UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

The Cornelia I. Crowell GST Trust, individually and on behalf of all others similarly situated,

Plaintiff,

v.

PEMSTAR Inc., Allen Berning, Roy Bauer, and Gregory Lea,

Defendants.

Civil File No. CV05-1182 JMR/FLN

(ORAL ARGUMENT REQUESTED)

DEFENDANTS' MEMORANDUM OF LAW IN SUPPORT OF MOTION TO DISMISS CONSOLIDATED COMPLAINT

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I. INTRODUCTION

Plaintiff's Consolidated Complaint ("Complaint") fails as a matter of law. Just because PEMSTAR Inc. ("PEMSTAR" or the "Company") issued a financial restatement that arose out of a failure of internal controls in its Mexico facility does not mean that defendants have committed securities fraud. Relying on unnamed sources, plaintiff dwells on the business challenges facing PEMSTAR's Mexico facility and leaps to the conclusion that defendants "must have known" the financial statements were inaccurate when they had been initially filed. What is missing from plaintiff's Complaint are allegations as to what defendants specifically knew at the time of the filing of PEMSTAR's financial statements that put them on notice that the financial statements were incorrect. This defect alone compels dismissal. Conclusory allegations such as these are insufficient as a matter of law under the Private Securities Litigation Reform Act of 1995 ("PSLRA"). Plaintiff has also failed to plead facts giving rise to a strong inference of scienter. Here, the Individual Defendants[1] sold no stock and received no bonuses, and no individual shareholder would have experienced more loss as a result of the decline in stock price than the Individual Defendants.

Plaintiff has also failed to adequately plead loss causation. Plaintiff has not and cannot identify the loss directly caused by any of the alleged misstatements.

Finally Plaintiff's Section 11 claim must also be dismissed as a matter of law. Plaintiff fails to recognize the risk factors set forth in the Prospectus that warn investors about the precise risks that materialized.

II. STATEMENT OF FACTS

A. PEMSTAR and the Individual Defendants

PEMSTAR was incorporated in Minnesota in 1994 and has its headquarters in Rochester, Minnesota.[2] Consolidated Complaint ("Complaint" or "Compl."), ¶ 4, 7; see also 2005 10-K, filed June 14, 2005, Ex. 21 at 1, attached to the Declaration of Gretchen Agee.[3] PEMSTAR provides engineering, product design, automation and test, manufacturing, and fulfillment services to its customers in the industrial equipment, medical, computing and data storage, and communications industries. Id. at 1.

PEMSTAR is a publicly traded company on the NASDAQ, and during the class period had approximately 3,346 full-time employees. Id. at 6. In its fiscal year ending March 31, 2005, it had revenues of $689.9 million, with a net loss for the year of $33.7 million, or $0.75 per share. Id. at 16, 19. In the previous fiscal year ending March 31, 2004, PEMSTAR had revenues of $669.4 million, with losses of $25.3 million, or $0.60 per share. May 24, 2005, Press Release, Ex. 42.

As alleged in the Complaint, Al Berning is the Chief Executive Officer of PEMSTAR and the Chairman of the Board, and was also President of PEMSTAR until December 16, 2004. Compl. ¶ 8. Greg Lea is PEMSTAR's Chief Financial Officer, and

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1 Defendants are Allen Berning, Roy Bauer, and Gregory Lea.

2 This statement of facts is drawn from (1) the Consolidated Complaint, the factual allegations of which are assumed to be true for purposes of this motion only, and (2) the various public disclosure documents, many of which are incorporated by reference in the Complaint. In the securities litigation context, such documents can be considered on a Rule 12(b)(6) motion to dismiss without converting the motion to one for summary judgment. See In re K-tel Int'l Sec. Litig., 300 F.3d 881, 889 (8th Cir. 2002); Brogren v. Pohlad, 933 F. Supp. 793, 795 (D. Minn. 1995).

3 All Exhibits referenced herein are attached to the Declaration of Gretchen Agee.

is a member of its Board. Compl. ¶ 9. Roy Bauer is the Chief Operating Officer and a member of PEMSTAR's Board. Compl. ¶ 10. Since December 16, 2004, he has also been the President of PEMSTAR. Id. (Referred to collectively as the "Individual Defendants"). During the class period, none of the Individual Defendants sold any of their shares of PEMSTAR stock.

B. The Registration Statement for the Secondary Offering

On August 20, 2003, PEMSTAR filed its prospectus for the secondary offering, through which it offered 6,500,000 shares of common stock. See Compl. ¶ 18; Aug. 20, 2003, Prospectus Supplement to Prospectus Dated Jan. 4, 2002 ("Prospectus"), Ex. 25.

In the Prospectus, PEMSTAR informed the market: "you should consider the following risk factors . . . before deciding to purchase any shares of our common stock. . . If any of these risks actually occur, our business could suffer, the market price of our common stock could decline and you could lose all or part of your investment." Id. at S-5. PEMSTAR then carefully identified the risks associated with its business as well as the risks related to the secondary offering itself. See, e.g., id. at S-5 to S-12. With respect to its business, PEMSTAR stated that its industry was "characterized by intense competition, relatively short product life-cycles and significant fluctuations in product demand." Id. at S-5. PEMSTAR stated that the markets that dictated incoming business were "subject to rapid technological change and product obsolescence." Id. PEMSTAR also warned that "[i]f any of these factors or other factors reduce demand . . . our net sales would likely be negatively affected." Id. In addition to the extensive and detailed identification of numerous industry-specific risks, and risks specific to PEMSTAR, the

Company cautioned potential investors that risks associated with the offering included:

> The market price of our common stock has fluctuated significantly in the past and may fluctuate significantly in the future in response to quarterly operating results and other factors, including many over which we have no control and that may not be directly related to us. The stock market has from time to time experienced extreme price and volume fluctuations, which have often been unrelated or disproportionate to the operating performance of particular companies.

Id. at S-11.

With regard to its foreign operations, PEMSTAR was very clear that such operations exposed it (and the investors) to substantial risks. It first pointed out that:

> We have experienced significant growth in a short period of time and we may have trouble managing our expanded operations . . . Our rapid growth has placed and will continue to place a significant strain on our management, financial resources and on our information, operations and financial systems. ***We face risks associated with coordinating multinational operations and reporting systems,*** diverse technologies and multiple products and services . . . . We cannot assure you that we will manage our growth effectively.

Id. at S-7. Moreover, PEMSTAR made clear that

> Operating in foreign countries exposes us to increased risks, which could adversely affect our results of operations. We currently have foreign operations in Brazil, China, Ireland, Israel, Japan, Mexico, The Netherlands, Singapore and Thailand . . . . ***We have limited experience in managing geographically dispersed operations and in operating in foreign countries*** . . . . Because of the scope of our international operations, we are subject to the following risks . . .:
>
> . . . .
>
> • Incompatibility of systems and equipment used in

> foreign operations; [and]
>
> • Difficulties in staffing and managing foreign personnel and diverse cultures . . . .

Id. at S-9.

C. PEMSTAR's Auditors

On June 24, 2004, PEMSTAR announced that Ernst & Young LLP resigned as its independent auditor. June 24, 2004, Press Release, Ex. 34. As PEMSTAR noted in its press release,

> Ernst & Young issued unqualified opinions on PEMSTAR's financial statements for fiscal years 2000 through 2004, and there were no disagreements between the Company and Ernst & Young on any matter of accounting principles or practices, financial disclosure or audit procedure.

Id.; see also June 24, 2004, 8-K, Ex. 11. On August 18, 2004, PEMSTAR announced that it had selected Grant Thornton to replace Ernst & Young. Aug. 18, 2004 Press Release, Ex. 36.

D. The Mexico Facility and PEMSTAR's Restatement

PEMSTAR acquired its Mexico facility as a subsidiary in 1997 to take advantage of Guadalajara's emerging communications and computing markets. 2001 10-K for the Period Ending Mar. 31, 2001, Ex. 1 at 8. The Complaint makes multiple allegations regarding the Mexico facility, whose operations caused PEMSTAR as a whole to issue a restatement in 2005. For instance, according to plaintiff, the General Manager of the Mexico facility, Marcio Pavageau, had "a ***secret*** agreement with a customer" and created "phony invoices." Compl. ¶ 31(a) (emphasis added). Plaintiff also alleges that Pavageau caused the balance sheet to be falsified, Compl. ¶ 31(c), thus ensuring that PEMSTAR

corporate received false information. Plaintiff does not allege any specifics as to the dollar amounts implicated, the name of the customer, or how these supposed entries impacted PEMSTAR's bottom line.

Plaintiff also alleges that Pavageau fired Ernst & Young in 2003 when they would not sign certain documents. Compl. ¶ 32. When PEMSTAR corporate learned of this in March 2004, they became "extremely angry" and rehired Ernst & Young. Compl. ¶ 37. Eventually, PEMSTAR fired Pavageau in 2003, and Jorge Ramirez was hired. Compl. ¶ 31. He, too, was fired in April 2004. Compl. ¶ 39.

1. The Investigation

On November 3, 2004, PEMSTAR announced that it had launched an investigation of certain "accounting discrepancies" that it had discovered in its Guadalajara, Mexico facility. November 3, 2004, Press Release, Ex. 37. This was necessary because in the course of its normal reconciling process, PEMSTAR had "[d]ifficulty in obtaining satisfactory explanations for specific items . . ." Id. As such, PEMSTAR's CFO, Greg Lea, stated that "We have launched a thorough investigation, led by an independent review team, to determine the extent of any discrepancies in our Mexico results[.] . . . . We're confident that this issue is confined to our Mexico operation." Id. With regard to how long PEMSTAR had known about these accounting discrepancies, Lea explained that it had been "[n]ot that long. Obviously, ***once we discovered that we had the issue***, we really got on it, and so we're working through that process right now." Nov. 3, 2004, Conference Call Transcript, Ex. 44 at 30 (emphasis added).

The investigation, as was explained at the analyst telephone conference held the same day, would involve "independent resources" and the participation of both Ernst & Young, PEMSTAR's previous auditors, and Grant Thornton, PEMSTAR's current auditors. Id. at 18; see also Nov. 18, 2004, Press Release, Ex. 38. The investigation itself was led by PriceWaterhouseCoopers and an independent review team. Feb. 14, 2005, Press Release, Ex. 40.

On November 18, PEMSTAR further updated the market and stated that its investigation was "nearing completion." Nov. 18, 2004, Press Release, Ex. 38. On January 13, 2005, PEMSTAR informed investors that its financial statement for the year ended March 31, 2004,[4] "should no longer be relied upon." Jan. 13, 2005, Press Release, Ex. 39. In the same 8-K filing PEMSTAR announced that it was considering whether financial results for fiscal year 2003 would have to be restated as well. Form 8-K, Jan. 13, 2005, Ex. 15.

Eventually, the investigation determined "that inappropriate and irregular accounting entries were made at [PEMSTAR's] Mexico facility. These inconsistencies occurred in recording certain expenses, taxes, product costing and asset valuations, and impacted both the statement of operations and the balance sheet of its Mexico operations." Feb. 14, 2005, Press Release, Ex. 40. As a result, PEMSTAR restated its fiscal year 2004 (April 2003 to March 2004) loss by $5.5 million to ($25.3) million from ($19.8) million and adjusting the fiscal 2005 first quarter (April to June 2004) by $0.7

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[4] PEMSTAR's fiscal year 2004 ran from April 1 to March 31, 2004.

million to income of $0.5 million from $1.2 million. Feb. 14, 2005, Press Release, Ex. 40.

2. PEMSTAR's Response to the Results of the Investigation

After PEMSTAR issued the restatement, the Company informed the market that

> The important fact is that we discovered the problem, brought in an independent team to lead the investigation, calculated the financial impact and determined that the inappropriate and irregular entries are no longer occurring[.] We are glad to put this matter behind us, and we have implemented rigid controls to ensure that this situation does not happen again.

Id. These rigid controls included:

- Hiring new site and financial leadership;
- The implementation of operational excellence initiatives, improving the cost structure and enhancing manufacturing capabilities going forward;
- The disengagement from unprofitable business with certain customers; and
- The centralization of the Americas accounts payable and accounts receivable functions at the company's Rochester headquarters.

Id. Four months later, PEMSTAR announced that it was exiting its Mexico facility. Form 8-K, June 22, 2005, Ex. 24.

E. The Class Period and PEMSTAR's Stock Price

Plaintiff has alleged a class period of almost two years. At the beginning of the class period (January 30, 2003), the day after PEMSTAR disclosed its third quarter results for the quarter ended December 31, 2002, PEMSTAR's stock closed at $3.26.

On January 13, 2005, almost two years after the start of the class period, PEMSTAR filed an 8-K that provided an update on the accounting review at its Mexico facility. PEMSTAR also revised its fiscal third-quarter outlook, stating that it expected

net sales for fiscal 2005 third quarter "at the low end of previous guidance." Jan. 13, 2005, Press Release, Ex. 39. On January 12, the end of the class period, PEMSTAR's stock closed at $2.06. The next day (a day outside of the class period) PEMSTAR's stock price declined to $1.79. While the Complaint ends the class period at January 12, 2005, PEMSTAR issued the actual restatement and the results of its investigation on February 14, 2005.

F. The First Securities Fraud Class Action Lawsuit and Its Settlement

In 2002, PEMSTAR faced its first federal securities lawsuit when several complaints were filed in the District Minnesota on July 24, 2002. See Brody v. PEMSTAR Inc., et al., Case No. 02-1821 DWF/SRN (D. Minn. July 24, 2002). The Court ordered the actions consolidated for all purposes under the caption In re PEMSTAR Inc. Securities Litigation, Case No. 02-1821 DWF/SRN ("PEMSTAR I").[5] PEMSTAR I's underlying allegations concerned PEMSTAR's representations regarding levels of inventory, accounts receivable, and goodwill. PEMSTAR I, No. 02-1821(DWF/SRN), 2003 WL 21975563, *2-*3 (D. Minn. Aug. 15, 2003), Ex. 51.

PEMSTAR I's class period was from June 8, 2001 to May 3, 2002. However, litigation of the case and discovery regarding it extended through 2004 – and the putative class period of the case at hand. Compl. ¶ 1 (setting class period from January 30, 2003, to January 12, 2005). In fact, plaintiffs in PEMSTAR I amended their complaint as late as December 23, 2004, based upon evidence obtained in 2004. PEMSTAR I, Dec. 23, 2004, [Corrected] Interlineated Amended Consolidated Complaint ("PEMSTAR I

Compl."), Ex. 46; See also PEMSTAR I, Dec. 10, 2004, Order, Ex. 45. Some of these amendments directly implicated the Mexico facility, a key allegation in PEMSTAR II. See id.; see also PEMSTAR I Compl. Ex. 46, ¶ 125 ("Pemstar's inventory representations were false because Pemstar included approximately $3.5 million in inventory at their Mexican facility, in which Pemstar admitted to its accountants during the FY02 audit process, was physically absent."). Moreover, the PEMSTAR I Court specifically ordered that PEMSTAR provide discovery regarding the Mexico facility. PEMSTAR I, Apr. 23, 2004 Order at 10, Ex. 43.

The litigation in PEMSTAR I was hard fought, but eventually, settlement was reached at a January 20, 2005 mediation with Lewis Remele. See Ex. 47. The terms of the settlement provided $12 million would be paid out to the shareholders (less attorney's fees), and that PEMSTAR and all defendants were released from

> ***any and all claims***, including both known or Unknown Claims, arising out of or related directly or indirectly, in any way, to both (1) the purchase or sale of PEMSTAR common stock during the Class Period, and (2) the allegations set forth ***or that could have been set forth*** in the Litigation.

Stipulation and Agreement of Settlement, PEMSTAR I, Ex. 48, ¶ 1.16 at 9 (emphasis added). "Unknown Claims" was further defined as:

> [A]ny and all Released Claims which any Lead Plaintiff, Named Plaintiff, or Settlement Class Member does not know or suspect to exist in his, her, or its favor at the time of the release of the Released Parties . . . which if known by him or it might have affected his or its decision(s) with respect to the Settlement.

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[5] Where necessary, this instant case will be referred to as PEMSTAR II.

Id. ¶ 1.24 at 10. The settlement in the Securities Action was approved by Judge Donovan W. Frank on May 27, 2005. See Ex. 49. Payments of $12 million of the settlement proceeds to the shareholders of PEMSTAR have commenced.

III. ARGUMENT

A. The Motion to Dismiss Standard

Defendants bring this motion to dismiss under Rules 9(b) and 12(b)(6) of the Federal Rules of Civil Procedure and under the Private Securities Litigation Reform Act ("PSLRA"). Rule 9(b) requires all averments of fraud to be pled with particularity. Rule 12(b)(6) permits the Court to dismiss a complaint if it fails "to state a claim upon which relief can be granted." The basic elements of a private federal securities fraud action are:

> (1) a material misrepresentation (or omission);
> (2) scienter, i.e., a wrongful state of mind;
> (3) a connection with the purchase or sale of a security;
> (4) reliance, often referred to in cases involving public securities markets (fraud-on-the-market cases) as "transaction causation;"
> (5) economic loss; and
> (6) "loss causation," i.e., a causal connection between the material misrepresentation and the loss.

Dura Pharm., Inc. v. Broudo, __ U.S. __, 125 S. Ct. 1627, 1631 (2005) (citations omitted); see also In re Nash Finch Co. Sec. Litig., 323 F. Supp. 2d 956, 961 (D. Minn. 2004).

Complaints brought under Rule 10b-5 and Section 10(b) are also governed by the special pleading standards adopted by Congress in the PSLRA. The pleading standards applicable to this motion to dismiss are unique to securities actions and "were adopted to curb abuses of securities fraud litigation." In re Navarre Corp. Sec. Litig., 299 F.3d 735,

741 (8th Cir. 2002). Congress therefore requires securities plaintiffs to plead the elements of falsity and scienter with particularity, thereby incorporating the Rule 9(b) requirement that plaintiffs plead fraud with particularity. See id. at 742.

Thus, in order to meet the heightened pleading standards of the PSLRA, the complaint must "specify each statement alleged to have been misleading [and] the reason or reasons why the statement is misleading." 15 U.S.C. § 78u-4(b)(1). Included in this requirement is the plaintiff's obligation to articulate why the statements were false or misleading "***at the time they were made***." See Navarre, 299 F.3d at 743 (emphasis added). The complaint must also "state with particularity facts giving rise to a ***strong inference*** that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2) (emphasis added). While the Court must assume all factual allegations in the Complaint are true, the PSLRA also directs the Court to "disregard 'catch-all' or 'blanket' assertions that do not live up to the particularity requirements of the statute." Fla. State Bd. of Admin. v. Green Tree Fin. Corp., 270 F.3d 645, 660 (8th Cir. 2001) (citations omitted). A failure to meet these pleading requirements is fatal to the complaint. 15 U.S.C. § 78u-4(b)(3).

The remaining elements of the securities fraud cause of action are governed by the pleading standards articulated in Rule 8. Although the plaintiffs are only required to provide "a short and plain statement of the claim," the Supreme Court has recently emphasized that the complaint "must provide the defendant with fair notice of what the plaintiff's claim is and the grounds upon which it rests." Dura, 125 S. Ct. at 1634 (quotation omitted). Accordingly, a plaintiff who has suffered an economic loss must

"provide a defendant with some indication of the economic loss and the causal connection that the plaintiff has in mind." Id. Even under Rule 8, the Court is "not bound to accept as true a legal conclusion couched as a factual allegation . . . and may disregard the allegation." Papasan v. Allain, 478 U.S. 265, 286 (1986); see also Farm Credit Serv. of Am. v. American State Bank, 339 F.3d 764, 767 (8th Cir. 2003) (the Court is "free to ignore legal conclusions cast in the form of factual allegations" when deciding a motion to dismiss). Where the plaintiff fails to meet these standards, the complaint will be deemed "legally deficient" and must be dismissed. Dura, 125 S. Ct. at 1634.

B. The Complaint Does Not Meet the Heightened Pleading Standard of Rule 9(b) and the PSLRA

Although certain PEMSTAR financials were ultimately restated, this does not automatically lead to the conclusion that the defendants acted fraudulently. Instead, the plaintiff must allege with particularity that defendants knew the statements were false "***when they were made***." Navarre, 299 F.3d at 742 (emphasis added). Mere "rote allegations that the defendants knowingly made false statements of material fact" do not satisfy the heightened pleading standard under the PSLRA. Id. at 745.

Here, plaintiff is unable to make such specific allegations. In the section of its Complaint entitled "Material Representations During the Class Period," plaintiff alleges that defendants made misrepresentations regarding: (1) financial statements (Compl. ¶¶ 14-23); (2) internal controls (¶¶ 24-27); and (3) PEMSTAR's relationship with its suppliers (¶¶ 28-29). But plaintiff's failure to plead his allegations with particularity –

especially as regards knowledge that the misstatements were false when made – is "insufficient and fatal under the PSLRA," Navarre, 299 F.3d at 743.

1. The Complaint Fails to Establish that Statements Regarding PEMSTAR's Income Statements and Balance Sheets Were Material Misrepresentations or False When Made.

Plaintiff's allegations regarding the supposed misstatements in its income statements and balance sheets fail to plead with specificity the "who, what, when, where and how" of the misstatements, and fail to show that defendants knew the statements were false when they were made. See Navarre, 299 F.3d at 745. This is fatal to these allegations.

Plaintiff alleges in Paragraphs 15 to 23 that PEMSTAR misstated its financial results from the fiscal quarter ending December 31, 2002 (the third quarter fiscal 2003) to the fiscal quarter ending June 30, 2004 (the first quarter fiscal 2005). As an initial matter, plaintiff fails to inform the Court that neither the third or fourth quarters of fiscal 2003 or fiscal 2003 itself were restated. Compl. ¶¶ 15-16. The Complaint furthermore makes a general conclusory statement that inventory and accounts receivable were overstated but there are no specific facts alleging what statements were false and misleading, how much was overstated, or who had knowledge of the alleged overstatements. See Navarre, 299 F.3d at 745.

In addition, plaintiff's allegations that the Mexico facility controller resigned rather than provide inaccurate financial information is similarly deficient, as it does not provide what the allegedly inaccurate financial information was, how it affected PEMSTAR's financials, or who of the defendants knew the information was inaccurate.

See Compl. ¶¶ 14-16. In fact, even as alleged the only person who knew about the inaccurate financial information was General Manager Pavageau, and the Complaint admits that Pavageau actually concealed information from defendants. See Compl. ¶ 31.

In addition, while PEMSTAR's decision to issue the restatement indicates that some of the initially filed financial information was incorrect, the Complaint must indicate "that the defendants had access to, or knowledge of, information contradicting their public statements ***when they were made***." Navarre, 299 F.3d at 742 (emphasis added). As discussed in the scienter section, Paragraph III.B., infra, the Complaint is devoid of any facts that would lead the Court to conclude that the defendants knowingly issued inaccurate financial statements.

2. The Complaint Fails to Establish that Statements Regarding PEMSTAR's Internal Controls Were Material Misrepresentations or False When Made.

With respect to the statements about PEMSTAR's internal controls, the Complaint fails to meet the threshold statutory requirement that a complaint "specify each statement alleged to have been misleading." 15 U.S.C. § 78u-4(b)(1). [First plaintiff fails to differentiate strictly between company-wide controls and the representations required about those controls under Section 404 of Sarbanes-Oxley, and the controls in a single facility, which obviously did not prevent the restatement.] No facts are alleged that at the time the Company disclosed its Section 404 entity assessment that it knew the internal controls at the PEMSTAR Mexico facility were deficient.

For instance, the Complaint alleges that Berning knew of the problems in Mexico because according to Confidential Witness "C" "***one*** telephone conference call took place

prior to the Class Period" that indicated that the general ledger in Mexico was out of balance. Compl. ¶ 25 (emphasis added). The allegation is significant for what it does ***not*** say. When did the conversation take place? Who from PEMSTAR Mexico made the reports? How much was the general ledger out of balance? What did it have to do with controls? And what is the significance of a facility's general ledger being out of balance? The Complaint's failure to plead with specificity the "who, what, when, where and how of this alleged scheme" is fatal to their claims regarding internal controls.[6] Navarre, 299 F.3d at 745.

3. The Complaint Fails to Establish that Statements Regarding PEMSTAR's Relationship with Its Suppliers Were Material Misrepresentations or False When Made.

Plaintiff contends that PEMSTAR's statements in its 2003 10-K report about its "strong relationships with a broad range of materials and component suppliers" was misleading because, allegedly, PEMSTAR's vendors refused to ship components to PEMSTAR due to PEMSTAR's significant problems paying vendors on time. Compl. ¶¶ 28-29. The Complaint, however, does not make any specific allegations as to when specific production lines were closed, the number of lines closed, or the significance of the closures. This is particularly important because the allegations are based on Confidential Witness "B", (see Compl. ¶ 29), who is represented as stating that between February 2003 and January 2005 PEMSTAR was forced to close production lines

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[6] Plaintiff's further allegations regarding internal controls – that a General Manager intimidated Ernst & Young and that inventory counts did not agree with PEMSTAR's records – suffers from the same infirmities as their allegations regarding a single phone call at an unspecified time in the past. Compl. ¶¶ 25-26. Without specificity,

because vendors were refusing to send parts. Compl. ¶¶ 44-46. PEMSTAR's 2003 10-K, in which the alleged misstatements were made, covered the time period from March 2002 to March 2003 thus rendering ***twenty-one months*** of allegations of Confidential Witness "B" completely irrelevant to the alleged misrepresentation.

In addition, the Complaint fails to allege what vendors refused to send parts, when they refused to send parts, how much the parts were worth, and the impact all of this had on the financial statements. Indeed, the best that plaintiff can do is allege that PEMSTAR owed a supplier named "Arrow" $50-$60 million. Compl. ¶ 46. But the Complaint fails to articulate what effect this had on PEMSTAR and its financial statements (if any), what goods (if any) Arrow supposedly failed to ship, and the impact on PEMSTAR's financials. Plaintiff's claims regarding misstatements and PEMSTAR's suppliers are insufficient as a matter of law.

C. The Complaint Fails to Adequately Plead Scienter.

Not only does plaintiff fail to properly identify misrepresentations and plead with particularity why each statement was misleading when made, he also fails to adequately plead, "with particularity facts giving rise to a ***strong*** inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2) (emphasis added). The required state of mind is scienter, the "intent to deceive, manipulate, or defraud." Kushner v. Beverly Enter., Inc., 317 F.3d 820, 827 (8th Cir. 2003). The Eighth Circuit has made clear that "inferences of scienter survive a motion to dismiss only if they are both reasonable and strong." Id. at 826. Bald statements of knowledge do not satisfy

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such allegations do not satisfy the PSLRA's heightened pleading standard.

plaintiff's burden. See Navarre, 299 F.3d at 743; see also Nash Finch, 323 F. Supp. 2d at 960-61 (noting that the PSLRA requires a court to disregard catch-all or blanket assertions of scienter). Plaintiff's Section 10(b) claim should be dismissed on this basis alone.

Indeed, a claim of securities fraud cannot proceed simply because a company restated its financial statements, nor may it proceed simply by attributing the failure of the internal controls of a foreign subsidiary to its parent. See In re Comshare, Inc. Sec. Litig., 183 F.3d 542, 554 (6th Cir. 1999). While restatements are corrections of errors, they are not admissions of an intent to defraud.

1. The Restatement of Financial Information Does Not Give Rise to a Strong Inference of Scienter.

Violations of GAAP do not give rise to a strong inference of scienter. See Kushner, 317 F.3d at 831; K-Tel Int'l, 300 F.3d at 894. Courts have consistently held that a restatement itself does not give rise to a strong inference of scienter. See, e.g., Comshare, 183 F.3d at 553; Greebel v. FTP Software, Inc., 194 F.3d 185, 204 (1st Cir. 1999); In re U.S. Office Prod. Sec. Litig., 326 F. Supp. 2d 68, 79-80 (D. D.C. 2004); In re Metawave Comm. Corp., 298 F. Supp. 2d 1056, 1079 (W.D. Wash. 2003).

Thus, plaintiff's attempts to allege scienter by reference to the existence of a restatement or GAAP violations fall short because they lack the *sin qua non* of securities fraud under the PSLRA – facts demonstrating intentional misconduct or conduct that is extremely reckless. As one court recently observed, attempting to infer intent from the fact of a restatement is a "circular" argument. In re Office Prod., 326 F. Supp. 2d at 79-

80. It is not enough, then, for plaintiff to plead, even at length, that GAAP violations occurred and that restatements were made. Such allegations are insufficient to plead scienter.

2. A Subsidiary's Lack of Internal Controls Does Not Establish Scienter.

Plaintiff bases most of his Complaint on the inappropriate and irregular accounting at the Mexico facility that led to PEMSTAR's eventual restatement. But a subsidiary's wrongdoing "cannot be automatically imputed to its corporate parent . . .let alone to the parent's principal officer . . . or principal owner . . . ." In re Baesa Sec. Litig., 969 F. Supp. 238 (S.D.N.Y. 1997) (dismissing complaint based in part on Brazilian subsidiary's false financial statements). Moreover, as the Sixth Circuit stated, "This Court should not presume recklessness or intentional misconduct from a parent corporation's reliance on its subsidiary's internal controls." Comshare, 183 F.3d at 554; see also Chill v. Gen. Elec. Co., 101 F.3d 263 (2d Cir.1996) (pre-PSLRA case concluding that "[f]raud cannot be inferred simply because [the parent] might have been more curious or concerned about the activity at [the subsidiary].").

Comshare is instructive. As in this case, the plaintiff in Comshare contended that a restatement caused by a foreign subsidiary's GAAP violations supported a strong inference of scienter. See 183 F.3d at 553. The court properly rejected plaintiff's argument, noting that subsequent revelation of a falsehood in previous statements does not itself imply scienter, nor does reliance on a subsidiary's internal controls. Id. In addition, the Comshare Court concluded that plaintiff failed to allege any facts that

demonstrated that the accounting errors of the foreign subsidiary were obvious, or that Comshare intentionally disregarded "red flags" that would have revealed the accounting errors prior to issuing the financial statements. See id. at 554; see also Svezzese v. Duratek, 67 Fed. Appx. 169, 173 (4th Cir. 2003) (affirming that complaint did not even meet "most lenient PSLRA pleading standard" where "[u]pon inspection, it is clear that Plaintiffs allege little more than accounting failures and breakdowns in . . . internal procedures."). It is not enough, therefore, for plaintiff to make allegations about wrongdoing by those in PEMSTAR's Mexico facility and impute those allegations to defendants.

3. The Allegations of the "Confidential Witnesses" Do Not Establish Scienter.

The Complaint offers four confidential witnesses purporting to provide information about the PEMSTAR Mexico facility. While these witnesses allege that they knew about the malfeasance of various employees at the Mexico plant, the Complaint does not allege that defendants ***knew*** that these individuals were misstating the plant's financial information ***at the time*** PEMSTAR issued its quarterly or yearly financial statements. "Without allegations of particular facts demonstrating ***how*** the defendants knew of the scheme ***at the time they made their statements*** . . . a showing in hindsight that the statements were false does not demonstrate fraudulent intent." Kushner, 317 F.3d at 827.

a. The Complaint Fails to Allege that Any Report Read by the Individual Defendants Prior to a Public Announcement Reflected the Financial Overstatement at the Mexico Facility.

Each of the confidential witnesses describe various internal reports on PEMSTAR's operations, but the Complaint fails to allege ***what*** in the reports would have told the defendants about the accounting problems in Mexico or ***when*** such reports were read by the defendants. For example, Confidential Witnesses "B" and "D" allege that the Individual Defendants reviewed various reports relating to the Mexico facility. But, just because senior managers are receiving financial performance reports does not mean that the review of such reports provided notice of fraud. The Complaint fails to plead that these reports described the existence of fraud at the plant, or that the information contained in these reports raised any specific "red flags" which might alert the defendants to any material accounting irregularities. See, e.g., Compl. ¶ 41 (Confidential Witness "B" allegedly attended "Executive Meetings" in which the Individual Defendants "reviewed and analyzed weekly and monthly reports, broken down by site and by customer"); ¶ 55 ("Monthly Consolidated Report" read by Lea); ¶ 57 (Bauer implemented new reporting system and read the new "Monthly Operational Report"); see also Compl. ¶¶ 47-49 (Confidential Witness "C" allegedly wrote a report allegedly given to Lea on the ***profitability*** of the Mexico plant in 2002). Even the defendants' responsibility to "review Pemstar Mexico's financial data," Compl. ¶ 53, does not tell the Court what information was contained in these reports that would have told the Individual Defendants that they needed to "investigate further." Kushner, 317 F.3d at

829.

The Complaint also fails to allege when and how any report disclosing the financial problems in Mexico was given to the Individual Defendants. For instance, according to the Complaint, Confidential Witness "A," a consultant at PEMSTAR Mexico, knew that the "assets" were overstated by $3.5 million and made various reports detailing the problems. See Compl. ¶¶ 31, 33-35. The Complaint, however, states only that "A" "***was told*** that his monthly reports . . . were shared by Controller Larson with his boss, Defendant Lea." Compl. ¶ 33 (emphasis added). But, there is no ***specific*** allegation that Lea actually read a report early in the class period that explained the accounting problems in Mexico. Moreover, even if PEMSTAR senior management was aware of a $3.5 million asset overstatement, this allegation does not mean that Defendants were aware of the circumstances that generated the ***earnings*** restatement. Plaintiff fails to explain how asset value (a balance sheet item) has anything to do with the restatement or how an overstatement amounting to less than 1% of PEMSTAR's total assets could be material. See Form 10-Q, filed Feb. 17, 2004 for period ended Dec. 31, 2003, Ex. 9 at 3 (placing PEMSTAR's total assets at $383,137,000); see, e.g., Romine v. Acxiom Corp., 296 F.3d 701, 708 (8th Cir. 2002) (concluding a decline in revenues of 5% was not material as a matter of law).

b. The Complaint Fails to Allege that the Defendants Knew of the Alleged Fraudulent Accounting Practices at the Mexico Facility.

The Complaint alleges, again without ***specific*** facts, that the Individual Defendants knew about and discussed the accounting irregularities in Mexico before making public

statements. Confidential Witness "B" alleges that in weekly "Executive Meetings" at PEMSTAR's headquarters, the Individual Defendants and other PEMSTAR executives and employees, including Confidential Witness "B," "reviewed and analyzed monthly reports" and "began to discuss the issue of the financial and accounting problems at Pemstar Mexico with the Individual Defendants, but the Individual Defendants tabled the discussion of those issues." Compl. ¶¶ 40-41. As is consistently the case with the Complaint, these allegations lack crucial details and therefore cannot meet the heightened pleading standard of the PSLRA.

According to Confidential Witness "B," "the financial results reviewed at . . . 'Super Honcho' meetings ***two weeks prior to the public release of financial results*** were materially worse than the financial results that were subsequently publicly announced by the Company." Compl. ¶ 43 (emphasis added). However, by the Complaint's own admission, "B" could not have known what was said at these meetings because "B" admits that he was not one of the "super honchos" invited to the meetings; he only alleges that he "was able to ***see*** who was in the meeting." Compl. ¶ 42 (emphasis added). Furthermore, the Complaint does not articulate with particularity ***when*** this alleged meeting about the financial results took place, ***who*** was there, ***how much*** was overstated, or any of the other necessary particular details to adequately plead fraud under Rule 9(b) and the PSLRA.

Plaintiff also insinuates that because the Individual Defendants "discussed," "monitored," or otherwise showed an interest in the Mexico plant, they must have known about the accounting issues at the plant. According to Confidential Witness "C," "all of

Pemstar Mexico's senior executives knew about the profitability issues in Mexico . . . and Defendant Berning and Singh had also met regularly and discussed Pemstar Mexico's operations." Compl. ¶ 52. Given that the Mexico facility was a division of PEMSTAR's global operations, it is not surprising that the PEMSTAR executives would discuss and study its performance. It also makes sense that "D," as PEMSTAR's international Financial Controller would be asked, as part of his basic job description, to monitor the Mexico facility. See Compl. ¶¶ 12(d), 56. Moreover, even if there were difficulties at the Mexico facility, "mere knowledge of mismanagement hardly creates a strong inference that the subsidiary's financial statements are false . . . ." Baesa, 969 F.Supp. at 243.

c. The Complaint Fails to Allege That the Individual Defendants Learned of the Accounting Practices from the Mexico Employees Prior to the Issuance of Any Public Statement.

The Complaint describes several interactions between the Individual Defendants and employees of the Mexico plant, but fails to demonstrate that any information was communicated during these meetings that would have told the Individual Defendants that the employees in Mexico were "cooking the books." For example, Confidential Witnesses "C" and "D" allege that the Individual Defendants met with the different PEMSTAR managers from around the world, including the General Manager of PEMSTAR Mexico. See Compl. ¶ 53 (Lea attended bi-annual meetings with managers), ¶ 58 (Bauer met monthly with general managers). There is no allegation that in these meetings, either of the Confidential Witnesses heard the General Managers disclose the

accounting problems at the Mexico facility to any of the Individual Defendants.

Moreover, the vague allegation that an unnamed source talked to Lea about "financial statements" is consistent with Lea's job as CFO. see Compl. ¶ 9. The Complaint does not allege that "A" specifically told Lea that the financial results for the Mexico facility were overstated. The Complaint also alleges that "Confidential Witness 'C' ***watched*** as Defendant Lea confronted Pemstar Mexico General Manager Pavageua [sic] concerning the Mexican facility's financial issues." Compl. ¶ 53 (emphasis added). Again, the Complaint fails to describe the content of the communication because it cannot; "C" admits that he only saw the interaction.

Finally, the Complaint makes an important admission with regard to what the Individual Defendants were capable of discovering from their employees in Mexico. According to Confidential Witness "A," Pavageau—the General Manager who was fired by PEMSTAR in September or October 2003—had a "***secret agreement*** with a customer that allowed Pavageau to inflate Pemstar Mexico's accounts receivable and revenue, without a corresponding increase in cost of goods sold." Compl. ¶ 31(a) (emphasis added). By plaintiff's own admission, what Pavageau was doing to inflate PEMSTAR Mexico's accounts receivable was "***secret***." The Complaint does not explain how or when the Individual Defendants knew or could have known about this ***secret*** scheme.

4. Allegations Regarding Motive and Opportunity Are Insufficient.

Plaintiff's allegations of motive and opportunity are similarly insufficient to plead scienter. Plaintiff must allege a "concrete and personal benefit to the individual defendants resulting from fraud." K-Tel Int'l, 300 F.3d at 893-94. Each of the alleged

motives relied upon fails as a matter of law. Plaintiff first attempts to plead motive and opportunity by alleging that PEMSTAR needed high stock prices to "obtain critical financing for Pemstar." Compl. ¶ 61. But, as a matter of law, a mere "desire to consummate [a] corporate transaction does not constitute a motive for securities fraud." In re Health Mgmt. Sys., Inc. Sec. Litig., 1998 WL 283286, at *6 n. 4 (S.D.N.Y. June 1, 1998); Nash Finch, 323 F. Supp. 2d at 963 (stating that "common business aspirations are insufficient to support a claim of scienter."); see also K-Tel Int'l, 300 F.3d at 894 (noting that conclusory allegations regarding general motives possessed by all corporate insiders are insufficient to establish scienter as a matter of law).

Second, plaintiff attempts to plead motive and opportunity by alleging that defendants were "motivated" to misrepresent PEMSTAR's financial statement in order for PEMSTAR to "sell stock at artificially high prices" in a Secondary Offering completed in August of 2003. Compl. ¶ 66-67. But, such an alleged desire is insufficient to demonstrate motive as a matter of law. See Johnson v. NYFIX, 399 F. Supp. 2d 105, 114 (D. Conn. 2005) (dismissing complaint where plaintiffs alleged defendants were motivated to use artificially inflated share prices to raise funds in a secondary offering); Rombach v. Chang, 355 F. 3d 164, 177 (2d Cir. 2004).

Finally, the Complaint is devoid of any allegation that any Individual Defendant engaged in insider sales of PEMSTAR stock while it was trading at an allegedly inflated price. This lack of insider trading creates a "negative inference regarding scienter as a result of the plaintiffs' unsuccessful attempt to demonstrate motive." In re Acterna Corp. Sec. Litig., 378 F. Supp. 2d 561, (D. Md. 2005) (quoting Cutsforth v. Renschler, 235 F.

Supp. 2d 1216, 1250 (M.D. Fla. 2002)); see also Keeney v. Larkin, 306 F. Supp. 2d 522, 535-36 (D. Md. 2003).

D. The Complaint Fails to Plead Loss Causation or Economic Loss.

1. The Pleading Standard

Essential elements of a securities fraud claim are economic loss and loss causation. See Dura, 125 S.Ct. at 1631. Although the pleading of these elements is governed by notice pleading under Rule 8, a complaint must provide the defendant with fair notice of what the plaintiff's claim is and the grounds upon which it rests. See id. at 1634. Here, plaintiff fails to plead either economic loss or loss causation (let alone both as is required), and the Complaint should be dismissed.

a. Dura Pharmaceuticals and its Progeny

Based on the reasoning in Dura, and decisions of other courts applying Dura, plaintiff's allegations that PEMSTAR's stock price declined after the three separate press releases relating to the resignation of Ernst & Young, the announcement of an investigation into the accounting practices of the Mexico facility, and the announcement that a restatement would be likely (Compl. ¶¶ 70-73) are insufficient to plead economic loss and loss causation. As the Supreme Court explained, when a stock price falls, that lower price may reflect not the earlier misrepresentation, but changed investor expectations, new industry specific or firm specific facts, conditions, or other events, which taken separately or together, account for some or all of that lower price. See Dura, 125 S.Ct. at 1632. Recognizing this, several courts applying Dura have dismissed complaints for failure to plead economic loss and loss causation even where the plaintiffs

alleged a drop in the price of the stock, because the plaintiffs failed to identify the actual loss and how the decline was directly ***caused by*** the alleged misrepresentations. See e.g., D.E.&J. Ltd. P'ship v. Conaway, 133 Fed. Appx. 994, 2005 WL 1386448 (6th Cir. 2005); In re Acterna, 378 F. Supp. 2d 561 (D. Md. 2005); In re Tellium, Inc. Sec. Litig., No. 02-5878, 2005 WL 1677467 (D. N.J. June 30, 2005); In re Compushare Sec. Litig., 386 F. Supp. 2d 913, 918-19 (E.D. Mich. 2005). Here, while plaintiff has alleged several declines in the stock price, plaintiff has failed to give Defendants notice of what the ***actual economic loss*** is and how that loss was ***caused by*** each alleged misrepresentation.

Tellium and Acterna are instructive. In Tellium, 2005 WL 1677467, the court rejected plaintiff's attempts to distinguish itself from the plaintiff in Dura by simply identifying a stock price drop after the disclosure of corrective information. See id. at *26. Similar to this case, the plaintiff in Tellium alleged a series of stock price drops associated with disclosures relating to alleged misrepresentations. See id. at *26. The court held that even with a stock price drop, the complaint had not alleged a causal nexus between the misrepresentations of any defendant and the lower price of the stock, as opposed to other market factors that might have also lowered the price of the stock. See id. at *26 - *27.

Similarly, in Acterna, 378 F. Supp. 2d at 588, the court dismissed a complaint for failure to plead economic loss and loss causation where plaintiffs contended that during the class period there had been a 94% decline in the company's stock price caused in some way by alleged misrepresentations and omissions. See id. at 589. After reviewing the stock price history of the company in connection with the alleged misrepresentations

and corrective disclosures, the court found that the complaint's allegations actually suggested that the price decline was not caused by defendants. See id. The court noted that some comparatively small portions of the stock price drop had occurred on days on which "the truth was revealed," and further noted that within a week of the alleged corrective disclosures, the company's stock price had in fact risen again, rather than dropped further. All of these facts, the court reasoned, strongly suggested that the decline in the company's share price was not the result of the alleged fraud being revealed, but rather a continuation of the rapid decline caused by other factors. See id.

2. Dura's Application to the Complaint

a. The June 24, 2004 Press Release Regarding Ernst & Young's Resignation Was Not a Corrective Disclosure.

Plaintiff's inclusion of Ernst & Young's resignation announcement and subsequent market reaction illustrates the precise point articulated in Dura – the market reacts to other factors that influence stock price. See Dura, 125 S.Ct. at 1632. The Complaint alleges that PEMSTAR learned of Ernst & Young's resignation on June 22, 2004 and announced the resignation on June 24, 2004. See Compl. ¶ 71. Following the announcement, PEMSTAR's stock price dropped to $1.97 per share on June 25, 2004. See id. This announcement, however, was not a corrective disclosure, nor does it relate to any allegedly false or misleading statements as alleged in the Complaint. Instead, it demonstrates that the stock price drops alleged by plaintiff are attributable to ***other*** market conditions and not any "corrective disclosures" made by Defendants. Even more important, within approximately ***three days*** of June 25, 2005, PEMSTAR's stock price

had fully recovered any losses that had occurred after the announcement of Ernst & Young's resignation. See id.

b. January 12, 2005

On January 12, 2005, PEMSTAR's stock closed at a ***five-month high*** of $2.06. See Stock Price History, Ex. 50. Before the market opened on January 12, 2005, PEMSTAR announced that it would restate its financials for the prior fiscal year. Compl. ¶ 73. The following day, January 13, 2005, PEMSTAR's stock fell 13% to close at $1.79. See Compl. ¶ 74; Stock Price History, Ex. 50. What plaintiff fails to inform the Court is that for 86 out of the 110 trading days preceding the January 13, 2005 corrective disclosure, PEMSTAR's stock traded ***at or below*** the $1.79 price reached on January 13, 2005. See id. In fact, the day following the corrective disclosure, PEMSTAR stock price went up again and closed at $1.84. See id. Again, there is no meaningful way to distinguish between the 86 trading days prior to January 12, 2005 and the one point plaintiff identifies as starting on January 13, 2005.

The Complaint does not plead economic loss and loss causation. See Dura, 125 S.Ct. at 1634; Acterna, 378 F. Supp. 2d at 588.

E. Plaintiff's Complaint Fails To Plead The Necessary Elements Of A Section 11 Claim.

For plaintiff to avoid dismissal of a Section 11 claim in this case, he must allege: (1) the registration statement for the secondary offering contained a false statement; and (2) the misstatement was material. See Romine, 296 F.3d at 704.[7] This plaintiff has

[7] The heightened pleading standards of the PSLRA do not apply to a Section 11claim.

failed to do — when compared to the total mix of information available in the Prospectus, the misstatements alleged by plaintiff are simply not material, and, as the Eighth Circuit has therefore held, "a complaint that alleges only immaterial misrepresentations presents an insuperable bar to relief, and dismissal of such a complaint is proper." Parnes v. Gateway 2000, Inc., 122 F.3d 539, 546 (8th Cir. 1997).

Eighth Circuit case law has long held that alleged misstatements, even in a registration statement under Section 11, are immaterial as a matter of law when considered against the "total mix" of information available to a plaintiff. See Parnes, 122 F.3d at 546. In fact, "[w]here a reasonable investor could not have been swayed by an alleged misrepresentation, however, a court may determine, as a matter of law, that the alleged misrepresentation is immaterial." Id.

Parnes is strikingly similar to the present case. In Parnes, investors claimed that defendants had misstated earnings, improperly accounted for accounts receivable and inventory, and overstated their future prospects, among other things. See id. at 544. Against these allegations, the Court referred to the wealth of information provided to the market, including cautionary information in the registration statement. See id. at 543-44. Parnes held that in light of the disclosure of risks in the total mix, the alleged financial misstatements were insubstantial so as to require dismissal as a matter of law. Id.

As an initial matter, the Prospectus here cautioned potential investors that risks associated with the offering included significant stock price fluctuation. Ex. 25 at S-11.

See Romine, 296 F.3d at 704-05.

With respect to the Mexico facility itself, PEMSTAR was quite straight forward with investors. It plainly stated that "[o]perating in foreign countries exposes us to increased risks, which could adversely affect our results of operations." Id. at S-9. The Prospectus further stated that "[w]e face risks associated with coordinating multinational operations and reporting systems," id. at S-7, and admitted that "[w]e have limited experience in managing geographically dispersed operations and in operating in foreign countries." Id. at S-9. Moreover (and as came to pass), PEMSTAR specifically pointed out that it may have "[d]ifficulties in staffing and managing foreign personnel and diverse cultures." Id.

With regard to the alleged "trends" of lack of liquidity and inability to make timely payments to vendors and inventory issues, these issues were specifically addressed in the Prospectus. These allegations are similar to those in Oxford Asset Mgmt., Ltd. v. Jaharis, 297 F.3d 1182 (11th Cir. 2002). In Oxford Asset, the defendants' registration statement was allegedly misleading because it had failed to disclose "trends" regarding sales of a pharmaceutical product. The Court held that defendants had no duty to disclose such immaterial information, in part because omission of the information had not rendered the registration statement misleading. See id. at 1192.

Similarly, in this case the disclosure of risks in the Prospectus specifically disclosed the very types of "known trends" articulated by plaintiff. For example, the Prospectus cautioned investors that PEMSTAR previously violated covenants for revolving credit and that "[o]ur failure to meet any of our covenants under our credit facility could significantly harm our liquidity and financial position." Prospectus, Ex. 25 at S-6. It also pointed out that "[o]ur ability to maintain sufficient liquidity depends, in

part, on our achieving anticipated revenue targets and intended expense reductions from our restructuring activities. We may not achieve these targets or realize the intended expense reductions." Id.

With respect to alleged misstatements regarding inventory, at the time of the Secondary Offering, PEMSTAR was engaged in active litigation in the PEMSTAR I securities suit which specifically involved claims regarding inventory discrepancies and collectability of accounts receivable. PEMSTAR I, Aug. 15, 2003, Order, Ex. 51. The fact of the PEMSTAR I lawsuit was public knowledge and disclosed in the Prospectus's Risk Factors section. See Prospectus, Ex. 25 at S-11. In addition, the Prospectus specifically addressed inventory stating that "if we fail to manage our inventory effectively, we may bear the risk of fluctuations in materials costs, scrap and excess . . . which may increase expenses and decrease our profit margins and operating income." Id. at S-9. It also pointed out that in fiscal 2003, PEMSTAR recognized "charges for inventory reserves and adjustments of $8.1 million. ***We may be required to recognize similar charges in future periods.***" Id. at S-6 (emphasis added).

Thus, each of the risks was addressed in the Prospectus, and based on the total mix of information available to investors any misstatements must be immaterial as a matter of law. Any reasonable inventor must have known that there could be issues with PEMSTAR's foreign facilities, its liquidity, on its inventory. Under Parnes, therefore, plaintiff's Section 11 must be dismissed.

F. The Complaint Fails To Plead A Claim Under Section 20(a).

The Complaint also alleges a claim under Section 20(a) of the Exchange Act. Because plaintiff has failed to state a claim for securities fraud against defendants, there can be no secondary liability for the individual defendants as alleged "controlling" persons. See Parnes, 122 F.3d at 550 n.12; Nash Finch, 323 F. Supp. 2d at 960. Plaintiff's "control person" claims under Section 20(a) of the Securities Exchange Act should also be dismissed.

G. Res Judicata Bars A Significant Portion Of The Claims.

Not only does the Complaint not meet the pleadings standards under the PSLRA, but significant numbers of purported class members have already settled this matter and are receiving payments from defendants. Paragraph 1 of the Complaint states that the PEMSTAR II class consists of "all persons who purchased common stock . . . of Pemstar . . . from January 30, 2003 through and including January 12, 2005."

Where there is a judgment of dismissal with prejudice entered upon a settlement, such as is the case here, it will constitute a final judgment on the merits as to those claims settled, and has res judicata effect. See Lawlor v. Nat'l Screen Serv. Corp., 349 U.S. 322, 327 (1955). Federal courts are in accord that such settlements (especially where approved by the court) will therefore bar future claims by those who have settled such claims. Jones v. Gann, 703 F.2d 513, 516 (11th Cir. 1983); Bradford v. Bronner, 665 F.2d 680, 682 (5th Cir. 1982); Gen. Motors Corp. v. Cavanagh, 23 Fed. Appx. 727, 730 (9th Cir. 2001); Morris v. Lindau, 196 F.3d 102, 108 (2d Cir. 1999).

As set forth in the settlement agreement approved by Judge Frank, as of January 20, 2005 (eight days after the end of the class period in PEMSTAR II) the class in PEMSTAR I released PEMSTAR and all of the defendants (including defendants' employees, officers, and directors) from "any and all claims . . . ***that could have been set forth in the Litigation***." Stipulation and Agreement of Settlement, PEMSTAR I, Ex. 48, ¶ 1.16 at 9 (emphasis added). These involved a Section 10(b) and Rule 10b-5 claim, a Section 11 claim, and a Section 20 claim, as does PEMSTAR II. In addition, each of the class members in PEMSTAR I released claims that he, she, or it "does not know or suspect to exist in his, her, or its favor at the time of the release of the Released Parties . . . which if known by him or it might have affected his or its decision(s) with respect to the Settlement." Id. ¶ 1.24 at 10.

IV. CONCLUSION

For the reasons set forth above, plaintiff's Complaint should be dismissed with prejudice.

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