



IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IAN BEISER,)
)
Plaintiff,)
)
v.) C.A. No. 3893-VCL
)
PMC-SIERRA, INC., a Delaware corporation,)
)
Defendant.)

**DEFENDANT PMC-SIERRA, INC.'S
OPENING BRIEF IN SUPPORT OF ITS MOTION TO DISMISS**

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INTRODUCTION

For at least seventeen years, the Delaware courts have urged stockholders to use the “tools at hand” by pursuing books and records inspections *before* filing derivative complaints. *See Levine v. Smith*, 591 A.2d 194, 209 (Del. 1991). Plaintiff here has done precisely the opposite: having filed a derivative complaint without first seeking to inspect any books and records, Plaintiff did not make an inspection demand until after his original consolidated complaint had been dismissed for failure to plead demand futility, and he did not file this action until after his first amended consolidated complaint had been dismissed for the same reason.

Indeed, before filing this case, Plaintiff went ahead and filed his second amended complaint, which the federal court hearing the case indicated would be his last. The defendants’ motions to dismiss the second amended complaint are scheduled to be heard on August 20, 2008. By having filed a total of four complaints in the federal action over a period of nearly two years before pursuing any remedies under Section 220, Plaintiff has made clear that he believes he has sufficient information to go forward, and he should be held to that decision.

The Delaware courts have long held that a plaintiff with a pending derivative claim is not entitled to discovery or a books and records inspection under Section 220. This is particularly true where, as here, the underlying derivative case is subject to the discovery stay imposed by the Private Securities Litigation Reform Act (“PSLRA”), and this Section 220 action is a clear attempt by Plaintiff to circumvent that stay. Under the circumstances, Plaintiff does not have a “proper purpose” for the requested inspection demand, and the Complaint should be dismissed.

Plaintiff’s Complaint should be dismissed also because Plaintiff has failed to plead any credible basis to suspect wrongdoing. Based on little more than the fact that defendant PMC-Sierra, Inc. (“PMC” or the “Company”) restated certain financial statements to account for errors in its accounting for stock option compensation, Plaintiff claims that a massive group of current

and former directors and officers engaged in a lengthy scheme to backdate stock options at PMC. Plaintiff has not pled, however, any basis for the assumption that the restatement was due to backdating as opposed to innocent accounting errors. Indeed, in the underlying derivative case, the federal court has twice held that Plaintiff failed to plead facts supporting an inference that any backdating occurred. Plaintiff's Complaint here is far more conclusory than the complaints that the federal court has dismissed on this ground, and it should be dismissed accordingly.

Finally, Plaintiff's Complaint should also be dismissed on the independent grounds that he has failed to comply with the clear procedural requirements of Section 220 in failing properly to direct the Demand to the Company's principal place of business or registered agent in Delaware and failing to provide a proper power of attorney.

STATEMENT OF FACTS

Plaintiff Ian Beiser (“Beiser”) is also the lead plaintiff in a stockholder derivative action pending in the United States District for the Northern District of California, styled *In re PMC-Sierra, Inc. Deriv. Litig.*, Case No. 5:06-CV-05330-RS (N.D. Cal.) (the “Federal Action”). *See* Compl. at 4, ¶ 11; *see also* Affidavit of Elizabeth T. Sudderth (“Sudderth Aff.”) Ex. 1.¹ Beiser filed his original derivative complaint in the Federal Action on August 29, 2006. *See* Sudderth Aff. Ex. 1.

On October 16, 2006, a second derivative action was filed in the United States District for the Northern District of California on behalf of another alleged PMC stockholder, *Barone v. Bailey, et al.*, Case No. 4:06-CV-06473-RS) (N.D. Cal.). *See id.* Ex. 2. The *Beiser* and *Barone* actions were consolidated on December 6, 2006, and plaintiffs were ordered to file a consolidated complaint on January 22, 2007. *See id.* Ex. 1. Beiser became the lead plaintiff and filed a Consolidated Verified Complaint on January 29, 2007. *See id.*

On March 15, 2007, PMC moved to dismiss the Federal Action based on demand futility, and the individual defendants moved to dismiss for failure to state a claim and for lack of personal jurisdiction as to some individual defendants. *See id.* The Court heard the demand futility motion on June 20, 2007, and issued an order on August 22, 2007, dismissing Plaintiff’s complaint with leave to amend. *See id.* Ex. 3. Beiser filed a First Amended Consolidated Complaint (“FAC”) on October 2, 2007. *See id.* Ex. 1.

On November 6, 2007, PMC moved to dismiss the FAC for failure to plead demand futility, and the individual defendants moved to dismiss for failure to state a claim and for lack of personal jurisdiction as to some individual defendants. *See id.* On December 26, 2007, ten days

¹ The Company respectfully requests that the Court take judicial notice of the documents that have been publicly filed in the Federal Action. *See In re Gen. Motors (Hughes) S’holder Litig.*, 897 A.2d 162, 168-69 (Del. 2006).

after filing his Opposition briefs to PMC's motion to dismiss the FAC, Plaintiff also filed a Motion to Compel the same documents which he now seeks to obtain through the Complaint in this action. *See id.* Ex. 4. The Court heard each of these motions on January 30, 2008.

Pending an order on these motions, Beiser sent PMC's counsel, Patrick Gibbs, a letter on April 15, 2008, purporting to make a demand for corporate books and records pursuant to Section 220 of the Delaware General Corporation Law. *See* Compl. at 5, ¶ 14 and Ex. A. On May 8, 2008, the Court issued an order dismissing Plaintiff's FAC with leave to amend "one final time." Compl. Ex. B at 5. The Court also denied Plaintiff's Motion to Compel the production of the very documents Plaintiff now seeks to obtain through a Section 220 inspection. *See id.* at 6-7. The Court noted that the PSLRA stay applies to derivative actions and commented that discovery in the Federal Action was inappropriate "until such time as plaintiffs have filed a complaint that meets applicable pleading standards." *See id.* at 7.

Although Beiser had made a books and records demand on April 15, 2008, he did not immediately file this action, nor did he seek at that time a stay of the Federal Action to pursue a books and records action in this Court. Instead, following the federal Court's May 8, 2008 order dismissing the FAC, Beiser chose to file a Second Amended Consolidated Complaint ("SAC") on May 28, 2008. *See* Sudderth Aff. Ex. 1. On June 25, 2008, PMC moved to dismiss the SAC for failure to plead demand futility, and the individual defendants moved to dismiss for failure to state a claim and for lack of personal jurisdiction as to some individual defendants. *See id.* Those motions are scheduled to be heard on August 20, 2008. *See id.*²

² On August 5, 2008, Plaintiff moved to stay the Federal Action pending the outcome of this action or, in the alternative, requested that the August 20 argument date be postponed until at least October 22, 2008. *See* Sudderth Aff. Ex. 1. Plaintiff's motion to stay is currently scheduled to be heard on August 13, 2008.

Beiser filed the Complaint in this action on July 15, 2008, more than a month and a half after filing his SAC in the Federal Action, and three months after making his initial Section 220 demand, and almost two years after filing his original complaint in the Federal Action.

ARGUMENT

I. PLAINTIFF CANNOT PURSUE A SECTION 220 DEMAND WHILE HIS DERIVATIVE LITIGATION IS STILL PENDING.

It has been the law of this State for nearly twenty years that derivative plaintiffs with claims already in litigation are not permitted to seek books and records under Section 220 or other discovery in aid of their allegations that demand is futile. *See Beam v. Stewart*, 845 A.2d 1040, 1056-57 (Del. 2004); *White v. Panic*, 783 A.2d 543, 549-50 (Del. 2001); *Brehm v. Eisner*, 746 A.2d 244, 266-67 (Del. 2000); *Scattered Corp. v. Chicago Stock Exch., Inc.* 701 A.2d 70, 77-79 (Del. 1997); *Grimes v. Donald*, 673 A.2d 1207, 1216 n.11 (Del. 1996); *Rales v. Blasband*, 634 A.2d 927, 934 n.10 (Del. 1993); *Levine*, 591 A.2d at 209. Thus, Plaintiff is prohibited from obtaining books and records under Section 220 while the Federal Action is pending.

II. PLAINTIFF DOES NOT HAVE A PROPER PURPOSE.

The right of a stockholder to inspect the corporation's books and records is not unfettered. In order to prevent improper use of the corporation's information, Section 220 requires that the stockholder demonstrate a "proper purpose" for the inspection of books and records. 8 *Del. C.* § 220(c); *W. Coast Mgmt. & Capital, LLC v. Carrier Access Corp.*, 914 A.2d 636, 646 (Del. Ch. 2006). It is insufficient to "state, in a conclusory manner, a generally accepted proper purpose. [A plaintiff] must state a reason for the purpose, i.e., what it will do with the information, or an end to which that investigation may lead." *Id.* (footnote omitted). Though Plaintiff has proffered three conclusory purposes for the inspection, Compl. Ex. A at 2, none are proper under the circumstances here.

A. The Public Policy Of This State Prohibits Plaintiffs Who Have Filed Derivative Actions From Seeking Books And Records.

"[T]he Delaware Supreme Court has made it clear that the public policy of this State is to encourage stockholders to utilize Section 220 *before* filing a derivative action." *Freund v.*

Lucent Techs., Inc., 2003 Del. Ch. LEXIS 3, at *13 (Del. Ch. Jan. 9, 2003) (emphasis added). Indeed, as Vice Chancellor Strine has noted: “It’s wholly unrealistic and burdensome for plaintiffs to believe that you can invoke compulsory litigation machinery ... and then turn around and use 220 [to obtain books and records]. It is a whipsaw on the company and it’s unduly burdensome, and it’s a whipsaw on the processes of dispute resolution.” *Parfi Holding, AB, v. Mirror Image Internet, Inc.*, C.A. No. 18457, tr. at 7 (Del. Ch. Mar. 23, 2001) (TRANSCRIPT) (attached hereto as Exhibit A). Encouraging derivative plaintiffs to seek books and records before filing a derivative action, and correspondingly precluding them from obtaining books and records after filing, promotes Delaware’s policy and prevents “expensive and time-consuming procedural machinations that too often occur in derivative litigation” when plaintiffs fail to author a pleading that will survive a motion to dismiss pursuant to Court of Chancery Rule 23.1. *In re Walt Disney Co. Deriv. Litig.*, 825 A.2d 275, 279 n.5 (Del. Ch. 2003).

Indeed, those expensive and time-consuming machinations have already occurred in the Federal Action. Although Plaintiff could have sought books and records from the Company under Section 220 before filing his initial complaint on August 29, 2006, he waited until April 15, 2008 to make a Section 220 request. By April 15, 2008, he had already filed *three* complaints in the Federal Action. *See* Sudderth Aff. Ex. 1. The Company has now twice prevailed on a Rule 23.1 motion to dismiss Plaintiff’s complaints in the Federal Action. *See* Compl. Ex. B at 1, 7; Sudderth Aff. Ex. 1. The most recent order granting the Company’s Rule 23.1 motion to dismiss was clear that Plaintiff was only being granted leave to amend “one final time.” Compl. Ex. B at 1, 7. Despite this warning, Plaintiff waited to file this action to enforce his Section 220 demand until *a month and a half* after he filed his SAC on May 28, 2008, which is now the *fourth* complaint that he has filed in the Federal Action. Moreover, he waited to file

this action until almost *a month* after the Company moved to dismiss the SAC on June 25, 2008. *See* Sudderth Aff. Ex. 1. The Company has therefore already incurred significant expenses and spent valuable time and resources in connection with moving to dismiss Plaintiff's insufficiently-pled federal derivative action a total of three times over a two-year period.

The utility of a Section 220 demand is completely thwarted, where, as here, Plaintiff has failed to utilize Section 220 before commencing litigation. For example, in *Taubenfeld v. Marriott Int'l, Inc.*, Chancellor Chandler denied plaintiffs' request to stay a pending derivative action, which the nominal defendant had moved to dismiss in order to allow the plaintiffs time to pursue a books and records demand before either filing an amended complaint or opposing the motion to dismiss. 2003 Del. Ch. LEXIS 108, at *7-11 (Del. Ch. Oct. 28, 2003). In reaching this result, the Chancellor concluded that by filing the derivative action first, plaintiffs had effectively foregone the opportunity to seek books and records. *Id.* at *10 ("Plaintiffs chose to file a complaint before pursuing their § 220 rights. Although that decision did not affect plaintiffs' § 220 rights, it did effect the benefit such rights could afford the plaintiffs."); *cf.* *Freund*, 2003 Del. Ch. LEXIS 3, at *11 (permitting books and records inspection because "there is no reason to infer that [plaintiff] is prosecuting this demand in order to obtain evidence for use in some other pending proceeding").

Plaintiff here should be precluded from obtaining books and records under Section 220 for the same reason the *Taubenfeld* plaintiffs were not permitted the opportunity to inspect books and records—he made a knowing choice to initiate litigation without the benefit of first obtaining books and records. *Taubenfeld*, 2003 Del. Ch. LEXIS 108, at *10 ("In this case, plaintiffs filed their complaint in January 2003. That filing was a certification under Rule 11 that the plaintiffs had enough information to support their allegations."). Indeed, Plaintiff filed three complaints in

the Federal Action before even making a Section 220 request, and waited to file this action until after he had filed his *fourth* complaint in the Federal Action. Dismissing the Complaint and denying Plaintiff the opportunity to obtain books and records in support of his pending derivative litigation, Compl. ¶ 11, will thereby advance this State’s policy of encouraging books and records inspections *before* filing derivative suits, so as not to force corporations to incur needless litigation expenses defending themselves against meritless complaints.

B. Plaintiff Is Improperly Attempting To Evade The PSLRA Discovery Stay In The Federal Action.

Plaintiff readily admits that the books and records he seeks in this action relate to the same factual issues in his complaint in federal court. Compl. ¶ 11. Given that Plaintiff has yet to pass the pleading stage there, Compl. Ex. B, Plaintiff is subject to the mandatory stay of discovery imposed by the PSLRA. 15 U.S.C. § 77z-1(b)(1); Compl. Ex. B at 6-7. Plaintiff’s attempt to seek books and records in this action is an improper attempt to circumvent the PSLRA’s discovery stay and an improper purpose under Section 220.³

In *Romero v. Career Educ. Corp.*, defendants argued that the plaintiff should not be permitted to obtain books and records in light of a pending federal case subject to a PSLRA discovery stay. 2005 Del. Ch. LEXIS 112 (Del. Ch. July 19, 2005). This Court essentially adopted a test that precludes a stockholder from obtaining books and records if the stockholder’s

³ The impropriety of Plaintiff’s purpose is also shown by the overly broad nature of the eight categories of books and records requested, which are more akin to document requests under Rule 34 than a request made with “rifled precision” as required by Section 220. *Highland Select Equity Fund, L.P. v. Motient Corp.*, 906 A.2d 156 (Del. Ch. 2006) (noting that the Delaware Supreme Court in *Security First Corp. v. U.S. Die Casting & Dev. Co.*, 687 A.2d 563 (Del. 1997), concluded that a “wide, eight category demand letter” was overbroad), *on remand, clarified at* 2007 Del. Ch. LEXIS 37, at *3 (Del. Ch. Feb. 26, 2007) (holding that despite a proper stated purpose, plaintiff’s actual purpose was improper because of the “extreme overbreadth” of the requests and “the way [plaintiff] used [the demand] to advance other objectives”), *aff’d*, 2007 Del. LEXIS 157 (Del. Apr. 4, 2007). Should the Company’s motion to dismiss be denied, the Company reserves all rights to challenge the breadth of the requests made.

intent is “to circumvent the PSLRA’s proscriptions.” *Id.* at *16. In *Romero*, the Court concluded that the stockholder did not intend to evade the PSLRA discovery stay and permitted the stockholder to make the inspection because: (1) the stockholder “has not been involved in the [federal] action; (2) “her counsel ... has represented to the Court that, although they were involved in [the federal action], they have no continuing involvement”; and (3) the parties had entered into a confidentiality agreement preventing the requesting stockholder from sharing the materials obtained in the inspection with the plaintiffs or their counsel in the federal action. *Id.*; *Cohen v. El Paso Corp.*, 2004 Del. Ch. LEXIS 149, at *9-10 (Del. Ch. Oct. 18, 2004) (allowing inspection when same three considerations were present).

Here, the precise opposite is true. Plaintiff here is the lead plaintiff in the pending Federal Action, his counsel are counsel in the Federal Action, and it is clear from the Complaint that the purpose of the inspection is to attempt to bolster the allegations made by Plaintiff in the Federal Action. *See* Compl. ¶ 11 & Exs. A & B. In fact, Plaintiff here only filed this action after the federal court denied Plaintiff’s request to lift the PSLRA discovery stay (to obtain the very same documents Plaintiff seeks through this action) and granted him one final opportunity to amend the federal complaint. *Id.* Ex. B at 6-7.⁴ It is apparent from the face of the Complaint that Plaintiff’s purpose in attempting to circumvent the PSLRA’s discovery stay is improper, and his Complaint should therefore be dismissed.

⁴ On multiple occasions, the federal court was very clear that Plaintiff would only be granted one final opportunity to amend. Compl. Ex. B at 2, 5. Given that Plaintiff has since amended the federal complaint, Sudderth Aff. Ex. 1, permitting the books and records inspection would be futile because Plaintiff will not obtain leave to incorporate any information learned from the inspection in a new complaint. When a stockholder’s only purpose for inspecting books and records is to support allegations in a derivative suit, and the opportunity to make those allegations is foreclosed, it is appropriate to deny the stockholder’s inspection request. *W. Coast*, 914 A.2d at 644-45 (dismissing Section 220 complaint where stockholder was estopped from filing a new complaint).

C. Plaintiff Cannot Demonstrate A Credible Basis To Suspect Wrongdoing.

Because Plaintiff is purportedly seeking to investigate wrongdoing by the Company's current or former directors or officers, Plaintiff bears the burden of demonstrating a "credible basis from which the Court of Chancery can infer there is possible mismanagement that would warrant further investigation." *Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 123 (Del. 2006). Here, Plaintiff cannot demonstrate a credible basis to suspect wrongdoing because judicially noticeable facts undercut any inference that intentional backdating occurred at PMC

Despite Plaintiff's discussion of backdating in the Complaint, there has yet to be an admission from PMC or a conclusion by any court, that intentional backdating occurred at PMC, as opposed to innocent error. *Compare* Compl. ¶¶ 7-9 *with* *Melzer v. CNET Networks, Inc.*, 934 A.2d 912, 917 n.20 (Del. Ch. 2007) (holding that CNET's admission of backdating was sufficient to create a credible basis to suspect wrongdoing). In fact, on two occasions, the court in the Federal Action concluded that Plaintiff here had failed to plead facts that would create "an inference of backdating." *See* Compl. Ex. B at 1, 4. Just because Plaintiff may believe that backdating occurred does not make it so. He cannot demonstrate a credible basis for his suspicions of wrongdoing, and his Complaint should be dismissed.

III. PLAINTIFF HAS NOT COMPLIED WITH THE BASIC PROCEDURAL REQUIREMENTS OF SECTION 220.

The statutory right of a stockholder to obtain books and records of the corporation is prescribed by Section 220 of the General Corporation Law. 8 *Del. C.* § 220. "A stockholder's exercise of the right to inspect books and records beyond stock lists and related information depends upon *strict compliance* with the requirements of Section 220." *Freund*, 2003 Del. Ch. LEXIS 3, at *7 (emphasis added). Failure to comply with the procedural requirements of Section 220 when making a demand mandates dismissal of the stockholder's subsequent

complaint. *Seinfeld v. Verizon Commc'ns, Inc.*, 873 A.2d 316, 317-18 (Del. Ch. 2005) (“The statute is both clear and commanding. Compliance with it is not difficult, and it is not too much to ask of a stockholder or his lawyers to read the statute and comply with its plain provisions when making a demand.”).

Plaintiff, despite being represented by counsel that is more than familiar with Section 220’s procedural requirements, has failed to comply with those clear requirements.⁵ The Demand is deficient in that it was not “directed to the corporation at its registered office in this State or at its principal place of business” and was not accompanied by a power of attorney authorizing the Plaintiff’s purported agent to make the Demand itself.⁶ *See* 8 *Del. C.* § 220(b).

A. Plaintiff Did Not Direct The Demand To the Corporation’s Registered Office Or Principal Place Of Business.

Section 220 has left no doubt regarding the appropriate addressee of a stockholder’s demand, requiring that a demand be “directed to the corporation at its registered office in this State or at its principal place of business.” 8 *Del. C.* § 220(b). The Demand in this case was directed neither to the Company’s principal place of business, nor to its registered office in

⁵ Indeed, based solely upon the allegations in the Complaint and the exhibits thereto, Plaintiff’s Demand would not be in compliance with *four* of the statute’s requirements and subject to dismissal in that it: (1) was not “directed to the corporation at its registered office in this State or at its principal place of business;” (2) was not made “under oath” under penalty of perjury under the laws of the United States or any state; (3) was not accompanied by a power of attorney even though it was made by an agent of the person seeking inspection; and (4) did not “state that [the] documentary evidence” of the Plaintiff’s beneficial ownership of the Company’s stock “is a true and correct copy of what it purports to be.” 8 *Del. C.* § 220(a)(4) and (b). In the interests of judicial economy and efficiency, PMC has included as Sudderth Aff. Ex. 5, additional documents provided to PMC after rejection of the Demand in anticipation that Plaintiff might seek to amend his pleading to include reference to these documents. By so doing, PMC does not concede that this motion can or should be converted into one for summary judgment as provided by Court of Chancery Rule 12(b), and were the Court inclined to make such a conversion, PMC would withdraw Sudderth Aff. Ex. 5.

⁶ Though not properly raised on a motion to dismiss, the Company has grave concerns regarding the propriety of the verification and statement under oath signed by Plaintiff given that it is dated *nearly a month* before the Demand was delivered. *Compare* Compl. Ex. A at 1 (dated April 15, 2008) *with* Sudderth Aff. Ex. 5 at 2 (dated March 19, 2008).

Delaware, but instead was directed to the Company’s counsel in the Federal Action. Compl. Ex. A at 1. The Complaint fails to state a claim upon which relief can be granted because it does not allege compliance with Section 220(b) with respect to where the Demand was directed, and should therefore be dismissed.

B. Plaintiff’s Power Of Attorney Does Not Authorize His Counsel To Make The Demand.

Section 220 allows a stockholder to appoint an attorney or agent to make the demand or conduct the inspection on his behalf. *See 8 Del. C. § 220(b)*. In those situations, however, the General Assembly has imposed a simple requirement—that the stockholder’s demand be “accompanied by a power of attorney or such other writing which authorizes the attorney or other agent *to so act* on behalf of the stockholder.” *Id.* (emphasis added). Though the Demand states that “the stockholder has executed a Power of Attorney,” none accompanied the Demand, Compl. Ex. A at 3, and the actual power of attorney (submitted nine days after the Demand) is limited to “the *examination*” of the Company’s books and records. *Sudderth Aff. Ex. 5 at 3* (emphasis added).⁷ The Complaint, thus, does not set forth allegations that the stockholder provided written authorization to his purported counsel to make the Demand on his behalf as required by Section 220(b), and the Complaint should be dismissed. *See Henshaw v. Am. Cement Corp.*, 252 A.2d 125, 128 (Del. Ch. 1969) (requiring power of attorney when demand made by attorney).

Each of these defects alone would justify dismissal. Together, they demonstrate Plaintiff’s bad faith efforts to flaunt these simple statutory requirements in a misguided effort to support his meritless derivative litigation. The Complaint should be dismissed.

⁷ The description of the power of attorney in the Demand is similarly limited. *See* Compl. Ex. A at 3 (“The stockholder has designated his counsel...to conduct, as his agent, *the inspection and copying* requested herein.”) (emphasis added).

CONCLUSION

For the foregoing reasons, PMC respectfully requests that the Complaint be DISMISSED with prejudice.

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