Timothy R. Pestotnik, State Bar No. 128919
Russell A. Gold, State Bar No. 179498
LUCE, FORWARD, HAMILTON & SCRIPPS LLP
600 West Broadway, Suite 2600
San Diego, California 92101-3372
Telephone No.: 619.236.1414
Fax No.: 619.232.8311

Attorneys for Defendants Lawrence Oberkfell, Kevin Claudio, and David Rane

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

In re SUREBEAM CORPORATION SECURITIES LITIGATION,

This Document Relates To:

ALL ACTIONS

Case No. 03-CV-01721-JM (POR)

CLASS ACTION

(Consolidated)

The Hon. Jeffrey T. Miller

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF MOTION TO DISMISS CONSOLIDATED COMPLAINT AGAINST DEFENDANTS OBERKFELL, CLAUDIO AND RANE

[F.R.C.P. 9(b) and 12(b)(6)]

Date: September 17, 2004
Time: 11:00 a.m.
Courtroom: 6

Complaint Filed: 8/27/03

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Defendants Lawrence Oberkfell ("Oberkfell"), Kevin Claudio ("Claudio"), and David Rane ("Rane") (collectively the "SBC Defendants") respectfully submit the following memorandum of points and authorities in support of their motion to dismiss the first and third claims for relief of the consolidated complaint pursuant to Federal Rules of Civil Procedure Rule 9(b) and Rule 12(b)(6).[1] The SBC Defendants are former officers of SureBeam Corporation. Oberkfell was once its Chief Executive Officer. He was also on the board of directors. [Complaint, ¶ 71.] Claudio was once SureBeam's Vice-President of Global Business Operations and former Chief Financial Officer. [Complaint,¶ 72.] Rane was once SureBeam's Chief Financial Officer. [Complaint, ¶ 73.]

I. INTRODUCTION AND SUMMARY OF ARGUMENT

Plaintiffs improperly attempt to plead fraud by hindsight. Because SureBeam ultimately filed for bankruptcy, plaintiffs erroneously conclude that it must be because of some fraud. However, the facts alleged do not meet the threshold required to allege securities fraud against defendants Oberkfell, Claudio and Rane.

Plaintiffs assert causes of action against the SBC Defendants for alleged violations of the Securities and Exchange Act of 1934 (the "1934 Act") (alleging violations of Section 10(b) and SEC Rule 10b-5). Plaintiffs also assert a cause of action for alleged violation of Section 11 of the Securities and Exchange Act of 1933 (the "1933 Act") against the SBC Defendants.

As to the 1934 Act claims, plaintiffs' Complaint is based on two theories of fraud. Plaintiffs allege that (1) SureBeam improperly recognized revenue from foreign joint ventures in Brazil (the "Tech Ion" transaction) and Saudi Arabia (the "RESAL" transaction) and published false and misleading statements about revenue recognition in SEC filings, press releases, and conference calls with analysts (the "Revenue Recognition Allegations"); and (2) SureBeam made false and misleading statements about the domestic demand for SureBeam's electronic irradiation services in press releases and conference calls with analysts (the "Demand Allegations").

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[1] For the Court's convenience, a copy of plaintiffs' Consolidated Complaint (the "Complaint") is attached to the SBC Defendants' Notice of Lodgment (NOL) as Exhibit 1.

As to the Revenue Recognition Allegations, plaintiffs attempt to impose personal liability on the SBC Defendants under the "group published" pleading device. [Complaint, ¶ 74] However, this district has held that this pleading device is not viable in light of the heightened pleading requirements announced by the Ninth Circuit applying the Private Securities Litigation Reform Act of 1995 ("PSLRA"). As to the Demand Allegations, statements allegedly made by Oberkfell and Rane concerning demand are future-looking statements that were either (i) not false when made, or (ii) made without any actual knowledge that the statements were false when made and are, thus, not actionable. Plaintiffs allege no false or misleading statements made personally by Claudio.

Plaintiffs also fail to state a claim for relief based on the Revenue Recognition Allegations because it is well-settled that a failure to follow GAAP (Generally Accepted Accounting Principles), without more, is insufficient to establish scienter for securities fraud. Here, plaintiffs fail to allege specific facts showing the SBC Defendants had contemporaneous knowledge of the accounting errors alleged or that they had an intent to defraud, as required by the PSLRA. Indeed, the logical inferences that should be drawn are precisely the opposite. ***None*** of the email excerpts relied on by plaintiffs show the SBC Defendants knew or even believed that funding would not be available for the Tech Ion or RESAL transactions. On the contrary, the emails demonstrate an ongoing process to secure funding. ***Nowhere*** do the excerpts state the funding options discussed are the ***only*** funding options available, or that funding would not be obtained.

In addition, SureBeam relied on two national accounting firms to audit the transactions at issue. These firms concluded SureBeam's revenue recognition was proper. Moreover, when replacing one accounting firm with another, it is logical to expect that the new firm will conduct its own due diligence before accepting the engagement, as well as due diligence concerning complicated transactions such as the Tech Ion and RESAL transactions at issue here. With two national accounting firms approving the revenue recognition for the transactions at the time the revenue was recognized and shortly thereafter, the inference that should be drawn is that there is ***no*** scienter. Plaintiffs fall far short of meeting the threshold requirement under the PSLRA, which requires a ***strong inference*** of an intent to deceive. Plaintiffs' attempt to allege fraud based on a

later, different interpretation of the Tech Ion and RESAL transactions by a third accounting firm three years ***after*** the transaction was entered into is a classic attempt to plead fraud by hindsight, which is prohibited by the PSLRA.

Plaintiffs' Demand Allegations, involve statements concerning the anticipated domestic demand for SureBeam's electronic irradiation services in the future. These are classic forward-looking statements. Plaintiffs must therefore allege specific facts showing that the SBC Defendants had ***actual knowledge*** that the statements were untrue when made. Plaintiffs fail to do so, and cannot do so. The only statements alleged (by Oberkfell and Rane only), concern anticipated future demand for SureBeam's services and are devoid of any specific facts to show the defendants had actual knowledge that the statements were untrue when they were made. Moreover, the rational inferences that can be drawn from the defendants' statements and actions negate scienter. As plaintiffs allege, SureBeam was ***expanding*** its manufacturing capabilities. That is consistent with the belief that demand will be ***increasing*** and is wholly inconsistent with the belief that demand would be decreasing. Consequently, SureBeam's actions, as alleged in the Complaint, negate scienter.

Finally, the stock sales alleged by Oberkfell and Claudio do not support a strong inference of scienter.[2] Indeed, if anything, the stock sales negate an inference of scienter. For example, Oberkfell and Claudio exercised and then immediately sold options at prices far less than the alleged peak share price during the class period, and they sold amounts that the Ninth Circuit has considered insufficient to infer scienter in other cases. Plaintiffs do not allege that Rane, allegedly armed with the same information as Oberkfell and Claudio, sold any shares. That is because Rane ***purchased*** shares on the open market during the class period, which wholly negates any inference of scienter.

Plaintiffs' first claim for relief alleges violations of Section 11 of the 1933 Act for alleged false and misleading statements made in SureBeam's registration statement for its IPO. Plaintiffs fail to plead any false or misleading statements contained in the registration statement at the time

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[2] No sales by Rane are alleged.

the registration statement was issued. Instead, plaintiffs allege statements that were (i) either not false when made, or (ii) forward-looking statements that do not give rise to a securities fraud claim. Plaintiffs' Section 11 claim is also based on the same alleged underlying fraud allegations that purportedly support the Revenue Recognition Allegations. Because these allegations are grounded in fraud, they are also deficient for the same reasons set forth above.

II. PLAINTIFFS' "GROUP PUBLISHED" ALLEGATIONS ARE INSUFFICIENT TO ESTABLISH LIABILITY AS TO THE SBC DEFENDANTS

Plaintiffs' third claim for relief, asserted against the SBC Defendants, is for alleged violations of Section 10(b) of the 1934 Act, and SEC Rule 10b-5. To properly allege a claim for relief under section 10(b) of the 1934 Act and Securities and SEC Rule 10b-5, plaintiffs must allege facts showing: "(1) defendants ***made*** a false statement or omission with regard to a material fact; (2) in connection with the purchase or the sale of a security; (3) with scienter; (4) upon which plaintiffs reasonably relied; (5) to his/her harm or detriment." *In re Dura Pharmaceuticals Sec. Litig.*, 2000 Dist. LEXIS 15258, at *14-15 (S.D. Cal. July 11, 2000) (emphasis added). Here, plaintiffs do not allege any statements ***made*** by the SBC Defendants concerning SureBeam's revenue recognition. Instead, plaintiffs attempt to attribute written statements in SureBeam's press releases and SEC filings to the individuals through the "group-published" pleading device, a substitute for particularized pleading accepted by some courts prior to the PSLRA.[3] Specifically, plaintiffs allege that "Defendants Oberkfell, Rane, and Claudio . . . are liable for the written false statements pleaded in ¶¶ 81-138, as those statements were 'group-published' information." [Complaint, ¶ 74.] However, courts in the Southern District of California (and specifically ***this*** Court) have held that the "group-published" doctrine is no longer viable because it is at odds with the heightened pleading requirements of the PSLRA. *Allison v. Brooktree Corp.*, 999 F.Supp. 1342, 1350 (S.D. Cal. 1998).

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[3] Under the group published doctrine (as it existed prior to the PSLRA), courts applied a "presumption that statements in prospectuses, registration statements, annual reports, press releases, or other group published information, are the collective work of those individuals with direct involvement in the day-to-day affairs of the company." *In re PETsMart Sec. Litig.*, 61 F.Supp.2d 982, 997 (D. Ariz. 1999); *see also Wool v. Tandem Computers, Inc.*, 818 F.2d 1433, 1439 (9th Cir. 1987).

In *Allison, supra,* this Court explained:

> To begin with, the continued vitality of the judicially created group-published doctrine is suspect since the PSLRA specifically requires that the untrue statements or omissions be set forth with particularity as to "the defendant" and that scienter be plead in regards to "each act or omission" sufficient to give "rise to a strong inference that the defendant acted with the required state of mind." [citation omitted] To permit a judicial presumption as to particularity simply cannot be reconciled with the statutory mandate that plaintiffs must plead specific facts as to each act or omission by the defendant. The group published doctrine permits an inference of wrongdoing not based on defendant's conduct, but based solely on defendant's status as an officer of a corporation. . . ."
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> 999 F.Supp. at 1350.

This Court's logic has been followed by other courts in this district. *In re Ashworth, Inc. Securities Litig.,* 2000 U.S. Dist. LEXIS 15237, * (S.D. Cal. July 18, 2000) ("This Court concurs with Judge Miller's reasoning. Further, recognition of the group pleading doctrine would be at odds with *Silicon Graphics'* pleading requirements regarding scienter."); *In re Dura Pharmaceuticals, supra,* 2000 U.S. Dist. LEXIS 15258, at *33-34 ("Although other courts have held that the group pleading standard survives [the PSLRA], this district has held that it likely does not.").

Therefore, plaintiffs cannot state a securities fraud claim against the SBC Defendants by merely relying on the ***company's*** SEC filings or press releases. Plaintiffs had to allege particularized, contemporaneous facts demonstrating that the SBC Defendants actually knew and deliberately disregarded that the ***accounting*** for the Tech Ion or RESAL transactions was improper. *In re Silicon Graphics Sec. Litig.,* 183 F.3d 970, 985 (9th Cir. 1999). Plaintiffs fail to do so here.

III. PLAINTIFFS FAIL TO PLEAD SPECIFIC FACTS GIVING RISE TO A STRONG INFERENCE THAT DEFENDANTS OBERKFELL, CLAUDIO AND RANE ACTED WITH SCIENTER

A. THE HEIGHTENED STANDARD FOR PLEADING SCIENTER IN THE NINTH CIRCUIT

Under the PSLRA, plaintiffs must allege "with particularity facts giving rise to a strong inference that [each] defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2);

Ronconi v. Larkin, 253 F.3d 423, 429 (9th Cir. 2001). In this regard, the PSLRA heightened the pleading requirements under Federal Rule of Civil Procedure 9(b). *Ronconi, supra,* 253 F.3d at 429, n.6. Plaintiffs must allege, "at a minimum, particular facts giving rise to a strong inference of deliberate or conscious recklessness." *Silicon Graphics, supra,*183 F.3d at 979. "The purpose of this heightened pleading requirement was generally to eliminate abusive securities litigation and particularly to put an end to the practice of pleading 'fraud by hindsight,'" as plaintiffs attempt to do here. *In re The Vantive Corporation Sec. Litig.*, 283 F.3d 1079, 1084-85 (9th Cir. 2002).

The PSLRA also departs from the standard of review for motions to dismiss under Rule 12(b)(6) regarding the treatment of inferences. Unlike other motions to dismiss, under the PSLRA, courts will not construe the plaintiffs' allegations in a vacuum "in the light most favorable to the plaintiff." *Gompper v. VISX, Inc.*, 298 F.3d 893, 896 (9th Cir. 2002). Instead, "the court must consider *all* reasonable inferences to be drawn from the allegations, including inferences unfavorable to the plaintiffs." *Id.* at 897 (emphasis in original). The court in *Gompper* explained:

> Because we believe Congress made it crystal clear that the PSLRA's pleading requirements were put in place so that only complaints with particularized facts giving rise to a strong inference of wrongdoing survive a motion to dismiss, we agree with the district court that when determining whether plaintiffs have shown a strong inference of scienter, the court must consider *all* reasonable inferences to be drawn from the allegations, **including inferences unfavorable to the plaintiffs**. District courts should consider all the allegations in their entirety, together with any reasonable inferences that can be drawn therefrom, including whether, on balance, the plaintiff's complaint gives rise to the requisite inference of scienter.

Gompper, 298 F.3d at 897 (italics in original, bold supplied); *see also, In re Foundry Networks, Inc. Sec. Litig,* No. C-00-4823, 2003 U.S. Dist. LEXIS 18200, * 6 (N.D. Cal. 2003)("Conclusory allegations of law and unwarranted inferences are insufficient to defeat a motion to dismiss for failure to state a claim."), quoting *Epstein v. Washington Energy Co.*, 83 F.3d 1136, 1139 (9th Cir. 1996).

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B. PLAINTIFFS' REVENUE RECOGNITION ALLEGATIONS ARE INSUFFICIENT TO RAISE A STRONG INFERENCE OF SCIENTER

In cases of alleged improper accounting, as plaintiffs attempt to allege here, publication of inaccurate accounting figures, or failure to follow GAAP, without more is insufficient to establish scienter. *DSAM Global Value Fund v. Altris Software, Inc.*, 288 F.3d 385, 390 (9th Cir. 2002); *see also Northpoint Communications Group, Inc. Sec. Litig.*, 184 F.Supp.2d 991, 998 (N.D. Cal. 2001); *In re U.S. Aggregates, Inc. Sec. Litig.*, 235 F.Supp.2d 1063, 1073 (N.D. Cal. 2002)("[E]ven an obvious failure to follow GAAP does not give rise to an inference of scienter."); *In re Dura Pharmaceuticals, supra,* 2000 U.S. Dist. LEXIS 15258, at *28 (S.D. Cal. July 11, 2000). GAAP is not a set of strict rules that result in strict liability for *fraud,* as plaintiffs allege here. Instead, GAAP characterizes "the range of reasonable alternatives that management can use" in presenting financial information. *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1420, n.10 (3d Cir. 1997).[4] Therefore, in order for alleged GAAP violations to establish scienter, the complaint must allege facts demonstrating "that [the defendant] knew or must have been aware of the improper revenue recognition, [or] intentionally or knowingly falsified the financial statement." *DSAM, supra,* 288 F.3d at 390-91; *see also City of Philadelphia v. Fleming Cos., Inc.*, 264 F.3d 1245, 1261 (10th Cir. 2001)("Only where such allegations [of violations of GAAP] are coupled with evidence that the violations or irregularities were the result of the defendant's fraudulent intent to mislead investors may they be sufficient to state a claim."). Absent specific facts alleged demonstrating the SBC Defendants' knowledge of accounting errors relating to Tech Ion and RESAL at the time the financial information concerning revenue recognition was published (which is not present here), and an intent to mislead investors, plaintiffs' Complaint fails to meet the PSLRA's pleading standards. *DSAM, supra,* 288 F.3d at 390-91; *In re Fritz Cos. Sec. Litig.*, 282 F.Supp.2d 1105, 1113 (N.D. Cal. 2003).

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[4] Generally accepted accounting principles (GAAP) are "the conventions, rules, and procedures that define accepted accounting practices." *United States v. Arthur Young & Co.*, 465 U.S. 805, 811 n.7, 104 S.Ct 1495 (1984). GAAP "includes broad statements of accounting principles amounting to aspirational norms as well as more specific guidelines and illustrations. *Bily v. Arthur Young & Co.*, 3 Cal.4th 370, 382 (1992)(citing standard textbook which comprehensively restates GAAP, "includes 90 major sections and more than 500 pages.").

Plaintiffs allege no particularized facts showing that any of the SBC Defendants had actual, contemporaneous knowledge that SureBeam's revenue recognition was improper at the time it was made, or that these defendants had an intent to defraud investors. Instead, plaintiffs merely plead in a conclusory manner that Rane "actually made the decision when to recognize the revenue" solely based on his status as Chief Financial Officer of SureBeam. [Complaint ¶ 148.] Plaintiffs similarly attempt to attribute actual knowledge or deliberate recklessness to Oberkfell and Claudio based solely on their status as officers of the company. [*See* Complaint, ¶ 139.] However, in the Ninth Circuit, a strong inference of scienter cannot be made simply based on a defendant's status as an officer or the defendant's job duties. *See In re Read-Rite Corp. Sec. Litig.*, 335 F.3d 843, 848-49 (9th Cir. 2003) (Explaining that even where there is a "reasonable inference" that the defendants were aware of the falsity of statements based on their job duties at the company, that "does not satisfy the PSLRA's requirement that Plaintiffs allege particular facts that give rise to a 'strong inference' of scienter on part of the Defendants."); *see also In re Autodesk, Inc. Sec. Litig.*, 132 F.Supp.2d 833, 844-45 (N.D. Cal. 2000); *In re Vantive Sec. Litig.*, 283 F.3d 1079, 1088 (9th Cir. 2002)(vague allegations of "hands-on" management style do not establish scienter).

Here, plaintiffs do not allege any specific facts that show the SBC Defendants had any responsibility for determining SureBeam's revenue recognition policy, reporting SureBeam's revenue in SEC filings or press releases, or that they knew the revenue recognition policy was improper at the time.

Moreover, nowhere do plaintiffs allege any facts demonstrating the defendants had any motivation to commit fraud that would lead to a strong inference of scienter. *See In re Metawave Communications Corp. Sec. Litig.*, 298 F.Supp.2d 1056, 1071 (D. Wash. 2003)(Routine business objectives, without more, cannot be considered a motivation to commit fraud.) Plaintiffs' allegations concerning stock sales are thin, and actually negate scienter as discussed below. Plaintiffs make no other attempt to show a motivation to commit fraud and this "weighs in favor" of granting the SBC Defendants' motion to dismiss. *See Id.*

Further, each of plaintiffs' theories fail as explained below.

1. A Difference of Opinion Among Auditors Does Not Create A Strong Inference of Scienter

Here, ***two*** national accounting firms, Arthur Andersen ***and*** KPMG, served as SureBeam's independent auditor, and each auditor concluded that the accounting for the Tech Ion and RESAL transactions was proper. [Complaint, ¶ 133; plaintiffs' original complaint, Ex. 2, ¶ 38; SureBeam's Form 10-K for 2001, Ex. 3, p. 46, and Form 10-K for 2002, Ex. 4, p. 53]

Because a ***third*** accounting firm two years ***later*** questioned precisely the same accounting previously approved by two major accounting firms certainly does not mean there was fraud. It reflects a difference in accounting judgment, expressed after-the-fact, which cannot give rise to a securities *fraud* claim. *See e.g., SEC v. Seaboard Corp.,* 677 F.2d 1301, 1311, fn. 13 (9th Cir. 1982) ("Generally accepted accounting standards are general standards of conduct relating to the auditor's professional qualities and to the judgments exercised by him in the performance of his examination and report."); *DSAM, supra,* 288 F.3d at 391 (Explaining that "[n]egligence, even gross negligence, does not rise to the level of the nefarious mental state necessary to constitute securities fraud under the PSLRA and *Silicon Graphics.*") Indeed, even when there has been a restatement of financial results (which did ***not*** occur here), "the fact that a restatement of financials occurred is not sufficient to raise a strong inference of scienter, for it is settled that 'scienter requires more than a misapplication of accounting principles." *In re MicroStrategy, Inc. Sec. Litig.*, 115 F.Supp.2d 620, 634-35 (E.D. Va. 2000)(citations omitted); *see also In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1426 (9th Cir. 1994) (Stating that even a *deliberate* violation of GAAP, without more, does not amount to fraud), citing with approval the statement in *Vasgerichian v. Commodore Intl'*, 832 F.Supp. 909, 915, n.8, (E.D. Pa. 1993) that "clearly, even deliberate violations of those guidelines, without more, do not amount to fraud."

Further, an inference of scienter is even more difficult to make where, as here, the accounting rule allegedly violated is not a simple accounting principle that the defendants should have known they were violating. *In re E.Spire Communications, Inc. Sec. Litig.,* 127 F.Supp.2d 734, 746-747 (D.Md. 2001) (dismissing case where accounting principle was "currently evolving in the industry"); *cf. MicroStrategy, supra,* 115 F.Supp.2d at 638 ("violations of simple rules are

obvious, and an inference of scienter becomes more probable as the violations become more obvious").

Therefore, to plead scienter adequately in this case, plaintiffs had to allege specific facts showing a strong inference that SureBeam's original accounting for the Tech Ion and RESAL transactions, in light of the circumstances that existed at the time, was the product of deliberate recklessness or conscious misconduct, and the SBC Defendants somehow had a hand in committing a fraud. Plaintiffs cannot meet this requirement. Here, the accounting principle at issue, revenue recognition under the percentage-of-completion accounting method (Complaint ¶¶ 154-156), is hardly a "simple accounting principle."[5] Reasonable minds do differ in its application and, in fact, a difference in opinion ultimately arose among one of three of the largest accounting firms in the world on the application of this revenue recognition method for the Tech Ion and RESAL transactions. A "strong inference" of scienter cannot possibly be drawn in this case simply because the third accounting firm that examined a transaction two years later questioned the conclusion reached by two prior national accounting firms about the application of a complex accounting method. In sum, plaintiffs must plead more than a violation of GAAP to adequately allege scienter. Plaintiffs fail to do so here.

Further, as noted above, in deciding a motion to dismiss based on securities fraud, the court must consider all reasonable inferences, not just those suggested by the plaintiffs. *Gompper, supra,* 298 F.3d at 897. Here, SureBeam replaced Arthur Andersen with KPMG as its independent auditor on April 15, 2002. [*See* June 3, 2003 Form 8-K, at Ex. 6; original Complaint, ¶ 38] Arthur Andersen had ***no*** disputes with SureBeam over accounting practices during the period that Arthur Andersen was SureBeam's auditor. [*Id.*] Under such circumstances, and particularly in light of the *Enron* matter and Arthur Andersen's role, defendants' logical inference is that KPMG would conduct its own due diligence before accepting the engagement. Defendants' knowledge that KPMG (or any other accounting firm considering the engagement) would conduct its own due diligence negates any inference that the defendants intended to defraud the public

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[5] Under the percentage-of-completion method of accounting, a company may recognize income as work under the contract progresses. [*See* Complaint, ¶¶ 154-155]

concerning SureBeam's recognition of revenue. *See e.g., Coates v. Heartland Wireless Communications, Inc.*, 55 F.Supp.2d 628, 643 (N.D. Tex. 1999)(Finding it "facially implausible" to draw a strong inference of fraud based on alleged concealment of the seller's customer base and financial information when the seller knows that a sophisticated buyer will conduct its own due diligence before acquiring the company.)

This inference negating scienter is strengthened by SureBeam's replacement of KPMG with Deloitte & Touche as its outside auditor. [See Form 8-K dated June 03, 2003, Ex 7] Now ***two*** national, outside accounting firms would have conducted their own due diligence and investigation into the transactions at issue in this lawsuit. While SureBeam might have had to replace Arthur Andersen, it certainly did not have to replace KPMG. Moreover, SureBeam did not replace KPMG because of any disagreements over SureBeam's accounting. [*See* Form 8-K, Ex. 6; and original complaint, Ex. 2, ¶ 38, citing to SureBeam's 8-K, which states the company had no disagreements with Arthur Andersen or KPMG "on any matter of accounting principles or practices, financial statement disclosure, auditing scope or procedure. . . ."] The hiring of two subsequent national accounting firms following Arthur Andersen that the defendants must have known would conduct their own independent investigation concerning SureBeam's accounting makes it facially implausible that any of the defendants were "deliberately reckless" or acted with "conscious misconduct" in reporting SureBeam's revenue.

At most, plaintiffs have alleged that the SBC Defendants were aware that two possible funding sources did not prove fruitful (even assuming that is true), and construction in Brazil and Saudi Arabia was behind schedule. That does not mean, as plaintiffs erroneously conclude, that those were the ***only*** funding sources available. Plaintiffs plead no ***facts*** demonstrating that the funding sources mentioned were the only two funding sources available or known. Indeed, the more plausible inference is that World Bank and SUDAM were ***not*** the only funding sources available (and they were not). Nowhere do any of the email excerpts relied on by plaintiffs state that these were the only governmental funding sources available. Nor do any of the email excerpts mention that private funding would not be available. Significantly, plaintiffs have not alleged any facts showing that any of the defendants actually believed that the World Bank or SUDAM were

the only two funding sources available for Tech Ion.

Moreover, plaintiffs' attempt at misdirection concerning the status of construction in Brazil and Saudi Arabia ignores the fact that construction was, in fact continuing, in both locations. Moreover, plaintiffs cannot allege that production of the SureBeam irradiation systems for sale to these joint ventures was not on schedule. Indeed, plaintiffs must even admit that irradiation systems were sent to both Brazil and Saudi Arabia (regardless of plaintiffs' faulty conclusion as to why systems were shipped to Brazil). It defies logic to suggest that SureBeam would ship over $25 million worth of sophisticated machinery to a jurisdiction it could not likely retrieve it from if SureBeam did not expect payment.

Here, plaintiffs simply attempt to allege scienter as to the SBC Defendants based on their job titles (insufficient as explained above) and their purported participation in the Tech Ion and RESAL transactions. However, the inferences plaintiffs attempt to draw from piecemeal references to emails do not support the broad conclusions that plaintiffs' make.

2. The Delphos Emails Do Not Create A Strong Inference of Scienter

Plaintiffs next attempt to meet their burden of showing a strong inference of scienter by relying on an email from Michael Telford at Delphos International (a funding expert hired to assist with financing for the Tech Ion transaction). [Complaint, ¶¶ 25-27.] Plaintiffs make the broad assertion that this email somehow establishes that the SBC Defendants must have known that Tech Ion would not be able to obtain funding. Plaintiffs' overreaching allegations are not supported by the email.

The email discusses work that needed to be done in an attempt to secure financing from the World Bank. ***Nowhere*** does this email state that Tech Ion would ***not*** be able to obtain financing from the World Bank, ***or some other source***. [Complaint, ¶¶ 25-27] Plaintiffs' presumption that this is the only possible source of funding for the Tech Ion joint venture is pure speculation and hardly gives rise to a strong inference of scienter.

Moreover, the email even states that "the meetings at the IIC and IFC went very well." [Complaint, ¶ 25] This does not suggest that funding is "impossible" as plaintiffs speculate, but just the opposite. The email also states that the SureBeam technology is a "service that is

currently under-utilized (or non-existent) in Brazil." [*Id.*] Arguably, this fact could prove ***favorable*** to the joint venture, not harmful. The email excerpt even notes "this is at the heart of its potential for success." [*Id.*] In effect, SureBeam was entering a market where it would have little or no competition. In any event, nowhere does Delphos or anyone else suggest financing from all sources is impossible or even remote.

Plaintiffs' reliance on a December 28, 2000 email from Alan Beard at Delphos is equally unavailing. [Complaint, ¶ 27.] The email merely seeks additional information to assist Delphos in securing financing. ***Nothing*** in the email suggests that funding would not be available. [*Id.*]

3. The Medeiros Memo Does Not Create a Strong Inference of Scienter

Plaintiffs also rely on a December 2000 memo from Tech Ion's Jose Medeiros in an attempt to draw a strong inference of scienter. [Complaint ¶¶ 28-31.] While the memo provides Mr. Medieros' opinion concerning financing from the World Bank, ***nowhere*** does it suggest that funding will not be obtained from any source. Indeed, the memo provides Medieros' opinions and offers alternatives for proceeding with the joint venture and securing other sources of funding. It certainly did not spell "doom" for the project as plaintiffs erroneously conclude. On the contrary, the Medieros' memorandum explored options designed to ensure the project's ultimate success.

Nor is there any support for plaintiffs' bald conclusion that funding from SUDAM, (the Brazilian agency suggested by Medieros,) was the "venture's last hope." [Complaint, ¶ 32, and see ¶ 37.] Plaintiffs allege no corroborating facts to show this. Nor do plaintiffs allege any facts showing that any of the SBC Defendants (i) even knew about the end of the SUDAM program, or that (ii) any of the SBC Defendants even believed that there were no other financing options except through SUDAM. These are fatal flaws in plaintiffs' theory.

The more likely inference is that the defendants understood if SUDAM (or World Bank) did not provide financing, there were other options to pursue, including other possible government sources, or private financing. In addition, plaintiffs admit in their Complaint that Tech Ion would pay for the irradiators through financing as well as through profits from the venture. [Complaint, ¶¶ 20-21.] Consequently, Medieros' opinions and suggestions about possible financing options and technology use do not even raise an inference of scienter, much less meet the threshold for

showing a strong inference of an intent to defraud by the SBC Defendants.

4. The Shipment of Systems to Brazil or Their Pricing Does Not Support a Strong Inference of Scienter

Plaintiffs allege that the shipment of two systems to Brazil somehow evidences scienter. [Complaint, ¶¶ 33-35.] The shipment of systems to Brazil cannot plausibly give rise to a strong inference of scienter. When complete, systems should have been shipped to Brazil where they would ultimately be used. There is nothing sinister about shipping systems to a customer once complete. Plaintiffs' allegations that there was some type of fraudulent motive for doing so is simply unsupported with any actual facts plead in the Complaint.

The same is true for plaintiffs' allegations concerning pricing. [Complaint ¶¶ 36-37.] Medieros' request for an invoice and specification of the price (if it, in fact, would be changed) suggests nothing more than a request for clarification as to price, and a request for an invoice for the same. Obviously, since Medieros was seeking financing, he needed to show the lender what he will pay for the systems. Plaintiffs' inflammatory allegation that Oberkfell and Medieros agreed to "artificially increase the price of the irradiators" is unsupported by any *factual* allegations and, in fact, is contradicted by the full text of the email, which states "[i]f I do not hear from you or receive the amended Proforma Invoice, I will use the existing one of $5 million."[6] Plaintiffs simply attempt to distort the meaning of an email.

5. Oberkfell's Visit to Brazil Does Not Create A Strong Inference of Scienter

Plaintiffs allege that Oberkfell's visit to Brazil somehow creates a strong inference of scienter because Oberkfell learned that construction in Brazil was behind schedule. [Complaint, ¶¶ 41-43.] However, simply because construction in Brazil was behind schedule does not automatically mean that construction would not be completed (by Medieros or someone else). Not every construction project that falls behind schedule is doomed to failure as plaintiffs suggest. It

[6] The full text of the email is attached to the NOL as Ex. 8. The Court may consider this email in its entirety under the incorporation by reference doctrine because it is referred to, and partially quoted in plaintiffs' Complaint. *Branch v. Tunnel,* 14 F.3d 449, 454 (9th Cir. 1994).

certainly does not mean that ***SureBeam's*** production of the ***irradiators*** was behind schedule. Indeed, as even plaintiffs allege, SureBeam shipped irradiators to Brazil. [Complaint, ¶¶ 33-35.]

Ultimately, as even plaintiffs' allege, SureBeam replaced Tech Ion with a new construction firm to complete construction. [Complaint, ¶ 43.] Replacing Tech Ion with a new construction firm negates any inference that Oberkfell or any of the other the SBC Defendants believed the project could not go forward. Indeed, by hiring a new firm to complete construction, the logical inference is that the defendants believed the project would proceed and be completed, not fail. This negates any inference of scienter by the SBC Defendants.

6. Plaintiffs Allege No Facts Demonstrating a Strong Inference of Scienter Regarding the RESAL Transaction

Plaintiffs' allegations of scienter concerning the RESAL transaction are particularly thin. Plaintiffs merely allege that an unnamed "manager" purportedly witnessed Rane renegotiating a payment schedule with RESAL. [Complaint, ¶ 50.] Plaintiffs allege no foundation for this unnamed witness' actual knowledge of the financing for this transaction, or that he or she had any personal knowledge of the funding status of the transaction. Nor are there any facts alleged showing that this witness has any personal knowledge concerning the reason for the purported renegotiation (even assuming arguendo that a re-negotiation somehow shows a fraudulent purpose). A complaint must be dismissed if it relies on purported witnesses but fails to plead a specific factual basis showing the witnesses' first-hand knowledge of the pertinent allegations. *In re Northpoint Communications Group, Inc. Sec. Litig.*, 221 F.Supp.2d 1090, 1097-98 (N.D. Cal. 2002); *In re U.S. Aggregates Sec. Litig.*, 235 F.Supp.2d 1063, 1075 (N.D. Cal. 2002)(dismissing complaint where confidential witnesses had no factual basis to support claims of officers' role in alleged accounting fraud).[7] Here, plaintiffs allege no facts demonstrating this witness, or any confidential witness relied on in the Complaint, had any knowledge of the accounting decisions made concerning the RESAL (or Tech Ion) transaction, much less any knowledge from which one

[7] "Allegations are deemed to have been made on information and belief until the plaintiffs demonstrate that they have personal knowledge of the facts." *Vantive, supra,* 283 F.3d at 1085, n.3.

could infer that the accounting decisions were made with an intent to defraud or with deliberate recklessness.

Further, even assuming that Rane renegotiated payment terms, this does not raise an inference that payment would not be received or that the project would fail. On the contrary, a renegotiation of payment terms suggests a belief that payment would be made. Otherwise, there would be no point of renegotiating the terms for payment. This illustrates another instance in which the inference that should be drawn is just the opposite of what plaintiffs attempt to allege. The allegation falls far short of creating a strong inference of scienter as required by the PSLRA.

Moreover, SureBeam's SEC filings fully disclosed the status of the RESAL contract and the company's analysis in connection with recognizing revenue using the percentage-of-completion method. SureBeam's Form 10-K for 2002 states:

> In assessing the probability of collection, we performed financial due diligence on RESAL and its principals, which included discussions with Saudi banking officials, prominent Saudi business professionals, Saudi government agencies and review of available RESAL financial information. . . .
>
> [Form 10-K for 2002, at Ex. 4, p.50.]

This assessment process negates any inference "that [the defendants] knew or must have been aware of the improper revenue recognition, [or] intentionally or knowingly falsified the financial statement." *DSAM, supra,* 288 F.3d at 390-91

C. STOCK SALES BY OBERKFELL AND CLAUDIO DO NOT RAISE A STRONG INFERENCE OF SCIENTER

Planitiffs' allegations that defendants Oberkfell and Claudio sold stock during the class period are insufficient to raise a strong inference of scienter.[8] *See Silicon Graphics, supra,* 183 F.3d at 974, 986. Indeed, the stock sales here by Oberkfell and Claudio are unremarkable. Because directors and employees frequently hold stock, "[i]t follows . . . that these individuals will trade those securities in the normal course of events." *In re Burlington Coat Factory, surpa,* 114 F.3d at 1424; *see also Ronconi, supra,* 253 F.3d at 435 (identifying legitimate reasons why

[8] Plaintiffs do not allege that Rane sold any stock.

insiders sell). Because directors and employees will necessarily be selling at *some* time, "the mere existence of stock sales does not raise a strong inference of fraudulent intent." *PETsMART, supra,* 61 F.Supp.2d at 1000.

Therefore, allegations that corporate officers sold stock does not raise a strong inference of scienter unless plaintiffs also allege specific facts showing that the stock sales were "dramatically out of line with prior trading practices *at times calculated to maximize the personal benefit from undisclosed inside information.*" *Ronconi, supra,* 253 F.3d at 435 (emphasis in original), quoting *Silicon Graphics*, 183 F.3d at 986. In examining such allegations, courts consider: (1) the amount and percentage of shares sold by insiders; (2) the timing of sales, and (3) whether the sales were consistent with the insider's prior trading history. *Id.*

Here, plaintiffs allege that "Oberkfell sold approximately 37.5% of his SureBeam holdings while Claudio's sales represented 31.8% of his holdings." [Complaint, ¶ 110.] These percentages are within the range of percentage of sales held ***insufficient*** to create a strong inference of scienter in other cases. *See Silicon Graphics, supra,* 183 F.3d at 987 (scienter not plead against officer that sold 43.6 percent of his holdings); *Vantive, supra* 283 F.3d at 1095 (scienter not plead against officer who sold 32 percent of his holdings).[9]

Further, Oberkfell's and Claudio's Form 4s filed with the SEC demonstrates that Oberkfell and Claudio exercised options once vested, and then sold these shares.[10] There is nothing unusual about this and it does not demonstrate an effort to "time" sales in a manner to maximize profit based on undisclosed inside information. *Ranconi, supra,* 253 F.3d at 435. Instead, Oberkfell and Claudio sold stock options once they vested. This is not suspicious and raises no inference of scienter. *See PETsMART, supra,* 61 F.Supp.2d at 1000.

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[9] Plaintiffs also allege that Claudio previously sold 92,670 shares of SureBeam stock. [Complaint, ¶ 106.] However, as explained below, this represented the exercise of stock options that he immediately sold at below the peak sales price for the class period. As explained below, this does not raise a strong inference of scienter.

[10] Oberkfell's and Claudio's Form 4s filed with the SEC are attached to the NOL as Exs 9 and 10. The Form 4 for Rane, who did not sell, is at Ex. 11. The Court may take judicial notice of these forms filed with the SEC. *Silicon Graphics, supra,* 183 F.3d at 986; *Allison, supra,* 999 F.Supp. at 1352, n.3.

In addition, plaintiffs allege that Oberkfell and Claudio sold stock at prices between $5.20 and $6.20 per share. [Complaint, ¶ 110.] This is approximately 67 to 75 percent below the peak price – far less than the "Class Period high of $19.45 per share alleged in the Complaint. [Complaint, ¶ 3.] "When insiders missed the boat this dramatically, their sales do not support an inference" of scienter. *Ronconi, supra,* 253 F.3d at 435; *see also Vantive,* 283 F.3d at 1094-95 (Sales at 38 percent below peak created further doubt that defendant was operating on "inside knowledge.")[11]

Further, while insider trading-based scienter allegations must ultimately be judged and analyzed on a person-by-person basis, observations about similarly situated defendants can be relevant to the individualized analyses. *See Vantive, supra,* 283 F.3d at 1093 ("Had [defendant] been selling these shares to 'dump' what he knew was artificially inflated stock, other equally (or more) knowledgeable defendants presumably would have done the same thing.") Here, defendant Rane, who ***is alleged*** to be armed with the same information as Oberkfell and Claudio, made no sales during the class period. *See Nathenson v. Zonagen, Inc.,* 267 F.3d 400, 421 (5th Cir. 2001)("[T]he fact that the other defendants did not sell during the relevant class period undermines plaintiffs' claims."). Significantly, as demonstrated by Rane's Form 4, he ***purchased*** 78,103 shares of stock during the class period on the open market. [*See* Ex. 11] Accordingly, this case presents an even stronger case for negating scienter based on stock sales than *Vantive* and *Nathenson, supra,* because Rane did not simply chose not to sell; he purchased shares during the class period. No inference of scienter can be made based on the SBC Defendants' stock sales in this case. Instead, the inference that should be made is just the opposite -- the stock sales show a lack of scienter.

D. THE SBC DEFENDANTS' STATEMENTS CONCERNING DOMESTIC DEMAND ARE NOT ACTIONABLE

The balance of plaintiffs' claims allege that the defendants misled investors about the expected demand for SureBeam's irradiation systems. [*See* Complaint, ¶¶ 1, 10, 52, 90, 91, 95,

[11] Claudio's prior sales (Complaint, ¶ 106) at approximately $12.40 per share, are also well below the alleged peak share price of $19.45 during the class period (by approximately 37%).

124.] To the extent plaintiffs attempt to impose liability on the SBC Defendants for the Demand Allegations based on the "group-published" pleading device, those claims must be dismissed for the reasons explained in Section II, above.

1. Plaintiffs' Allegations Regarding Press Releases Fail to Show a Strong Inference of Scienter

Plaintiffs' Demand Allegations attempt to address classic forward-looking statements about the company's expectations concerning demand for its products. For example, plaintiffs allege that Oberkfell made statements in press releases such as demand is "expected to increase" [Complaint, ¶ 91, at 33:16-17, and see ¶ 124, at 48:2-3]. Plaintiffs allege the same type of forward-looking statements attributed to SureBeam and not the SBC defendants. [*See* Complaint, ¶¶ 52, 90.] These are the type of forward-looking statements that courts routinely find not actionable. *See Harris v. IVAX Corp.*, 182 F.3d 799, 805 (11th Cir. 1999)("[A] statement about the state of a company whose truth or falsity is discernible only after it is made necessarily refers only to future performance" and is forward-looking.); *see also* 15 U.S.C. § 78u-5(i)(1)(Defining a forward-looking statement to include, among other things, "a statement containing a projection of revenues, income, . . . earnings . . .or other financial items. . . a statement of the plans and objectives of management for future operations, including plans related to the products or services of the issuer. . . a statement of future economic performance.").[12]

Forward-looking statements such as those alleged here are protected from securities fraud under the PSLRA's safe harbor provisions for "forward-looking statements that are immaterial, are limited by meaningful cautionary statements, or are made without knowledge of their falsity." 15 U.S.C. § 78u-5(c). It is well-settled that a complaint attacking forward-looking statements must plead specific facts showing the speaker had "actual knowledge" that "the [forward-looking] statement was false or misleading" when made. 15 U.S.C. § 78u-4(b)(2), § 78u-5(c)(1)(B)(i), (ii);

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[12] Although not pertinent to the Demand Allegations, plaintiffs also suggest that statements made by Rane on a conference call with analysts concerning when SureBeam "expected" to collect on certain, unspecified contracts is somehow fraudulent. [Complaint, ¶ 112 (Collection on certain signed, but uncollected contracts expected to occur by the end of *2003*.)] No specific facts are alleged showing that in May 2002, when Rane allegedly participated on the conference call, he had actual knowledge that this would not occur.

Ronconi, supra, 253 F.3d at 430. Plaintiffs fail to do so here.

Plaintiffs' allegations about SureBeam's *existing* production output has nothing to do with what the individuals believed *future* demand might be. Plaintiffs cannot state a securities fraud claim based on allegations that *existing* demand is inconsistent with *forecasted* results. These allegations are immaterial as a matter of law. *In re Verifone Sec. Litig.,* 11 F.3d 865, 869 (9th Cir. 1993) (Motion to dismiss granted because nondisclosure of "future prospects" based on the company's past performance is immaterial.).

Moreover, as plaintiffs allege, SureBeam announced its intent to expand its production capacity and build additional facilities. [*See* Complaint, ¶¶ 10, 52] SureBeam's plan to expand and build additional facilities is consistent with the belief that demand will be increasing in the future. SureBeam's plan to expand and build additional facilities is entirely *inconsistent* with plaintiffs' theory that the individual defendants had "actual knowledge" at that same time that demand would be *decreasing* in the future. This negates any inference of scienter. *See Gompper, supra,* 298 F.3d at 897.

2. Plaintiffs' Reliance on Unnamed Witnesses Fails to Create a Strong Inference of Scienter

Plaintiffs attempt to bolster their Demand Allegations by attributing certain statements to unnamed SureBeam employees concerning *existing* demand. [Complaint, ¶¶ 53-56.] However, plaintiffs plead ***no facts*** demonstrating that these witnesses had any personal knowledge of the company's forecasts or expectations as to future demand. Instead, plaintiffs merely offer the opinions and conclusions of unnamed employees that are (i) irrelevant to the subject of future demand, (ii) fail to show the witnesses' personal knowledge of the individual defendants' knowledge about existing and future demand, and (iii) fail to show that that the opinions and conclusions purportedly reached by the unnamed witnesses are even based on personal knowledge. A confidential witness' conjecture is insufficient to support a strong inference of scienter. *Metawave, supra,* 298 F.Supp.2d at 1068 ("The Court must be able to tell whether a confidential witness is speaking from personal knowledge or 'merely regurgitating gossip and innuendo.'"). Here, plaintiffs allege no facts that any of the unnamed witnesses ever discussed the

issue of demand with any of the SBC Defendants. A strong inference of scienter as to the SBC Defendants simply cannot be made based on the conclusions and opinions of unnamed sources who are not even alleged to have communicated with the individual defendants.

Nor can a strong inference of scienter be made based on plaintiffs' allegation that Rane received a weekly report from SureBeam employee Jeff Boeger showing the volume of product being handled by the various SureBeam facilities. [Complaint, ¶ 147.] As Rane explained in a conference call alleged by plaintiffs, the production numbers included product that was for testing purposes, as well as product for which SureBeam had been paid. [Complaint, ¶ 147.][13] Nowhere do plaintiffs allege that Boeger ever discussed SureBeam's forecasts for anticipated demand with Rane, or that the then-existing "volume reports" contained any information that was relevant to the question of future demand. This innocuous allegation does not create any inference, much less a strong inference, that Rane had actual knowledge that the domestic demand for SureBeam's product in the *future* would decline.

3. Plaintiffs' Allegations of Statements Made to Analysts Do Not Create a Strong Inference of Scienter

Plaintiffs also allege various other statements made by Rane and Oberkfell during conference calls with analysts that are either unactionable forward-looking statements as described above, or not false or misleading at all. (See fn. 6, above.) For example, plaintiffs allege a statement by Rane concerning when "we have *projected* breakeven on our processing centers. . . ." [Complaint, ¶ 115, at 44:13-15] This is plainly a forward-looking statement and not actionable absent particularized facts showing Rane knew the statement was false when made. *See Harris, supra,* 182 F.3d at 805. Other statements made during conference calls are not even alleged to be false or misleading at all. [*See* Complaint, ¶ 126, at 48:24 – 49:4, ¶ 132, at 51:9-21.[14]][15]

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[13] Plaintiffs attempt to insinuate there is something wrong with Rane *not* mixing apples and oranges by disclosing the tonnage processed when this includes testing materials. Instead, Rane properly focused on a number that could be compared quarter to quarter, which was revenue. Focusing on numbers that cannot be compared, like tonnage that includes testing materials as well as material paid for would be meaningless. [Complaint, ¶ 147.]

[14] This includes the only statement made by Claudio alleged in the entire Complaint, and that statement is not even alleged to be false or misleading.

4. Plaintiffs' "Roadshow" Allegations Fail to Create a Strong Inference of Scienter

Plaintiffs allege that prior to the class period, in February 2001, Oberkfell and Rane participated in a "roadshow" to make favorable presentations about SureBeam to institutional investors and money/portfolio managers in connection with SureBeam's IPO. [Complaint, ¶ 82.] Plaintiffs allege that Oberkfell and Rane purportedly made statements about the "demand" for SureBeam's ground beef services, and revenues that SureBeam "expected to receive" . . ."over the next few years" as a result of the strategic venture with Tech Ion. [Complaint, ¶ 82.] These are the same type of forward-looking statements that are not actionable for the reasons stated above. Plaintiffs allege no particularized facts demonstrating that either Oberkfell or Rane actually knew these statements were false when made.

Moreover, Rane could not even have made the roadshow statements alleged in the Complaint. He was not even an employee of SureBeam prior to the IPO in February 2001 when the statements were allegedly made. [*See* Registration Statement listing officers and key employees, Ex 5, p.50, and Request for Judicial Notice.]

IV. PLAINTIFFS' SECTION 11 CLAIM SOUNDS IN FRAUD AND SHOULD BE DISMISSED

Plaintiffs' first claim for relief, alleged against defendants Oberkfell, Claudio (as well as others), attempts to state a claim for a violation of Section 11 of the 1933 Act, 15 U.S.C. § 77k. [Complaint, ¶ 176.] To state a claim for a violation of Section 11 of the 1933 Act, plaintiffs must demonstrate "(1) that the registration statement contained an omission or misrepresentation, and (2) that the omission or misrepresentation was material, that is, it would have misled a reasonable investor about the nature of his or her investment." *In re Stac Electronics Sec. Litig.*, 89 F.3d 1399, 1403-04 (9th Cir. 1996).

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[15] Moreover, the statements made during conference calls with analysts were preceded by a cautionary statement from SureBeam concerning the forward-looking statements. [*See* Cautionary Statement made by SureBeam at the outset of analyst conference calls, quoted in full by defendants Titan, Ray and Golding, which the SBC Defendants have joined.]

Here, plaintiffs attempt to rely on the very same allegations concerning the Prospectus as in their 1934 Act claims. [Complaint, ¶ 179 ("Each of the defendants identified in this Claim issued, caused to be issued and participated in the issuance of materially false and misleading written statements to the investing public, which were contained in the Prospectus, which misrepresented or failed to disclose, *inter alia*, the facts set forth above.").] Therefore, the particularity requirements of Rule 9(b) apply to plaintiffs' Section 11 claim here because this claim is grounded in fraud. *Stac, supra,* 89 F.3d at 1404-05 ("We now clarify that the particularity requirements of Rule 9(b) apply to claims brought under Section 11 when, as here, they are grounded in fraud."). Plaintiffs attempt to disclaim the obvious – that their Section 11 claim is grounded in fraud – by inserting conclusory allegations that this claim is not based on intentional or reckless misconduct or fraud. This is unavailing. *Id.*, 89 F.3d at 1405, n.2 (Nominal efforts to disclaim any allegations of fraud in connection with a Section 11 claim are disregarded when there is no other basis for liability alleged.). The same applies here. Plaintiffs make no effort to plead any alternative basis for liability other than fraud. [*See* Complaint, ¶ 179.]

A. PLAINTIFFS FAIL TO PLEAD ANY FALSE OR MISLEADING STATEMENTS AT THE TIME THE REGISTRATION STATEMENT WAS ISSUED

Section 11 of the 1933 Act applies only to material misstatements or omissions when the registration statement became effective. *In re Gap Stores Sec. Litig.*, 79 F.R.D. 283, 297 (N.D. Cal. 1978)("[T]he plaintiff must prove the registration statement contained a material misstatement or omission when it became effective. . . ."). Plaintiffs cannot state a Section 11 claim based on statements or omissions rendered misleading by subsequent events. *See In re Bank of Boston Corp. Sec. Litig.*, 762 F.Supp. 1525, 1536-37 (D. Mass. 1991) ("[O]missions that create a misleading impression – particularly one that is misleading only in *hindsight* – are not sufficient to constitute the basis of a securities action under Section 11 . . . ." [emphasis in original].); quoted and cited with approval in *Zucker v. Quasha,* 891 F.Supp. 1010, 1017 (D.N.J. 1995), and *Castlerock Management, Ltd. v. Ultralife Batteries, Inc.,* 68 F.Supp.2d 480, 488 (D.N.J. 1999). Here, that is precisely what plaintiffs attempt to do by alleging that statements made in the registration statement were misleading because of what later happened to the joint venture with

Tech Ion. Because Deloitte and Touche later questioned the revenue recognition method approved by Arthur Andersen, and subsequently reviewed and approved by KPMG, does not mean that the statements contained in the registration statement were false and misleading ***at the time they were made.***

For example, plaintiffs allege that the registration statement attributes $15.5 million in revenue to the sale of 11 irradiation systems to Tech Ion and that "expected revenues" from this sale were $55 million over three years. [Complaint, ¶ 38.] Plaintiffs allege this was false and misleading because, according to plaintiffs, there was no reasonable assurance that Tech Ion could pay and the revenue should not have been recognized under the percentage-of-completion method of accounting. [Complaint ¶¶ 38-39, 85, 153] However, as discussed above, plaintiffs have not plead any facts showing that at the time the registration statement was issued, the defendants knew that Tech Ion could not pay.

Plaintiffs also allege that the registration statement was false and misleading based on the statement that SureBeam "expected" to receive $55 million in revenue over the next three years. [Complaint, ¶ 38] This statement is not actionable for the reasons discussed above in Section IV-D relating to the Demand Allegations because this is a classic forward-looking statement. Indeed, the registration statement even identifies the use of the word "expects" as a forward-looking statement. [Registration Statement, at Ex. 5, p.19.]

In addition, forward looking statements are also protected under the Ninth Circuit's "bespeaks caution" doctrine. *In re Worlds of Wonder, supra,* 35 F.3d at 1413 ("The bespeaks caution doctrine provides a mechanism by which a court can rule as a matter of law (typically in a motion to dismiss for failure to state a cause of action or a motion for summary judgment) that defendants' forward-looking representations contained enough cautionary language or risk disclosure to protect the defendant against claims of securities fraud."). This doctrine applies to Section 11 claims as well as section 10(b) claims. *Id.*, at 1415, fn. 3.

Here, the registration statement contains numerous cautionary statements and risk disclosures that show the statements made in the registration statement are not actionable:

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- SureBeam's "international operations are subject to several inherent risks that could increase our costs and decrease our profit margins including. . . "changes in a specific country's or region's political or economic conditions." [Registration Statement, Ex. 5, at p.10.]

- Some of the systems [from which SureBeam recognizes revenue such as Tech Ion] "are not yet installed or in operation and we expect to continue to derive system sales revenue as we complete construction of these systems." [*Id.*, Ex. 5, at p.12]

- "We cannot assure you that we will continue to derive revenues from these customers [such as Tech Ion], [or] that revenues from these customers will continue at current or historical levels. . . ." [*Id.*, Ex. 5, at p.12]

- The registration statement contains the heading: **"DELAYS IN THE CONSTRUCTION AND INSTALLATION OF OUR SYSTEMS COULD NEGATIVELY AFFECT OUR REVENUES."** [*Id.*, Ex. 5, at p.15 (capitalization and bold in original)]

- "For example, the expected completion date of the first service center in Brazil was postponed from the fourth quarter of 2000 to the third quarter of 2001 as a result of unanticipated delays in the construction process." [*Id.*, Ex. 5, at p.15]

- "Any delay in the deployment of our systems could adversely affect our revenues and cash flows." [*Id.*, Ex. 5, at p.15]

Plaintiffs further allege that the statements that *SureBeam* "acquired a 19.9% equity interest in SureBeam Brasil without charge at the time of our signing the agreement to establish SureBeam Brasil" and that SureBeam Brasil was created "with no initial capital contribution from either party" were untrue because *Titan* contributed $5 million to Tech Ion without any provision for repayment. [Complaint, ¶ 40] There is nothing untrue about this statement. Titan and SureBeam were separate companies and even plaintiffs admit that the registration statement disclosed the $5 million contribution from Titan as loan *from Titan*, not a contribution from SureBeam. [Complaint, ¶ 40] The statement that SureBeam acquired its interest in SureBeam Brasil without charge is accurate.

V. CONCLUSION

For the reasons stated above, defendants Oberkfell, Claudio and Rane respectfully request that the Court dismiss the first and third claims of the Consolidated Complaint.

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Respectfully submitted,

LUCE, FORWARD, HAMILTON & SCRIPPS LLP

By: 

Timothy R. Pestotnik
Russell A. Gold
Attorneys for Defendants Lawrence Oberkfell, Kevin Claudio, and David Rane