.D. Cal. 2004) (finding stock sales did not give rise to inference of scienter because, in part, sales were made over a year before end of class period, and sales were not made immediately before corrective disclosures).

Second, the timing of Mr. Kadish's trading — after the November 5, 2003 and January 20, 2004 press releases — is also insufficient to create a strong inference of scienter. "Officers of publicly traded companies commonly make stock transactions following the public release of quarterly earnings and related financial disclosures." *Lipton v. Pathogenesis Corp.*, 284 F.3d 1027, 1037 (9th Cir. 2002) (affirming dismissal of claim because, among other things, allegations regarding the timing of stock trades was insufficient to plead scienter); *see also In re FVC.COM Sec. Litig.*, 136 F. Supp. 2d 1031,

1040 (N.D. Cal. 2000) (officers' sale of shares following press release announcement of anticipated increase in quarterly revenues is not suspicious and does not support inference of scienter). The November 5, 2003 press release, reporting the Company's results for the quarter ended September 30, 2003, was the Company's first report of net income since the quarter ended June 30, 2000. CAC ¶ 58. The January 20, 2004 press release also reported net income for the December quarter.[15] *Id.* ¶ 100(c). Not surprisingly, Mr. Kadish sold some shares of Netopia stock following what were, as far as he knew, successful quarters. Moreover, these sales occurred well in advance of any corrective disclosures about the ICC transactions. *See Syncor Int'l.*, 327 F. Supp. 2d at 1164-65.

B. Plaintiffs' Section 20(a) Claim Against Mr. Kadish Must Be Dismissed.

Plaintiffs' Second Claim for Relief charges the individual defendants, including Mr. Kadish, with control person liability under Section 20(a) of the 1934 Act. In order to state a Section 20(a) claim, a plaintiff must allege (1) a primary violation of federal securities law and (2) that the defendant exercised actual power or control over the primary violator. *Paracor Fin., Inc. v. G.E. Capital Corp.*, 96 F.3d 1151, 1161 (9th Cir. 1996). Moreover, even a controlling person does not have liability when he or she acted in good faith. *Howard v. Everex Sys., Inc.*, 228 F.3d 1057, 1065 (9th Cir. 2000). The CAC fails to allege that Mr. Kadish was a controlling person or that he did not act in good faith.

1. The Section 20(a) Claim Should Be Dismissed Because Mr. Kadish Was Not A Controlling Person.

Plaintiffs do not (and cannot) allege any facts suggesting that Mr. Kadish exercised control over the alleged misstatements. Whether a defendant is a controlling person requires scrutiny of the defendant's participation in the day-to-day affairs of the corporation and the defendant's power to control corporate actions. *Kaplan v. Rose*, 49 F.3d 1363, 1382 (9th Cir. 1994). Plaintiffs must provide a "specific indication that [the defendant] supervised or had any responsibility for the preparation of the financial statements."

[15] Interestingly, and contrary to plaintiffs' theory, the stock price actually declined following the January 20, 2004 announcement.

Howard, 228 F.3d at 1067.

Plaintiffs have alleged no "specific indications" showing that Mr. Kadish had responsibility for the preparation of the alleged misstatements. The conclusory charge that "Individual Defendants directly participated in the drafting" of various statements, CAC ¶¶ 100(a)-(e), is not sufficient to allege Mr. Kadish's responsibility. *See Splash Tech. Holdings*, 2000 WL 1727405, at *14. Nor is merely alleging that Mr. Kadish was a control person by virtue of his position as general counsel enough to state a Section 20(a) claim, as "a bare allegation that a person is a corporate officer, director, or shareholder is insufficient to allege 'control.'" *Cohen v. Citibank, N.A.*, 954 F. Supp. 621, 629 (S.D.N.Y. 1996); *see also Paracor Fin.*, 96 F.3d at 1161-64 (holding CEO not automatically a control person). Furthermore, Mr. Kadish, the Company's legal counsel, did not have responsibility for overseeing the day-to-day operations of Netopia's software sales or the preparation of the financial statements.

2. Plaintiffs' Section 20(a) Claim Should Be Dismissed Because Mr. Kadish Acted In Good Faith And Lacked The Requisite Scienter.

Even assuming that plaintiffs had alleged an underlying violation over which Mr. Kadish had control, he is still not liable under Section 20(a) because he acted in good faith. *See Howard*, 228 F.3d at 1065 ("[A] defendant is entitled to a good faith defense if he can show no scienter and an effective lack of participation."); 15 U.S.C. § 78t(a) (purported "controlling person" can defeat liability if he "acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action").

Plaintiffs' own allegations demonstrate that Mr. Kadish was unaware of the true nature of the challenged transactions. Mr. Kadish's alleged principal involvement in the ICC Transactions was to facilitate and seek out payment on the accounts. CAC ¶¶ 68, 84, 87. By pressing for payment from ICC, Mr. Kadish was hindering, not facilitating Netopia's alleged scheme to hide a contingent deal from the marketplace. Moreover, Mr. Kadish was instrumental in the bringing about the endgame of the Philadelphia Transaction — the discovery of ICC's side letter and the initiation of the Audit Committee

Investigation. *Id.* ¶¶ 93, 94, 96. Indeed, his collection efforts were, according to plaintiffs, working at cross-purposes to the furtherance of the alleged fraud. *See id.* ¶ 71. Mr. Kadish's actions prove his good faith as a matter of law. *See Paracor Fin.*, 96 F.3d at 1164 (CEO's "less than absolute" control over company sufficient to prove good faith defense as a matter of law). Because Mr. Kadish did not "directly or indirectly induce the act or acts constituting the violation or cause of action," the Court should dismiss the Section 20(a) claim against him. *Id.* (citing 15 U.S.C. § 78t(a)).

CONCLUSION

For all of the foregoing reasons, Netopia, Mr. Lefkof and Mr. Kadish request an Order from this Court dismissing: (1) all claims based on Netopia's statements regarding revenue from the Chicago Transaction; (2) all claims based on Netopia's statements regarding revenue from Swisscom; and (3) all claims for damages based on drops in Netopia's stock price prior to July 7, 2004.

In the alternative, the Court should enter an Order striking all allegations relating to the Chicago Transaction; all the allegations relating to Swisscom; and all of plaintiffs' loss causation allegations prior to July 7, 2004.

Finally, the Court should dismiss all claims in the CAC against Mr. Kadish. Because plaintiffs cannot amend the allegations against Mr. Kadish to state a claim for relief, those claims should be dismissed with prejudice.

DATED: August 29, 2005

Respectfully submitted,
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