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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	**REPLY MEMORANDUM IN FURTHER SUPPORT OF MOTIONS 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

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INTRODUCTION

In September 2003, plaintiffs allege in their Consolidated Amended Complaint ("CAC"), Defendant Netopia, Inc. prematurely recognized revenue associated with a software licensing transaction involving a software reseller, Interface Computer Corporation ("ICC"), and the School District of Philadelphia (the "Philadelphia Transaction"). When the aggressive efforts of defendant David Kadish — who knew nothing of the contingent nature of the transaction — to collect the receivable finally revealed, in July 2004, facts suggesting that two Netopia salespeople had promised ICC that it would not have to pay Netopia until ICC had received money from Philadelphia, the Company promptly announced an investigation and eventually restated the prior-reported financial results for the September 2003 quarter. That is plaintiffs' case: the Philadelphia Transaction eventually led to a small restatement in which Netopia ultimately confirmed that the transaction had real economic substance but acknowledged that the timing of that revenue had to be shifted.

Not content with this modest case, however, plaintiffs have loaded the CAC with three irrelevant and unsustainable sets of allegations that they labor fiercely to defend in opposition to defendants' motions to dismiss and to strike. *First*, plaintiffs argue that allegations about a May 2002 transaction in which ICC resold Netopia software to the Chicago Public Schools (the "Chicago Transaction") should remain in the CAC even though, as plaintiffs concede, they do not state a cause of action. With this concession, and because the Chicago Transaction allegedly took place more than a year before the beginning of the putative class period; was not part of a continuing scheme; and says nothing about defendants' scienter, the Court should strike these superfluous allegations from the CAC. *See infra* Section I(A).

Second, plaintiffs argue that they have properly alleged securities fraud relating to Netopia's alleged December 2003 sales to Swisscom, claiming that Netopia failed to disclose that its sales to Swisscom were somehow "excessive," or that some of them were shipped to Swisscom by boat. Plaintiffs desperately want the Swisscom allegations to

remain in the CAC because they relate to the quarter ended December 31, 2003, and would allow plaintiffs to argue that declines in the price of Netopia's stock in January, February and April 2004 — which were more significant than the stock price declines that arguably relate to the disclosure of the true nature of the Philadelphia Transaction — were causally connected to alleged securities fraud. But revenue from Swisscom was never restated or otherwise called into question; plaintiffs cannot dispute that (as alleged) Netopia fully disclosed the fact that its December sales to Swisscom benefited from a year-end promotion; and, most fundamentally, public statements that plaintiffs themselves quote in the CAC clearly reveal all of the details about the Swisscom sales that plaintiffs now claim were concealed. These allegations should accordingly be dismissed or, in the alternative, struck from the CAC. *See infra* Section I(B).

Third, because the Swisscom allegations fail to state a claim for securities fraud, and because plaintiffs cannot demonstrate any revelation of any previously-concealed facts about the Philadelphia Transaction before July 2004, plaintiffs' argument that they have sufficiently pled loss causation for alleged drops in Netopia's stock price in January, February and April 2004 is another attempt at overreaching that should be rejected under the pleading standards recently articulated by the Supreme Court in *Dura Pharmaceuticals, Inc. v. Broudo*, 125 S. Ct. 1627 (2005). *See infra* Section II.

Plaintiffs' efforts to explain why Mr. Kadish, Netopia's general counsel, should remain a defendant to these consolidated class actions are their final act of overreaching. No matter how plaintiffs strain to argue otherwise, they cannot overcome their own CAC, which does not allege that Mr. Kadish made any actionable public statements, but does allege conduct by Mr. Kadish that is logically inconsistent with an inference that he was knowingly involved in the Philadelphia Transaction. *See infra* Section III.

ARGUMENT

I. THE COURT SHOULD STRIKE OR DISMISS THE CHICAGO AND SWISSCOM ALLEGATIONS.

A. Plaintiffs Concede That Allegations About The Chicago Transaction Do Not State A Claim, And Are Therefore Immaterial.

In their motion to strike the CAC's allegations about the Chicago Transaction, which predates the putative class period by 18 months, defendants explained that these allegations are simply irrelevant to plaintiffs' claims. *See* Memorandum of Points and Authorities in Support of Motion to Dismiss or, In the Alternative to Strike Allegations from, Plaintiffs' Consolidated Amended Complaint ("MPA") at 16-17. Indeed, plaintiffs concede that they do not even purport to state a cause of action stemming from the Chicago Transaction:

> the Complaint does ***not*** even allege that the overstatement of Netopia's June 30, 2002 financial results operated to inflated Netopia's stock price during the Class Period, and ***expressly*** alleges that Plaintiffs ***only*** seek recovery on behalf of the Class arising out of Defendant's overstatement of Netopia's revenue and net income for the fourth quarter and year ended September 30, 2003.

Memorandum of Points and Authorities in Opposition to All Defendants' Motions to Dismiss and/or Strike ("Opp.") at 16-17 n.8 (emphasis in original). This should be the end of the inquiry, and the Court should strike the Chicago allegations from the CAC. Otherwise, should this case proceed through discovery, summary judgment or trial with these allegations as part of the operative complaint, they will distract from the Court's attention, forcing it to expend time and resources on a series of facts that plaintiffs *admit do not give rise to liability*. Striking these impertinent and immaterial allegations is necessary to "avoid the expenditure of time and money that must arise from litigating spurious issues."[1] *Sidney-Vinstein v. A.H. Robins Co.*, 697 F.2d 880, 885 (9th Cir. 1983).

[1] While motions to strike are generally disfavored, as plaintiffs note, when allegations are so obviously irrelevant to the causes of action asserted, courts do not hesitate to strike them. Even the court in *Lazar v. Trans Union LLC*, 195 F.R.D. 665 (C.D. Cal. 2000), the only case cited by plaintiffs for this general proposition, *see* Opp. at 15, granted in part and denied in part a motion to strike. The court decided not to strike allegations that, although they could not give rise to a cause of action because the statute of limitations had expired, established a "repeating pattern" of activity that continued right up until the allegations that did give rise to the cause of action in that case. 195 F.R.D. at 671. But, as alleged, the Chicago Transaction is an isolated incident that occurred more than a year and a half before the events plaintiffs allege give rise to liability here.

Plaintiffs argue that the Chicago Transaction allegations should remain in the pleadings because they are "backdrop" and evidence of scienter for the Philadelphia Transaction. Opp. at 17. Neither rationale justifies the inclusion of these distracting and irrelevant allegations.

As a "backdrop," the Chicago Transaction was very different from the Philadelphia Transaction. First, the Chicago Transaction occurred in May 2002 — some 18 months before the November 5, 2003 beginning of plaintiffs' putative class period. Such a long time gap renders the Chicago Transaction allegations irrelevant as background, and plaintiffs can cite no case to the contrary. Second, the Chicago Transaction is one isolated sale — plaintiffs are unable to point to an ongoing pattern or practice of behavior that would make the Chicago Transaction instructive or essential to understanding the Philadelphia Transaction (i.e. as the starting point of some larger scheme). For example, in the Chicago Transaction, Frankl and Deckard allegedly altered a purchase order from ICC to conceal the fact that, by the terms of ICC's agreement with them, Netopia gave ICC extended payment terms *for half* of the purchase order amount until ICC was paid by the Chicago public schools. *See* MPA at 5 (citing CAC ¶ 28). But plaintiffs allege that Netopia received payment for half of the transaction within 30 days (before the end of the third quarter of fiscal 2002), and received the remaining balance before the end of fiscal 2002. *Id*. (citing to CAC ¶ 112, RJN, Ex. 1 at 19, 59). This sequence of events does not resemble the Philadelphia Transaction, where, according to plaintiffs, Frankl executed a side letter with ICC pursuant to which ICC's purchase order only became valid, and created an obligation for ICC to pay Netopia, after ICC received a purchase order from the Philadelphia public schools. CAC ¶ 49.

Plaintiffs' attempt to use the allegations about the Chicago Transaction to create an inference of scienter relating to the Philadelphia Transaction makes no sense in this context. *See* Opp. at 17. The essential aspects of the two deals were strikingly different — Chicago involved extended payment terms, whereas with Philadelphia (as alleged), ICC and Netopia had no deal unless and until ICC found an end user, who was not yet in place at the time

ICC signed the Philadelphia purchase order. In addition, Netopia's receipt of a significant ($750,000) partial payment on the Chicago purchase order within 30 days, and the rest of the payment only a couple months late, meant that senior management had no reason to question Frankl when he submitted the Philadelphia purchase order from ICC. If, as plaintiffs assert, the lesson the individual defendants learned from Chicago was that "ICC would not agree to provide Netopia with a purchase order containing 'unconditional' payment terms," Opp. at 17, logic and common sense suggest that they should *not* have returned to ICC for their next allegedly fraudulent transaction. Instead, the individual defendants should have looked elsewhere to find a reseller that *would agree* to unconditional terms, rather than return to the reseller who had previously established it *would not* agree to unconditional terms.

Equally unpersuasive is the argument that the two ICC transactions were somehow interrelated because, for example, "Kadish used the information from the Chicago Purchase order to 'create' a purchase order that looked like an authentic ICC purchase order." Opp. at 18. The only connection this "fact" establishes is that ICC was Netopia's customer prior to the Philadelphia Transaction — plaintiffs do not even purport to explain how these allegations, if true, would create an inference that Mr. Kadish or any other defendant knew that the Philadelphia Transaction was improper. To the extent plaintiffs seek to connect the two transactions, the threads are simply too tenuous.

In sum, the Chicago Transaction is too distant and different to have any bearing on plaintiffs' allegations about the Philadelphia Transaction, and all allegations in the CAC concerning the Chicago Transaction should be struck. *See Fantasy, Inc. v. Fogerty*, 984 F.2d 1524, 1527 (9th Cir. 1993) ("Superfluous historical allegations are a proper subject of a motion to strike").

B. The Court Should Strike Or Dismiss The CAC's Swisscom Allegations Because Netopia's Statements, As Alleged, Were Accurate.

As noted in defendants' opening brief, plaintiffs appear to have worked backward from the drop in Netopia's share price that followed the April 19, 2004 announcement of its

disappointing March quarter, inventing a fraud related to Swisscom in an attempt to allege damages from that market capitalization loss. *See* MPA at 9-10. Netopia's public statements about Swisscom — that December quarter sales benefited from special year-end promotions offered by Swisscom; that Netopia's March quarter sales would not continue to grow; and that Netopia had shipped some product, at Swisscom's request, by boat — were demonstrably accurate. *See id.* at 10-11. Plaintiffs' tortured arguments in opposition confirm only that Netopia had a good quarter in December 2003, followed by a disappointing one. Their efforts to cook up a revenue recognition claim are belied by the fact that Netopia and its independent auditors never restated a single penny of Swisscom revenue — and are further contradicted by Mr. Lefkof's own public statements, as alleged in the CAC.

Plaintiffs argue that Netopia knew that December quarter shipments to Swisscom were excessive "when they placed the shipments on the boats rather than the normal method of shipment by air."[2] Opp. at 23; *see also id.* at 24 (arguing that Netopia shipped "unnecessary" product). But, in a statement that plaintiffs themselves quote in the CAC, Mr. Lefkof was careful to explain that Netopia "didn't have a choice" — it *had* to recognize in the December quarter the revenue from Swisscom orders that were sent, at Swisscom's request, by boat, during that quarter. CAC ¶ 116 (quoting January 20, 2004 conference call, Ex. 3 to Netopia's August 29, 2005 Request for Judicial Notice); *see* MPA at 11 (Swisscom chose the method of shipment, and accounting rules require Netopia to recognize revenue on "FOB origin" contracts at time of shipment). Whether by airplane, boat, or camel, how Swisscom decides to ship its product is simply not within Netopia's control. The question is whether Netopia accurately represented the nature and timing of the revenue, and neither the CAC nor plaintiffs' opposition can demonstrate any misleading statements on that issue.

[2] Plaintiffs seem to be arguing that Netopia should have tried to "smooth" or "massage" its revenues to ensure an even stream quarter to quarter. Undoubtedly, plaintiffs would be the first to complain if Netopia had managed its revenue streams. *E.g.*, *In re Network Assocs., Inc. Sec. Litig.*, No. C 99-01729 WHA, 2000 WL 33376577, at *10 (N.D. Cal. September 5, 2000) (defendant accused of "earnings management" by overallocating certain expenses to research and development so that revenue would meet quarterly earnings expectations).

Plaintiffs' argument also ignores the (fully-disclosed) explanation for Netopia's Swisscom revenue: Swisscom ran a promotion, and demand for Netopia's product went up. *See* CAC ¶ 113 (noting Swisscom's year-end promotions). When the promotion ended, demand did not continue at that level. *Id.* (quoting Mr. Lefkof's statement that Netopia did not expect a "sequential increase" from the December quarter to March). Mr. Lefkof directly contradicted plaintiffs' contention that he "led reasonable investors to conclude Netopia would report Swisscom revenues for the second quarter ended March 31, 2004 that were approximately the same as … reported for the December 31, 2003 quarter." Opp. at 25. What Mr. Lefkof said (as plaintiffs quote) was:

> And so, because we are conservative here at Netopia, we believe the rational thing to do is similar to what happened last year between December and March – *we did not have a sequential increase*. We would at least – at today's date, expect a similar thing, but then a very nice rebound for June, September and December, accordingly.

CAC ¶ 113 (quoting January 20, 2004 Conference Call) (emphasis added). The plain meaning of Mr. Lefkof's expectation of a "similar thing" is that Netopia expected what happened between December and March in 2002-2003 to occur again between 2003-2004 (*i.e.*, that Netopia would not experience a sequential increase in revenue), not that Netopia expected March results to be similar to December.[3]

Finally, plaintiffs attempt to create the specter of fraud by recasting their Swisscom allegations as a case of "channel stuffing," a theory not consistent with the facts, and not present in the CAC. Channel stuffing occurs when a company induces a customer to buy product prematurely or unnecessarily so that the company can increase its earnings in a particular quarter. *Steckman v. Hart Brewing, Inc.*, 143 F.3d 1293, 1298 (9th Cir. 1998). The CAC's Swisscom allegations do not support a channel stuffing theory. Moreover, the out-of-circuit channel stuffing cases plaintiffs cite all involve allegations of specific

[3] Plaintiffs argue that whether Mr. Lefkof's statement is misleading is a question of fact. *See* Opp. at 25 n. 13. But, they cannot simply jerry-rig a "question of fact" out of a strained and evidently erroneous reading of Mr. Lefkof's statement. Mr. Lefkof explained in clear terms what Netopia expected to happen with Swisscom sales — that Netopia's sales to Swisscom would not increase from December to March. His words cannot be read to suggest that he promised no reduction in Swisscom sales.

wrongdoing by defendants — such as unusual discounts or credits, liberal return policies, or offering to warehouse the product until the customer can actually use it.[4] None of these facts are present (or alleged) here. Swisscom offered *its* customers a promotion to encourage sales. Netopia simply shipped the product that Swisscom ordered. Plaintiffs have not alleged a single act that could constitute channel stuffing.[5]

Try as they might, plaintiffs cannot establish how Swisscom ordering "excess" product in the December 2003 quarter gives rise to a securities fraud claim, and these allegations should accordingly be dismissed. In the alternative, because the allegations are an enormous distraction to the issues concerning the Philadelphia Transaction, the Court should strike them.

II. PLAINTIFFS HAVE FAILED TO ALLEGE LOSS CAUSATION FOR THE JANUARY, FEBRUARY, AND APRIL STOCK PRICE DECLINES.

Defendants' moving papers explained why the CAC has failed to plead a causal connection between the misrepresentations alleged in the CAC and the downward movement in Netopia's stock price from November 2003 through July 2004. Plaintiffs' only response is an attempt to sidestep the Supreme Court's holding in *Dura* by arguing that Netopia's alleged misstatements somehow "materialized" through its public statements in

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[4] *See Carpenters Health & Welfare Fund v. Coca-Cola Co.*, 321 F. Supp. 2d 1342, 1350 n.2 (N.D. Ga. 2004) (channel stuffing allegations included customer not being required to pay for product already ordered and shipped until it actually used product, and senior management "convinc[ing]" customer to accept cash incentives to accept additional product); *Friedman v. Rayovac Corp.*, 295 F. Supp. 2d 957, 985-86 (W.D. Wis. 2003) (channel stuffing allegations that "scrape by, if only barely" included extending payment terms from 30 days to 60 or 90, giving customers advertising credits, offering bulk discounts, and "enticing" customers to buy more than they needed); *In re Scientific-Atlanta, Inc. Sec. Litig.*, 239 F. Supp. 2d 1351, 1359 (N.D. Ga. 2002) (discounts and liberal return policies at odds with company's stated return policy, credits for warehousing, and allowing customers not to pay for product); *In re Campbell Soup Co. Sec. Litig.*, 145 F. Supp. 2d 574, 580-81 (D.N.J. 2001) (unusually large bulk discounts and recording discounts as marketing expenses, warehousing product for free, and paying for shipping and storage).

[5] Even if they had, plaintiffs gain no traction with this tactic. "Courts in this district have almost uniformly rejected the idea that allegations of channel stuffing are sufficient to plead a securities fraud violation." *Wietschner v. Monterey Pasta Co.*, 294 F. Supp. 2d 1102, 1114 (N.D. Cal. 2003) (citing cases). In *Wietschner*, the court held that because channel stuffing amounts to nothing more than "speculation made in hindsight," even if the plaintiff had alleged facts that gave rise to channel stuffing, such allegations are insufficient to survive a motion to dismiss. *Id.* (citing *Steckman*, 143 F.3d at 1298).

January, February, and April 2004.[6] Opp. at 20-21. But these alleged statements had nothing to do with sales or revenues announced in the September 2003 quarter, let alone with the Philadelphia Transaction.

The key to the Supreme Court's holding in *Dura* is the establishment of a causal relationship between the stock drop and the alleged misstatements at issue. 125 S. Ct. at 1633. The CAC contains no allegations linking news released in January, February, or April 2004 to revenues associated with the Philadelphia Transaction. Plaintiffs cannot remedy this pleading defect by quoting the CAC ¶ 104 in its entirety and describing it as "more than sufficient." Opp. at 21 (also citing CAC ¶¶ 105-06). Nor does the assertion that Netopia's stock price decreases in January, February, and April "have removed some of the artificial inflation caused by the Defendants' overstatement of the September 30, 2003 financial results," *id.*, allege loss causation. This is mere solipsism — by plaintiffs' logic, *any* decrease in stock would "remove some of the artificial inflation," whether it was causally connected to the alleged misstatements at issue or not — and is insufficient under *Dura*. 125 S. Ct. 1632 ("lower price may reflect, not the earlier misrepresentation, but changed economic circumstances"). Indeed, plaintiffs are arguing precisely what *Dura* rejected: that once the alleged inflation has entered the stock price, any subsequent drop in the price must be attributable, in some way, to the alleged misstatement. *See* Opp. at 21.

Perhaps recognizing the flaws in their interpretation of *Dura*, plaintiffs try another tactic, conceding that "these drops were not caused by direct **admissions** by Defendants," yet claiming that somehow the alleged misstatements "materialized" in Netopia's later public statements and caused the drops. Opp. at 21 (emphasis in original). But this argument is based upon a supposed "fact" that is not alleged in the CAC — that "the market recognized that Netopia's true financial condition was inconsistent and contrary to Netopia's reported" financial results. *Id.* More fundamentally, plaintiffs' new theory does

[6] Plaintiffs incorrectly argue that "Defendants do not … dispute that the Complaint properly alleges that the losses of the Class were caused by Defendants' overstatement of Netopia's September 30, 2003 financial results." Opp. at 18. Defendants *do* dispute the sufficiency, under *Dura*, of all of plaintiffs allegations relating to pre-July 2004 disclosures.

not explain *how* Netopia's public statements *caused* the alleged misstatements to "materialize." Defendants are not suggesting that plaintiffs must allege that a stock price drop was caused by a *specific admission* relating to alleged prior misstatements, *see* Opp. at 20, only that the stock price declines are connected, and how, to the alleged fraud.

Plaintiffs have failed to do this, and the cases on which they rely cannot save their deficient allegations. In *Teamsters Local 445 Freight Division Pension Fund v. Bombardier, Inc.* 2005 U.S. Dist. Lexis 19506, at *58 (S.D.N.Y. September 6, 2005), the court held that the plaintiffs had pled loss causation because events subsequent to the fraud revealed facts the defendants had hidden. In that case, defendants concealed the fact that a certain pool of loans contained a substantial number of high risk loans. *Id*. When the loan pools experienced an unusually high delinquency and repossession rate, and those facts became public, defendants' misstatements had "materialized." *Id*. Similarly, in *Sekuk Global Enterprises* v. *KVH Industries, Inc.*, 2005 U.S. Dist. Lexis 16628, at *50 (D.R.I. August 11, 2005), defendants issued a press release announcing declining revenue, which, although it did not directly reveal the fraud, identified a decrease in sales to a specific subset of customers that purchased the product that was the subject of the allegedly misleading statement.[7] Nor does plaintiffs' newly submitted authority, *Plumbers & Pipefitters Local 572 Pension Fund v. Cisco Systems*, No. C 01-20418 JW, 2005 U.S. Dist. Lexis 25398, *20 (N.D. Cal. Oct. 26, 2005), help them. In that case, defendants' disclosures, about the establishment of a large, previously unannounced reserve fund for excess inventories and uncollected accounts receivable, revealed the previously concealed facts about inventory growth and slowing customer demand. *Id*.

What distinguishes each of those cases from the CAC is that even in the absence of a traditional corrective disclosure, the plaintiffs in these post-*Dura* cases alleged a real,

[7] The court in *Greater Pennsylvania Carpenters Pension Fund v. Whitehall Jewellers*, 2005 U.S. Dist. Lexis 12971 (N.D. Ill. June 30, 2005), held that its prior finding of loss causation was unaffected by *Dura*, but offered no relevant factual discussion regarding those loss causation allegations. Similarly, the decision in *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 510 (S.D.N.Y. 2005), merely restated the Second Circuit loss causation formula, which was unaltered by *Dura*.

substantial link between the decline in the stock price and the prior alleged misstatements at issue. In this case, by contrast, plaintiffs have pinned their hopes on loss causation "materializing" out of thin air.[8] There is no link, much less a substantial one, between the stock price declines in January, February, and April 2004 and the alleged misstatements.

III. THE CLAIMS AGAINST MR. KADISH SHOULD BE DISMISSED BECAUSE PLAINTIFFS FAIL TO STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED.

A. Plaintiffs Failed To Allege That Mr. Kadish Made Any Misrepresentations Or That He Acted With Scienter.

Disregarding the requirements of the PSLRA and the fraud pleading standards of Rule 9(b), plaintiffs argue in opposition that they can pin liability on Mr. Kadish without making *any* specific allegations regarding his involvement in the alleged misstatements. Opp. at 26-28. Reliance on generic allegations of group action, however, does not establish with particularity any wrongdoing by Mr. Kadish. Acknowledging the flaw in this approach, plaintiffs suggest (for the first time) that alternatively, Mr. Kadish could still be liable for insider trading. This last-ditch effort to salvage a Section 10(b) claim fails on multiple fronts, most critically because plaintiffs make no showing that they traded contemporaneously with Mr. Kadish. Plaintiffs also ignore their fundamental obligation to establish that Mr. Kadish acted with scienter, and indeed, the CAC itself proves otherwise. According to the CAC, Mr. Kadish worked tirelessly to collect the ICC receivable from the Philadelphia purchase order, often at cross-purposes to those participating in the "scheme."

In order to claim that a defendant made a material misrepresentation, plaintiffs must allege the defendant's role in the alleged misstatement with particularity, whatever the currency of the "group pleading" doctrine.[9] 15 U.S.C. § 78u-4(b)(1); Rule 9(b); *see also In*

[8] This reality distinguishes this case from the hypothetical posed in Justice Breyer's statement at oral argument that a plaintiff can allege loss causation where the bad news "oozes out." Opp. at 19 n.10. Even assuming that a comment at oral argument could have any precedential or even logical value — which it cannot — that is not what happened in this case. No information concerning revenue attributed to the Philadelphia Transaction "oozed" out, and plaintiffs make no effort to try to identify how defendants' statements in January, February or April indicate any issue with the prior reported September 30, 2003 financial results.

[9] Many courts have rejected the group pleading doctrine after the passage of the PSLRA. *E.g.*, *Southland Sec. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353, 363-65 (5th Cir. 2004); *In*

(Footnote continued)

re Ramp Networks, Inc. Sec. Litig., 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)). By relying on the group pleading argument, plaintiffs as much as admit that their conclusory assertions that "Individual Defendants directly participated in the drafting" of the various alleged misstatements, CAC ¶¶ 100(a)-(e), do not meet the PSLRA's rigorous standard. *See also id.* ¶ 129 (it is "appropriate to treat the Individual Defendants as a group"). Glaringly absent from the CAC are any particularized allegations of Mr. Kadish's alleged role or that he specifically made a misstatement.

In an attempt to avoid the shortcomings in pleading Mr. Kadish's supposed misrepresentations, plaintiffs contrive an alternative, "insider trading" theory — one which is not evident in the CAC itself — upon which they now try to hatch a Section 10(b) claim against Mr. Kadish. Opp. at 27-28.[10] This newly conceived claim, however, does not even meet a threshold standing requirement because plaintiffs have not alleged that they traded in Netopia's stock contemporaneously with Mr. Kadish. *Brody v. Transitional Hosp. Corp.*, 280 F.3d 997, 1001 (9th Cir. 2001) (insider trading claim dismissed because plaintiffs' trades were almost two months after the defendant's). "The contemporaneous trading requirement … is another judicially-created standing requirement, specifying that to bring an insider trading claim, the plaintiff must have traded in a company's stock at about the same time as the alleged insider." *Id.* Absent allegations of contemporaneous trading,

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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). Nonetheless, plaintiffs cite to *Wool v. Tandem Computers, Inc.*, 818 F.2d 1433, 1440 (9th Cir. 1987), a pre-PSLRA and pre-*Silicon Graphics* case, to support their dependence on the group pleading doctrine to implicate Mr. Kadish. Opp. at 27, n. 15. However, even the group pleading doctrine, as set out by *Wool*, does not allow a "facile approach to group pleading." *Smith v. Network Equip. Tech., Inc.*, No. C-90-1138 DLJ, 1990 WL 263846, at *4 (N.D. Cal. Oct. 19, 1990) (interpreting *Wool*). Assuming, for the sake of argument, that the doctrine survived the PSLRA, plaintiffs cannot allege group pleading "without regard to the nature of the fraud alleged …, or the functional connection between the activities of an individual defendant and the activities involved in the fraud." *Id.*

[10] Plaintiffs argue that "Kadish is nonetheless liable based upon his participation in the fraudulent scheme and his sales of Netopia stock" Opp. at 27. Without further discussion save for a citation to Rule 10b-5 and generic case law, this comprises plaintiffs' "insider trading" argument.

plaintiffs have no basis to assert an insider trading claim.

Regardless of whether plaintiffs' Section 10(b) claim against Mr. Kadish is viewed as a claim of alleged misrepresentation or insider trading, plaintiffs must allege with particularity that Mr. Kadish acted with the requisite scienter, because "[i]n *any* private action" requiring "proof that the defendant acted with a particular state of mind, the complaint shall … 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); *see also Johnson v. Aljian*, No. 03-5968 FMC, 2004 WL 3571695, at *11-12 (C.D. Cal. Jul. 30, 2004) (setting out standard for alleging scienter in insider trading cases). Instead of alleging scienter, the CAC demonstrates the opposite: that Mr. Kadish knew nothing about the alleged schemes surrounding the Philadelphia Transaction.[11] Plaintiffs do not allege that any person or document ever informed Mr. Kadish of the contingent nature of the transaction. CAC ¶¶ 34, 37, 42-43. The fact that Mr. Kadish drafted a form purchase order for the Philadelphia Transaction does not demonstrate his knowledge of the alleged contingency. (If it were otherwise, this would in effect create strict liability for every person who had a hand, no matter how minor, in any transaction that was the subject of a securities fraud allegation.) To the contrary, the CAC alleges that Mr. Kadish's aggressive pursuit of payment from ICC uncovered the scheme, and ultimately precipitated the Audit Committee investigation. CAC ¶¶ 67-96, 108.

Plaintiffs rely on Mr. Kadish's stock transactions to concoct a scienter argument, without addressing the case law cited by defendants. Opp. at 29. Mr. Kadish's stock transactions, with no other allegations, are insufficient to create a strong inference of scienter.[12] *In re Vantive Corp. Sec. Litig.*, 283 F.3d 1079, 1093 (9th Cir. 2002). In fact, the

[11] Similarly, there are no allegations that Mr. Kadish was informed of the alleged contingent terms of the Chicago Transaction. CAC ¶¶ 25-28. Plaintiffs also argue that Mr. Kadish's alleged temporary position as the salesperson for Swisscom supports a finding of scienter. Opp. at 29 (citing CAC ¶ 117). This allegation is meaningless — even if the Swisscom allegations amounted to securities fraud, which they do not, *see supra* at I.B., the CAC sets forth no facts to demonstrate Mr. Kadish acted with scienter regarding any Swisscom-related decisions. CAC ¶¶ 113-18.

[12] Under plaintiffs' new insider trading theory, to establish scienter they would have to allege that Mr. Kadish was in possession of material non-public information at the time he traded. *(Footnote continued)*

timing of Mr. Kadish's trades after the November 5, 2003 and January 20, 2004 press releases, which both reported net income, CAC ¶¶ 58, 100(c), is unremarkable when considering that "[o]fficers 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, 1034 (9th Cir. 2002); *see also In re FVC.Com Sec. Litig.*, 136 F. Supp. 2d 1031, 1040 (N.D. Cal. 2000). The nearly two-week gap between the November 5, 2003 press release and Mr. Kadish's first alleged stock trade on November 18, 2003, CAC ¶ 64, also negates any nefarious inferences from Mr. Kadish's sale of stock.[13]

B. Plaintiffs' Section 20(a) Claim Against Mr. Kadish Should Be Dismissed Because He Exercised No Control Over The Allegedly Fraudulent Practices And Acted In Good Faith.

Ignoring well-established case law, plaintiffs argue in opposition that Mr. Kadish's position as Netopia's general counsel is sufficient to plead secondary liability for alleged violations committed by Netopia salespeople, and that any argument to the contrary would be "inappropriate for resolution on a motion to dismiss." Opp. at 30. Neither argument is correct: Mr. Kadish's position is presumptively *not* a "control person" position, and plaintiffs cannot attempt to avoid the most reasonable implication of the CAC's allegations — that Mr. Kadish acted in good faith and his actions ultimately *exposed* the alleged fraud.

Plaintiffs' contention that Mr. Kadish's place among Netopia's senior management is sufficient to attach control person liability finds no support in case law. The touchstone of

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E.g., *In re Sagent Tech., Inc., Deriv. Litig.*, 278 F. Supp. 2d 1079, 1089 (N.D. Cal. 2003) (insider trading claim requires allegation that the defendant was in possession of material non-public information). There is no such allegation in the CAC.

[13] Furthermore, publicly available SEC disclosure forms show that Mr. Kadish's last trade during the Class Period occurred on March 1, 2004, *over four months before* the negative disclosure in the July 7, 2004 press release, defeating any inference of scienter. *See In re Read-Rite Corp. Sec. Litig.*, 115 F. Supp. 2d 1181, 1183 (N.D. Cal. 2000) (stock trades occurring four and a half months before public disclosure "militates against finding a strong implication of the required scienter"); *Head v. NetManage, Inc.*, No. C97-4385 CRB, 1998 WL 917794, at *4 (N.D. Cal. Dec. 30, 1998) (stock trade two months before negative disclosure insufficient to allege scienter, since a defendant with scienter would have sold "when they learned that their scheme would be discovered"); *In re Party City Sec. Litig.*, 147 F. Supp. 2d 282, 313 (D.N.J. 2001) ("broad temporal distance between stock sales and disclosure of bad news" of 12, four and three months "defeats any inference of scienter").

liability under Section 20(a) is the exercise of *actual* control over the alleged violations. *See Paracor Fin., Inc. v. G.E. Capital Corp.*, 96 F.3d 1151, 1163 (9th Cir. 1996) (finding no control by CEO where plaintiffs introduced "no evidence that [he] exercised direct or indirect control over" transaction at issue); *In re Enron Corp.*, No. MDL-1446, Civ. A. H-01-3624, 2003 WL 21418157, at *13-14 (S.D. Tex. Apr. 24, 2003) (dismissing Section 20(a) claim against general counsel because complaint failed to make "specific allegations showing that he was involved in any way in the day-to-day business operations of Enron or with the individuals alleged to have been at the heart of the Ponzi scheme"). Netopia's general counsel had no power or control over the allegedly fraudulent sales transactions or the day-to-day sales operations at Netopia — much less the software sales personnel — nor have plaintiffs alleged as much.

Furthermore, participating in the drafting of press releases, conference call scripts or SEC filings — absent allegations that Mr. Kadish knew that the documents he drafted were materially misleading — cannot be enough to plead control person liability; otherwise, every executive or employee with a role in drafting public statements would be strictly liable under Section 20(a). *See Howard v. Everex*, 228 F.3d at 1067, n. 13 (that the defendant "reviewed and approved" financial statements was insufficient to impose Section 20(a) liability because "there is no showing that [he] was active in the day-to-day affairs of [the company] or that he exercised any specific control over the preparation and release of the financial statements"); *In re Splash Tech. Holdings, Inc. Sec. Litig.*, No. C 99-00109 SBA, 2000 WL 1727405, at *16 (N.D. Cal. Sept. 29, 2000) (Section 20(a) claim insufficiently pled where defendant signed prospectus and registration statement, but plaintiff did not allege specific facts such as "x individual in [the company] provided Berger y press release on z date with the request that Berger determine whether the disclosure was sufficient").[14]

[14] Plaintiffs cite extensively to *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.*, 320 F.3d 920 (9th Cir. 2003). *E.g.*, Opp. at 30. However, the *America West* court analyzed the control person liability of two institutions that were the largest shareholders of America West. 320 F.3d at 945-46. The court held that plaintiffs had adequately

(Footnote continued)

Plaintiffs' response to Mr. Kadish's good faith argument is to turn the CAC on its head, and draw the most nefarious inferences from the facts as alleged. Opp. at 30. But the Court need not accept plaintiffs' outlandish characterization of their own facts, and should draw all *reasonable* inferences from the CAC. *See Gompper v. VISX, Inc.*, 298 F.3d 893, 897 (9th Cir. 2002) (holding that court need not accept the plaintiffs' suggested inference that the defendants were acting in the worst possible manner in favor of the "more plausible" inference that the defendants were acting properly and lawfully); *TwoRivers v. Lewis*, 174 F.3d 987, 991 (9th Cir. 1999) (in deciding a motion to dismiss, the court accepts all allegations as true and draws all *reasonable* inferences in favor of the nonmoving party).

Affording the allegations their most reasonable interpretation, the CAC actually demonstrates that Mr. Kadish was working at cross-purposes to the alleged fraud.[15] Far from demonstrating any control over violations relating to ICC, Mr. Kadish's participation

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pled control person liability because of the presence of three "traditional indicia of control" — longtime share ownership, ownership of a majority of the issuer's shares, and the power to elect a majority of America West's board of directors. *Id.* Because plaintiffs cannot allege these "indicia of control" for Mr. Kadish, plaintiffs' extensive reliance on *America West* underscores the weakness of their position.

Most of the other cases plaintiffs cite in support of their argument that position alone is sufficient to state a Section 20(a) claim did not even address the elements of a "control person" claim. *See In re Secure Computing Corp. Sec. Litig.*, 184 F. Supp. 2d 980, 983 (N.D. Cal. 2001) (recounting in "*Background*" section of order that prior decision on previous version of complaint found that plaintiffs had sufficiently pled control person status); *In re Nuko Info. Sys. Sec. Litig.*, 199 F.R.D. 338, 345 (N.D. Cal. 2000) (refusing to dismiss Section 20(b) claim where defendants' only argument for dismissal was lack of predicate violation); *In re Network Assocs., Inc. II Sec. Litig.*, No. C 00-4849 MJJ, 2003 WL 24051280, at *14 (N.D. Cal. Mar. 25, 2003) (noting standard for "control person" status in discussion of scienter element of underlying securities fraud claims, and dismissing the underlying claims). The one exception, *In re Cylink Sec. Litig.*, 178 F. Supp. 2d 1077, 1089 (N.D. Cal. 2001), found that the complaint properly alleged control person liability against the chief executive officer and executives in finance, business development, and sales positions relating to their involvement in revenue recognition schemes.

[15] Plaintiffs also argue that Mr. Kadish's alleged involvement in an "Executive Staff Meeting" in which the Chicago Transaction was supposedly discussed, Opp. at 30 (citing CAC ¶ 24), and his role "in overseeing the Swisscom sales," *id.* (citing CAC ¶¶ 117-18), support a finding that they have pled a control person claim against him. None of these allegations are relevant to plaintiffs' Section 20(a) claim, however, because they have not pleaded an underlying violation relating to the Chicago Transaction or Swisscom. *See supra* Sections I-II. Furthermore, the various allegations regarding Mr. Kadish's alleged attendance at "Executive Staff" meetings, CAC ¶¶ 24, 34, and presence while others made innocent inquiries into the status of the Philadelphia Transaction, CAC ¶ 34, do not demonstrate Mr. Kadish's control over Netopia's sales personnel or the agreements they negotiate.

in Netopia's intensive collection efforts with ICC in the spring and summer of 2004 show that Mr. Kadish acted in good faith as a matter of law. CAC ¶¶ 67-95. For example, plaintiffs allege that, when the Netopia personnel supposedly aware of the "contingent" terms of the Philadelphia Transaction were forced by Mr. Kadish and others to try to collect funds from ICC, they were frustrated by Mr. Kadish's meddling. *See id*. ¶¶ 71 (complaining that collection efforts were "what they're making me do," and "David Kadish is f&*%king this account up"). Thus, Mr. Kadish's good faith is not a question of fact — on the pleadings as plaintiffs have alleged, he acted appropriately and in the best interests of the Company. Accordingly, the control person claim against him should be dismissed.

CONCLUSION

For the foregoing reasons, this Court should grant defendants' motion to dismiss and strike allegations from the CAC. Because the defects in plaintiffs claims against Mr. Kadish are not remediable, these claims should be dismissed with prejudice.

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By: _____/s/_____
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