IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

DILORENZO, Plaintiff, v. NORTON, et al., Defendants.	Civil Action No. 1:07-cv-00144-RJL

SUPPLEMENTAL MEMORANDUM IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS THE FIRST AMENDED VERIFIED SHAREHOLDER DERIVATIVE COMPLAINT

Dated: August 27, 2008

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TABLE OF CONTENTS

Page

INTRODUCTION AND SUMMARY 1

ARGUMENT 2

I. Plaintiff Has Failed To Establish Standing 2

II. Plaintiff Pleads No Viable Federal Claim And Thus No Basis For Jurisdiction 5

A. Plaintiff Has Not Adequately Alleged *Scienter* Under Section 10(b) (Count I) 5

B. The "Insider Selling" Claims Under Section 10(b) (Count I) Are Undefended And Indefensible 8

C. *Cowin v. Bresler* Demolishes The Section 14(a) Claims (Count II) 10

D. Plaintiff Did Not Support His Section 20(a) Claims (Count III) 10

E. The D.C. Circuit Has Authoritatively Rejected Private Section 304 Claims (Count XII) 11

III. Plaintiff Has Failed To Plead Any Valid Excuse For Not Making The Required Pre-Suit Demand 12

A. Reliance On Disclosures From Outside The Complaint Confirms That The Allegations Are Insufficient 12

B. The Delaware Supreme Court Has Squarely Rejected Plaintiff's *Per Se* Theories Of Pleading Scienter And Demand Futility 15

C. Plaintiff's Assertion That It Would Be Impossible To Issue The Disputed Options By Mistake Is Neither Correct Nor A Substitute For Particularized Allegations 17

CONCLUSION 19

TABLE OF AUTHORITIES

Page(s)

Cases

Abigail Alliance for Better Access to Developmental Drugs v. Eschenbach,
469 F.3d 129 (D.C. Cir. 2006) 2

Belova v. Sharp,
No. CV 07-299-MO, 2008 WL 700961 (D. Or. Mar. 13, 2008) 3, 5, 7, 8

Blue Chip Stamps v. Manor Drug Stores,
421 U.S. 723 (1975)..................... 9

CarrAmerica Realty Corp. v. Kaidanow,
331 F.3d 999 (D.C. Cir. 2003) 2

Conrad v. Blank,
940 A.2d 28 (Del. Ch. 2007) 14

Cowin v. Bresler,
741 F.2d 410 (D.C. Cir. 1984) 9, 10

Desimone v. Barrows,
924 A.2d 908 (Del. Ch. 2007) 15, 17, 18, 19

Dura Pharms., Inc. v. Broudo,
544 U.S. 336 (2005)..................... 9

Fin. Planning Ass'n v. S.E.C.,
482 F.3d 481 (D.C. Cir. 2007) 2

Freeland v. Iridium World Commc'ns, Ltd.,
233 F.R.D. 40 (D.D.C. 2006)..................... 9

Haw. Laborers Pension Fund v. Farrell,
No. CV 06-06935 ODW (FMOx),
2007 U.S. Dist. LEXIS 77777 (C.D. Cal. Aug. 22, 2007)..................... 4

In re Affymetrix Deriv. Litig.,
No. C 06-05353 JW. (N.D. Cal. Mar. 31, 2008)..................... 3

In re BISYS Group Inc. Deriv. Action,
396 F. Supp. 2d 463 (S.D.N.Y. 2005) 12

In re CNET Networks, Inc. S'holder Deriv. Litig.,
483 F. Supp. 2d 947 (N.D. Cal. 2007) 16

In re Computer Scis. Corp. Deriv. Litig.,
No. CV 06-05288 MRP,
2007 U.S. Dist. LEXIS 25414 (C.D. Cal. Mar. 26, 2007) 4

In re Diebold Deriv. Litig.,
Nos. 5:06CV0233 & 5:06CV0418,
2008 WL 564824 (N.D. Ohio Feb. 29, 2008) 11

In re Digimarc Corp. Deriv. Litig.,
No. 05-1324-HA, 2006 WL 2345497 (D. Or. Aug. 11, 2006) 11

In re Fed. Nat'l Mortgage Ass'n Secs., Deriv., & "ERISA" Litig.,
503 F. Supp. 2d 25 (D.D.C. 2007) 8

In re Goodyear Tire & Rubber Co. Deriv. Litig.,
Nos. 5:03CV2180, 2007 WL 43557 (N.D. Ohio Jan. 5, 2007) 11

In re iBasis, Inc. Deriv. Litig.,
532 F. Supp. 2d 214 (D. Mass. 2007) 11

In re Infosonics Corp. Deriv. Litig.,
No. 06cv1336 BTM(WMc), 2007 WL 2572276 (S.D. Cal. Sept. 4, 2007) 11

In re Maxim Integrated Prods., Inc., Deriv. Litig.,
No. C 06-0334JW, 2007 WL 2745805 (N.D. Cal. July 25, 2007) 4

In re Openwave Sys. Inc. S'holder Deriv. Litig.,
503 F. Supp. 2d 1341 (N.D. Cal. 2007) 7

In re Openwave Sys. Sec. Litig.,
528 F. Supp. 2d 236 (S.D.N.Y. 2007) 5, 6, 7

In re Verisign, Inc. Deriv. Litig.,
531 F. Supp. 2d 1173 (N.D. Cal. 2007) 16

In re Whitehall Jewellers, Inc. S'holder Deriv. Litig.,
No. 05 C 1050, 2006 WL 468012 (N.D. Ill. Feb. 27, 2006) 12

In re Zoran Corp. Deriv. Litig.,
511 F. Supp. 2d 986 (N.D. Cal. 2007) 5, 7

Kogan v. Robinson,
432 F. Supp. 2d 1075 (S.D. Cal. 2006) 11

Mehlenbacher ex rel. Asconi Corp. v. Jitaru,
No. 6:04CV1118ORL-22KRS, 2005 WL 4585859 (M.D. Fla. June 6, 2005) 12

Middlesex Ret. Sys. v. Quest Software Inc.,
527 F. Supp. 2d 1164 (C.D. Cal. 2007) 5, 6, 7

Middlesex Ret. Sys. v. Quest Software, Inc.,
No. CV 06-6863 DOC (C.D. Cal. July 10, 2008)... 6

Neer v. Pelino,
389 F. Supp. 2d 648 (E.D. Pa. 2005) 12

Pedroli ex rel. Microtune, Inc. v. Bartek,
No. 4:07-CV-43, ___ F. Supp. 2d ___,
2008 WL 901203 (E.D. Tex. Mar. 31, 2008) 11

Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust v. Raines,
No. 07-7108, 2008 WL 3166142 (D.C. Cir. Aug. 8, 2008)........................... 11, 15, 17

Rudolph v. UTStarcom,
No. C 07-04578 SI, ___ F. Supp. 2d ___ ,
2008 WL 1734763 (N.D. Cal. Apr. 14, 2008) 17, 18

Ryan v. Gifford,
918 A.2d 341 (Del. Ch. 2007) 14, 15

Steel Co. v. Citizens for a Better Env't,
523 U.S. 83 (1998)... 3

United Mine Workers v. Gibbs,
383 U.S. 715 (1966)... 5

Wood v. Baum,
No. 621, 2007, __ A.2d __, 2008 WL 2600981 (Del. July 1, 2008) 16, 17

Statutes

15 U.S.C. § 78u-4(b)(2) 5

Del. Code tit. 8, § 327 4

Rules

Fed. R. Civ. P. 23.1 .... 4, 7, 15

INTRODUCTION AND SUMMARY

This Court heard oral argument on Defendants' motion to dismiss the First Amended Complaint on August 6, 2008. Defendants respectfully submit the following supplemental brief to address three issues raised during oral argument.

First, Plaintiff failed to establish that he has standing to assert his claims. Implicitly acknowledging that the standing allegations are deficient on their own terms, Plaintiff urged this Court to assess the merits of his claims before assessing his ability to bring them. This inverted analysis turns well-settled standing principles on their head, and it is unsupportable under the law of the D.C. Circuit. This failure alone compels outright dismissal of the complaint.

Second, Plaintiff failed to establish federal jurisdiction. At oral argument, Plaintiff declined to defend most of his federal claims. He attempted to save his Section 10(b) claims merely by arguing that allegations of committee membership suffice to establish scienter. But even the cases Plaintiff cites as his best authorities fail to endorse such an end-run around the particularized pleading required for federal securities claims. Having pleaded no viable federal claims, Plaintiff has failed to establish any basis for proceeding in federal court.

Third, Plaintiff did not justify his failure to make a pre-suit demand on ePlus's board of directors. Plaintiff sought to bolster his claims by selectively citing information from outside his complaint, and he argued that knowledge of wrongdoing could be established *per se* simply by alleging committee membership or generic assertions of backdating. As the Delaware Supreme Court has made clear, Plaintiff's attempt to smear Defendants by committee is no more successful for his state law claims than for his federal claims.

For each of these reasons and for the reasons explained in Defendants' memoranda of law in support of dismissal, this Court should dismiss the First Amended Complaint.

ARGUMENT

I. Plaintiff Has Failed To Establish Standing

As explained in Defendants' papers and reiterated at oral argument, Plaintiff has failed to plead the minimum allegations of contemporaneous stock ownership that are essential to establish standing for his claims. Defs.' Mot. Dismiss First Am. Compl. ("Mot."), Docket Entry ("DE") 15 at 31–32; Reply Mem. Supp. Defs.' Mot. Dismiss, DE 19 ("Reply") at 15–16; Tr. Mot. Hr'g, Aug. 6, 2008 ("Tr.") 5–8, 49–50. When this Court asked about the standing problem, Plaintiff's counsel provided two ineffective responses. Tr. 41.

First, counsel invited this Court to overlook the fundamental issue of justiciability and "sustain[] the complaint" without regard to his lack of standing. Tr. 41–42. This decide-claims-now-and-ask-questions-later approach is contrary to the long-settled rule that "[s]tanding to sue is a threshold question." *Fund for Animals, Inc. v. Kempthorne*, 472 F.3d 872, 876 (D.C. Cir. 2006); *see also Fin. Planning Ass'n v. S.E.C.*, 482 F.3d 481, 486 (D.C. Cir. 2007); *Abigail Alliance for Better Access to Developmental Drugs v. Eschenbach*, 469 F.3d 129, 132 (D.C. Cir. 2006). As a result, it is hardly surprising that the D.C. Circuit has rejected a derivative suit where the plaintiffs did not own shares at the time of the wrongs they alleged. *See CarrAmerica Realty Corp. v. Kaidanow*, 331 F.3d 999, 1001 (D.C. Cir. 2003) ("[T]he action which underlies the plaintiffs' complaint occurred . . . [when] neither plaintiff was a shareholder, and thus neither has the requisite standing to challenge the propriety of that action."). The fact that the D.C. Circuit has not yet had the opportunity to reach the same conclusion in a backdating case is hardly material; standing is a threshold issue in *every* case.

Moreover, as the Supreme Court has emphasized, "[m]uch more than legal niceties are at stake" in addressing the preliminary question whether the plaintiff has standing to sue. *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 101–02 (1998). Rather, these jurisdictional issues are

"an essential ingredient of separation and equilibration of powers, restraining the courts from acting at certain times, and even restraining them from acting permanently regarding certain subjects." *Id.* Plaintiff's invitation for this Court to exceed appropriate limits on judicial authority should summarily be rejected.

Plaintiff's counsel asserted that the inverted approach he proposed was adopted in "*TriQuint*," referring to the District of Oregon's decision in *Belova v. Sharp*, No. CV 07-299-MO, 2008 WL 700961 (Mar. 13, 2008). But *Belova* did not sustain a deficient complaint. In fact, *Belova* addressed the very same standing allegations pleaded in this case and held that they are insufficient: "The Complaint states [that the plaintiffs] owned TriQuint stock at 'times relevant.' *This general allegation is not sufficiently particular* and is, in fact, inaccurate by the shareholders' own admissions." *Id*. at *3 (emphasis added; citation omitted). Because of this defect, the *Belova* court granted the defendants' motion to dismiss. *Id*. at *4.

Belova is not the only case Plaintiff cites that supports dismissal for lack of standing. The supplemental authorities Plaintiff filed with this Court, DE 26, also include *In re Affymetrix Derivative Litigation*, No. C 06-05353 JW, slip op. (N.D. Cal. Mar. 31, 2008), which dismissed a derivative complaint because the plaintiff had not adequately alleged standing. In *Affymetrix*, the plaintiffs alleged that they "were at all relevant times[] shareholders of nominal Defendant Affymetrix." *Id*. at 13 (quotation marks omitted). The court held that "[t]his statement is insufficient to plead continuous ownership because Plaintiffs have not alleged when they purchased the shares and whether they continue to hold them; similar conclusory allegations have been rejected as insufficient for purposes of Rule 23.1." *Id*. at 13–14. The same is true here.

Plaintiff's counsel's second response to the standing problem was that he could not have known that the allegations were insufficient when he filed the amended complaint because the

case-law was undeveloped at that time. Tr. 41–42. Even if it were a reasonable assertion, that is hardly a legal argument—misunderstanding is no cure for jurisdictional defects. But this assertion is not reasonable. Several courts had analyzed and rejected allegations similar to those pleaded here well *before* Plaintiff filed his amended complaint on November 29, 2007. *See Haw. Laborers Pension Fund v. Farrell*, No. CV 06-06935 ODW (FMOx), 2007 U.S. Dist. LEXIS 77777, at *30 (C.D. Cal. Aug. 22, 2007) ("Plaintiff alleges that it 'is, and at relevant times hereto was, a shareholder of THQ.' Defendant contends that this allegation falls short of Rule 23.1's contemporaneous ownership requirement. Defendant is correct."); *In re Maxim Integrated Prods., Inc., Deriv. Litig.*, No. C 06-0334JW, 2007 WL 2745805, *3–*4 (N.D. Cal. July 25, 2007), ("Plaintiffs merely allege that they owned Maxim stock 'at all relevant times.' This statement does not allege continuous ownership or ownership . . . ."); *In re Computer Scis. Corp. Deriv. Litig.*, No. CV 06-05288 MRP, 2007 U.S. Dist. LEXIS 25414, at *47–*48 (C.D. Cal. Mar. 26, 2007) ("This general allegation is insufficient to allege contemporaneous ownership during the period in which the questioned transactions occurred, and is, in fact, inaccurate by Plaintiffs' own varying admissions."). Plaintiff's counsel in this case was also counsel of record in the *Hawaii Laborers* case. Even if that were insufficient notice, Defendants raised the deficiencies in Plaintiff's standing allegations in the first motion to dismiss *in this very case*. *See* DE 8 at 37. There is simply no excuse for ignoring this issue in the second complaint.

In short, a derivative plaintiff must, to establish standing, allege specifically when he became a shareholder, that he remained a shareholder during the alleged wrongs, and that he remains a shareholder today. *See* Fed. R. Civ. P. 23.1; *see also* Del. Code tit. 8, § 327. Plaintiff's inverted approach is not accepted by the D.C. Circuit. Because the complaint fails to satisfy the standing requirements, dismissal is unavoidable.

II. Plaintiff Pleads No Viable Federal Claim And Thus No Basis For Jurisdiction

Even if this Court were to conclude that Plaintiff's unparticularized assertions of standing are sufficient, the Court should nonetheless dismiss the amended complaint for lack of jurisdiction. Plaintiff's sole basis for litigating this case in federal court is his attempt to refashion his state-law claims for breach of fiduciary duty as federal-law claims for securities fraud. Because each of Plaintiff's federal claims fails as a matter of law, this Court should dismiss this case in its entirety. *See United Mine Workers v. Gibbs*, 383 U.S. 715, 726 (1966); *see also* Mot. 20; Reply 2.

A. Plaintiff Has Not Adequately Alleged *Scienter* Under Section 10(b) (Count I)

Plaintiff's claims under Section 10(b) of the Exchange Act must be dismissed pursuant to the Private Securities Litigation Reform Act ("PSLRA"), among numerous other reasons, because he has not "state[d] 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).[1] Plaintiff illustrated this critical defect at oral argument by once again failing to identify specific facts alleged in the complaint that create any inference of scienter—let alone a "strong" one—with respect to *each* individual defendant. *See* Tr. 45–49.

Plaintiff instead relied on four cases that, he claims, excuse his failure to plead particularized factual allegations: *Middlesex Ret. Sys. v. Quest Software Inc.*, 527 F. Supp. 2d 1164 (C.D. Cal. 2007); *In re Openwave Sys. Sec. Litig.*, 528 F. Supp. 2d 236 (S.D.N.Y. 2007); *In re Zoran Corp. Deriv. Litig.*, 511 F. Supp. 2d 986 (N.D. Cal. 2007); and *Belova v. Sharp*. According to

[1] In addition, these claims should be dismissed because Plaintiff has insufficiently pleaded numerous other required elements of Section 10(b), including fraud in connection with the purchase or sale of securities, particular misstatements or omissions, materiality, loss causation, and reasonable reliance. *See generally* Mot. 5–10; Reply 3–7.

Plaintiff, these cases hold that a plaintiff may plead scienter simply by alleging membership on a compensation committee or stock option incentive committee. *See* Tr. 47–48. They do not. In fact, these cases contradict Plaintiff's position in this litigation by holding that compensation committee membership is *insufficient* to establish scienter where, as here, the plaintiff has failed to plead *other* particularized allegations to support scienter.

In *Quest*, for instance, the court held that a complaint satisfied the PSLRA's pleading standard because "Plaintiff has pled *numerous particularized facts*" supporting a strong inference of scienter. 527 F. Supp. 2d at 1191 (emphasis added); *see also Middlesex Ret. Sys. v. Quest Software, Inc.*, No. CV 06-6863 DOC, slip op. at 11 (C.D. Cal. July 10, 2008) (noting that "Plaintiff pleaded numerous particularized facts which give rise to a strong inference" of scienter). Although one of the numerous facts supporting scienter in *Quest* was the defendants' positions within the company, the court was careful to emphasize that it was "not finding that Defendant's [*sic*] positions alone are sufficient to establish scienter." 527 F. Supp. 2d at 1184 n.2. Rather, "it is this combination with *other particularized facts* that may allow the Court to find that scienter has been adequately pled." *Id.* (emphasis added). In this case, unlike *Quest*, Plaintiff has not adequately alleged "other particularized facts" to support the strong inference of scienter required by the PSLRA for each defendant.[2]

The plaintiffs in *Openwave* similarly relied on numerous particularized facts to plead scienter. Indeed, the plaintiffs "offer[ed] a variety of species of evidence to demonstrate [the required] intent, including confidential witness statements, statistical analysis of Openwave's stock option grants, the size and duration of the backdating scheme, violations of Generally Accepted

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[2] Indeed, the "Officer Defendants," Messrs. Mencarini and Parkhurst, are not even alleged to have served on ePlus's board or any of its committees.

Accounting Principles (GAAP), defendants' receipt of backdated options, the resignation of several Openwave executives, and defendants' false certifications under the Sarbanes-Oxley Act." 528 F. Supp. 2d at 249. Contrary to Plaintiff's reading of the case, the defendants' membership on the compensation committee was only one of the numerous factors that the court considered in concluding that scienter was adequately pleaded. *Id.* at 250.[3] Many of the other factors, such as confidential witness statements, are conspicuously absent here.

Zoran also emphasized—contrary to Plaintiff's position in this litigation—that "[s]imply pleading that defendants surely would have known that the statements were false by virtue of their positions at the company is not automatically sufficient to show a strong inference" of scienter. 511 F. Supp. 2d at 1013. The plaintiff adequately alleged scienter in *Zoran* by relying (like the plaintiff in *Openwave*) on two confidential witnesses to establish the role and knowledge of each defendant. *Id.* at 1012; *see also*, *e.g.*, *id.* at 1013 (noting that "plaintiff has alleged, on information from a confidential witness, that [one of the defendants] gave final approval of options grants").

Finally, *Belova v. Sharp* is equally unhelpful to Plaintiff. *Belova* dismissed the plaintiffs' complaint because, as in this case, the plaintiffs did not adequately allege standing under Federal Rule of Civil Procedure 23.1(b)(1). *See* 2008 WL 700961, at *3–*4; *see also supra* Part I. Despite granting the defendants' motion to dismiss, however, the court addressed several other is-

[3] Moreover, both *Quest* and *Openwave* were direct securities class actions rather than derivative suits on behalf of the corporation. Those opinions therefore had no need to address whether the plaintiffs could satisfy the demand requirement applicable to derivative suits. Tellingly, when *Openwave* shareholders attempted to raise backdating allegations in a derivative suit, the Northern District of California dismissed their claims for failure to make a pre-suit demand. *See In re Openwave Sys. Inc. S'holder Deriv. Litig.*, 503 F. Supp. 2d 1341, 1353 (N.D. Cal. 2007).

sues raised by the pleadings. The opinion contains only a single paragraph of analysis regarding scienter; it notes that the plaintiffs "allege[d that] the defendants prepared or approved false and misleading public statements relating to the stock options in question." *Id.* at *6. Whatever the merits of this sparse reasoning, it does not establish—as Plaintiff contends—that compensation committee membership is sufficient to establish scienter.

But even if any of the out-of-circuit cases on which Plaintiff relies *had* held that a plaintiff may establish scienter by alleging membership on a compensation committee, this Court should reject that view as inconsistent with its well-reasoned decision in *In re Federal National Mortgage Association Securities, Derivative, and "ERISA" Litigation*, 503 F. Supp. 2d 25 (D.D.C. 2007) ("*Fannie Mae II*"). In *Fannie Mae II*, this Court held that committee membership was insufficient to establish scienter because the plaintiff (like Plaintiff here) had failed to plead "(1) what facts, if any, were brought to the attention of the [Stock Incentive, Compensation, or] Audit Committee[s]; (2) when these facts were brought; or (3) what, if anything, the . . . Committee[s] did in response." *Id.* at 40. Because Plaintiff's complaint fails to include "such specific allegations," his "allegations, at best, rise to the level of negligence" and "do not demonstrate the required state of mind of extreme recklessness." *Id.* at 40–41; *see also* Tr. 20–21. Accordingly, this Court should dismiss Plaintiff's Section 10(b) claim. *See* Mot. 11–12; Reply 2–3, 8–9.

B. The "Insider Selling" Claims Under Section 10(b) (Count I) Are Undefended And Indefensible

Plaintiff's counsel made no effort at argument, and little effort in his brief, to contend that the so-called "insider selling" claims have merit. Such a contention would fall flat in any event. As explained by Defendants' counsel, ePlus—which Plaintiff purportedly represents in this lawsuit—is not alleged to have purchased any shares of common stock that the Defendants sold on

the open market. And ePlus certainly lacks standing to claim that *open-market purchasers*, who are not parties to this lawsuit, paid too much for shares *they* purchased. Tr. 23; *see also* Reply 3 n.1 (citing *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 754–55 (1975); *Cowin v. Bresler*, 741 F.2d 410, 420 (D.C. Cir. 1984) ("[O]nly purchasers or sellers of securities have standing to pursue private claims for damages under section 10(b) and Rule 10b-5 . . . .")).

Furthermore, Plaintiff fails to plead loss causation. The nondisclosure of options errors had no effect on ePlus's stock prices. Tr. 22–23; *see also* Mot. 9 & n.4, Reply 7–8 & n.5. That fact is judicially noticeable. *See Freeland v. Iridium World Commc'ns, Ltd.*, 233 F.R.D. 40, 43 n.3 (D.D.C. 2006). And it underscores the insufficiency of the allegations. "The complaint's failure to claim that [ePlus's] share price fell significantly after the truth became known suggests that the plaintiffs considered the allegation of purchase price inflation alone sufficient. . . . [H]owever, the 'artificially inflated purchase price' is not itself a relevant economic loss." *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 347 (2005).

If any portion of this case is permitted to proceed, these vague insider selling claims should be singled out for dismissal. Plaintiff attempts to use them to inflate the amounts at issue dramatically. *Compare* ePlus Form 10-K, FY 2006, at 4 (total restatement of $3.6 million); *id.* at 7 (only *$1.4 million* of incremental compensation expenses related to grants to officers and directors); *with* Compl. ¶¶ 1, 143 (alleging *$5 million* in so-called insider selling claims). He should be denied the *in terrorem* effect of these defective and insupportable claims.

C. *Cowin v. Bresler* Demolishes The Section 14(a) Claims (Count II)

Plaintiff's claims under Section 14(a) of the Exchange Act must be dismissed because, among other reasons, he has failed to plead the "essential link" element.[4] As the D.C. Circuit explained in *Cowin v. Bresler*, Section 14(a) provides a remedy only for alleged harm that results from "corporate action *authorized* by the proxy statement." 741 F.2d at 428 (emphasis added); *see also* Mot. 12–14; Reply 9–11. In this case, however, Plaintiff has admitted that the alleged backdating was *not authorized* by the stock option plans approved by shareholders. *See*, *e.g.*, Pl.'s Opp. Defs.' Mot. Dismiss, DE 17 ("Opp.") at 6.

Plaintiff has failed to address *Cowin* despite being given numerous opportunities to do so. Defendants raised this issue in their motion to dismiss the original complaint, but Plaintiff made no effort to remedy the "essential link" defect in his amended complaint. Defendants raised the same issue in their motion to dismiss the amended complaint, but Plaintiff's opposition brief does not even *mention Cowin*, let alone argue that it somehow does not foreclose his Section 14(a) claims. Finally, this Court invited Plaintiff to address the Section 14(a) "problem" during oral argument, but Plaintiff simply refused to do so. *See* Tr. 44–45 ("I prefer not to repeat my papers . . . ."). Plaintiff's repeated failure to address *Cowin* makes clear—as Defendants have argued since the beginning of this litigation—that the Section 14(a) claim must be dismissed.

D. Plaintiff Did Not Support His Section 20(a) Claims (Count III)

Despite this Court's invitation to address the 20(a) problem during oral argument, Plaintiff did not bother to defend his claims for control person liability under Section 20(a) of the Exchange Act. *See* Tr. 45. There is nothing Plaintiff could have said to save this claim. Not only

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[4] The Section 14(a) claims are also defective for the reasons explained in the Defendants' previous memoranda of law. *See* Mot. 14–16; Reply 10–11.

has Plaintiff failed to plead any viable primary violations of Section 10(b) or Section 14(a), he also has not adequately alleged that any of the Defendants controlled a primary violator or that they were culpable participants in any securities violations. For each of these reasons, Plaintiff's Section 20(a) claims must be dismissed. *See* Mot. 16–18; Reply 11–12.

E. The D.C. Circuit Has Authoritatively Rejected Private Section 304 Claims (Count XII)

Finally, this Court should dismiss Plaintiff's claims against Defendants Norton and Mencarini under Section 304 of the Sarbanes-Oxley Act because the D.C. Circuit has now held that Section 304 does not authorize private parties to sue to enforce its provisions. *See Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust v. Raines*, No. 07-7108, 2008 WL 3166142, at *10 (D.C. Cir. Aug. 8, 2008) (holding that section "304 does not create a private right of action"). At oral argument, defense counsel relied extensively on this Court's dismissal of a derivative suit on behalf of Fannie Mae. *See, e.g.*, Tr. 4–5, 10–11. *Pirelli* affirmed this Court's order of dismissal. *See* Ex. A. Although the plaintiffs claimed that Fannie Mae's directors should have sued its former CEO and CFO under Section 304, the D.C. Circuit rejected that argument because Section 304 does not create a private right of action. *Id.* This holding, which is consistent with the views of every other court to consider the issue, forecloses Plaintiff's attempt to plead a claim under Section 304.[5]

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[5] *See, e.g.*, *Pedroli ex rel. Microtune, Inc. v. Bartek*, No. 4:07-CV-43, ___ F. Supp. 2d ___, 2008 WL 901203, at *2 (E.D. Tex. Mar. 31, 2008) ; *In re Diebold Deriv. Litig.*, Nos. 5:06CV0233 & 5:06CV0418, 2008 WL 564824, at *2 (N.D. Ohio Feb. 29, 2008); *In re iBasis, Inc. Deriv. Litig.*, 532 F. Supp. 2d 214, 223–25 (D. Mass. 2007); *In re Infosonics Corp. Deriv. Litig.*, No. 06cv1336 BTM(WMc), 2007 WL 2572276, at *8–*9 (S.D. Cal. Sept. 4, 2007); *In re Goodyear Tire & Rubber Co. Deriv. Litig.*, Nos. 5:03CV2180, etc., 2007 WL 43557, at *7 (N.D. Ohio Jan. 5, 2007); *In re Digimarc Corp. Deriv. Litig.*, No. 05-1324-HA, 2006 WL 2345497, at *2 (D. Or. Aug. 11, 2006); *Kogan v. Robinson*, 432 F. Supp. 2d 1075, 1082 (S.D. Cal. 2006); *In re Whitehall Jewellers, Inc. S'holder Deriv. Litig.*, No. 05 C

[Footnote continued on next page]

III. Plaintiff Has Failed To Plead Any Valid Excuse For Not Making The Required Pre-Suit Demand

A. Reliance On Disclosures From Outside The Complaint Confirms That The Allegations Are Insufficient

At argument, Plaintiff's counsel subordinated the generic allegations pleaded in the complaint and largely relied instead on ePlus's Form 10-K for the fiscal year ended March 2006 (and filed with the SEC on August 16, 2007). Tr. 27–28, 33–34. This 10-K is not cited in the complaint.[6] As a procedural matter, Plaintiff's need to use materials outside the pleadings to justify his claims demonstrates that the pleadings are themselves insufficient.

As a practical matter, the 10-K undermines many of Plaintiff's allegations. Contrary to Plaintiff's cavalier assertion that it would be impossible for the so-called "suspicious" options to be misdated by negligence, *see* Tr. 45–46, the 10-K discloses that annual option grants to outside directors were flawed due to a misunderstanding over when they were due: "Until 2003, management believed that the annual awards should be given on the anniversary of the IPO, November 20." ePlus Form 10-K, FY 2006, at 9. In fact, grants were supposed to be issued on the anniversary of each director's appointment to the board. But since ePlus's first two directors were

[Footnote continued from previous page]

1050, 2006 WL 468012, at *8 (N.D. Ill. Feb. 27, 2006); *In re BISYS Group Inc. Deriv. Action*, 396 F. Supp. 2d 463, 464 (S.D.N.Y. 2005); *Neer v. Pelino*, 389 F. Supp. 2d 648, 657 (E.D. Pa. 2005); *Mehlenbacher ex rel. Asconi Corp. v. Jitaru*, No. 6:04CV1118ORL-22KRS, 2005 WL 4585859, at *10 (M.D. Fla. June 6, 2005).

[6] Plaintiff cites the 10-K in a filing styled "Plaintiff's Request for Judicial Notice in Support of Opposition to Defendants' Motion to Dismiss." DE 18. Defendants, who are otherwise limited to plaintiffs' version of the story at this stage of a case, commonly file judicial-notice motions to alert courts to facts that they may appropriately consider in support of dismissal. But plaintiffs control the allegations in the complaint and generally have no need for such motions—assuming they have adequately pleaded their allegations. Plaintiff's effort to introduce new information through this filing simply highlights the insufficiency of the complaint.

appointed on November 20, 1996, the IPO date, and were supposed to receive options on that day each year, management mistakenly assumed that *all* director options were due on that day. *Id*. Significantly, one of the grant dates that Plaintiff disputes corresponds to these ostensibly accidental director grants.[7] Given that Plaintiff cherry-picked only nine grant dates to challenge in the course of more than seven years, the circumstances surrounding this grant date significantly undermines the generic assertion of scienter.

The 10-K also refutes Plaintiff's repeated assertion that these errors resulted from management's efforts to reward itself; it discloses that the overwhelming majority of compensation expenses that had to be recorded as a result of misdated options stemmed not from options granted to the Defendants, but "to employees who were neither our executive officers nor our directors." *Id*. at 7. At oral argument, Plaintiff's counsel seized on the 10-K's statement that the "price of certain stock options were determined with hindsight." *Id*. at 4. But the 10-K does not say, and plaintiff does not allege, whether any of the *particular* Defendants that Plaintiff happened to sue played any *particular* role in such determinations. The Federal Rules and case law require that specificity.

Moreover, the 10-K discloses that ePlus *voluntarily* reviewed its options grants in response to a letter it received from a shareholder on June 20, 2006—long before the first (and later abandoned) complaint was filed in this case. *Id.* at 3. Although the shareholder's letter addressed only the 2004 option grants, ePlus's Audit Committee reviewed *all* of the company's option grants since its IPO in 1996. *Id*.

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[7] Plaintiff contests grants to Messrs. Faulders and O'Donnell on November 19, 1999. Compl. ¶ 69. These options were not granted at a quarterly low, and they issued on the Friday before ePlus's Saturday IPO anniversary in 1999.

Following this review, ePlus undertook extensive remedial measures to correct its options-related errors. *Id*. at 11, 46–47, 65–66. Among other things, ePlus adopted a host of new policies and procedures to prevent similar errors in the future. *Id*. at 46–47. ePlus also disclosed that it not merely re-priced, but *canceled* options awarded to its four senior executives in 2004. *Id*. at 11, 46; *see also* ePlus Form 8-K (May 11, 2007). This disclosure belies Plaintiff's assertion that "ePlus' Board of Directors . . . was simply unable or unwilling" to recover amounts due to ePlus. Compl. ¶ 6. Yet these *canceled* 2004 options are *also* listed among the mere nine grant dates on which the complaint hinges. Compl. ¶ 77.

The 10-K's disclosures of error and voluntary correction set this case apart from the cases to which Plaintiff clings most desperately. *See, e.g.*, *Conrad v. Blank*, 940 A.2d 28, 34 (Del. Ch. 2007) ("Importantly, the filing makes no mention of any action taken by the corporation to remedy the effects of the uncovered errors."); *Ryan v. Gifford*, 918 A.2d 341, 361 (Del. Ch. 2007) ("[D]efendants make no allegations that [the recipient of backdated options] is precluded from exercising these options or that the options have expired."). Here, Plaintiff arrived at the courthouse steps not before, but almost *six months after* another shareholder initiated the process of correcting ePlus's options errors. Rather than allowing this process to unfold without litigation, as another shareholder proved willing to do, Plaintiff filed this opportunistic lawsuit without satisfying his obligation to make a pre-suit demand on ePlus's Board.

Of course, Defendants do not rely on ePlus's disclosures for their truth or otherwise proffer facts to the Court at this stage of the proceedings. But if Plaintiff intends to rest his case on ePlus's disclosures, he cannot weave a fiction through selective citation. He should explain why disclosures that are at odds with his claims do not defeat them. Or he should specifically allege that those disclosures are untrue—if he can do so within the requirements of Rule 11. His failure

to address these disclosures in their entirety does not make his pleadings particularized, cogent, or compelling; it makes them incomplete.

B. The Delaware Supreme Court Has Squarely Rejected Plaintiff's *Per Se* Theories Of Pleading Scienter And Demand Futility

Making a pre-suit demand on the board of directors "is ordinarily required for share-holder derivative suits." *See Pirelli*, 2008 WL 3166142, at *5. If a derivative plaintiff does not make a demand, he must plead his reasons for being excused from doing so with particularity. *Id*. (citing Fed. R. Civ. P. 23.1). At oral argument and in his briefing, Plaintiff relied extensively on *Ryan v. Gifford* in an effort to sidestep his obligation to plead demand excusal with particular-ity. Instead of pleading specifically what *these* Defendants knew or what *these* Defendants did with regard to the issues raised in *this* complaint, Plaintiff argued that his generic backdating al-legations suffice to plead knowledge *per se* because "backdating is inherently knowing, fraudu-lent conduct." Opp. 26 (citing *Ryan*, 918 A.2d at 341); *see also* Tr. 32, 37. Plaintiff similarly argues, as he did in support of his Section 10(b) claims, that *Ryan* allows him to plead mere committee membership in place of specific allegations of wrongdoing. Tr. 34–35, 37, 40–41.

Defendants have explained at length why Plaintiff's reading of *Ryan* is incorrect. But even if *Ryan* could once have been read to support Plaintiff's pleading shortcuts, that reading has now been rejected by numerous courts. For example, the Delaware Chancery Court's later deci-sion in *Desimone v. Barrows* rejects the notion that mere committee-membership allegations suf-fice to show knowledge of backdating: "The complaint alleges that the Incentive plan was 'ad-ministered by the Compensation Committee,' . . . . [T]hat vague and conclusory statement does not suggest in any way that the Compensation Committee was involved in or had knowledge of any backdating." 924 A.2d 908, 938 (Del. Ch. 2007). Similarly, the Northern District of Cali-fornia has recognized repeatedly that pleading "conclusory allegations regarding Committee ser-

vice" is insufficient to overcome the pre-suit demand requirement. *In re Verisign, Inc. Deriv. Litig.*, 531 F. Supp. 2d 1173, 1194 (N.D. Cal. 2007). "Mere membership on a committee or board, without specific allegations as to defendants' roles and conduct, is insufficient to support a finding that the directors were conflicted." *Id*. (quoting *In re CNET Networks, Inc. S'holder Deriv. Litig.*, 483 F. Supp. 2d 947, 963 (N.D. Cal. 2007)) (internal quotation marks omitted); *see also CNET*, 483 F. Supp. 2d at 965 ("Plaintiffs' allegations that because [defendants] were on the compensation committee, they must have known, do not constitute particularized facts.").

If despite these cases there was ever any doubt that committee-membership allegations or the mere utterance of the word "backdating" are insufficient to overcome the demand requirement, the Delaware Supreme Court has now authoritatively put that doubt to rest. Less than two months ago, the court squarely held that a plaintiff cannot overcome the demand requirement with respect to an exculpated board, like ePlus's, without alleging *particularized facts* to show that the directors acted with scienter:

> Where directors are contractually or otherwise exculpated from liability for certain conduct, 'then a serious threat of liability may only be found to exist if the plaintiff pleads a *non-exculpated* claim against the directors based on particularized facts.' Where . . . directors are exculpated from liability except for claims based on 'fraudulent,' 'illegal' or 'bad faith' conduct, a plaintiff must also plead particularized facts that demonstrate that the directors acted with scienter, *i.e.*, that they had 'actual or constructive knowledge' that their conduct was legally improper.

Wood v. Baum, No. 621, 2007, __ A.2d __, 2008 WL 2600981, at *3 (Del. July 1, 2008) (footnotes and citations omitted; emphasis in original). The Delaware Supreme Court held that mere allegations that the board approved a disputed decision do not satisfy this pleading requirement. *Id*. ("Delaware law on this point is clear: board approval of a transaction, even one that later proves to be improper, without more, is an insufficient basis to infer culpable knowledge or bad faith on the part of individual directors."). The court also dispensed with the plaintiff's similar

assertion that scienter could be inferred merely from audit committee membership: such an "assertion is contrary to well-settled Delaware law." *Id.* at *4. In support of these well-settled legal principles, the Delaware Supreme Court cited the Chancery Court's familiar decision in *Desimone*—a decision that dismisses backdating claims for the very reasons set forth in the motion to dismiss here. *Id*. at *3 n.14, *4 n.24 (citing *Desimone*, 924 A.2d at 933-35); *see also* Mot. 22, 35; Reply 18.

Because, as in *Wood* and *Desimone*, Plaintiff has failed to plead particularized facts regarding these Defendants' knowledge and actions, he has not pleaded demand futility and his claims should be dismissed. *See also Pirelli*, 2008 WL 3166142, at *12 (affirming this Court's dismissal of a derivative lawsuit for failure to make a pre-suit demand).

C. Plaintiff's Assertion That It Would Be Impossible To Issue The Disputed Options By Mistake Is Neither Correct Nor A Substitute For Particularized Allegations

In further defense of his deficient allegations, Plaintiff argued that the disputed options could not possibly have been misdated by mistake. When asked whether the options could have been misdated by negligence, Plaintiff's counsel answered no. Tr. 45–46. He is incorrect, and courts demonstrate his error.

Several courts have considered this issue and reached the opposite conclusion: backdating can result from mere negligence. For example, the court in *Rudolph v. UTStarcom* determined that a plaintiff's allegations related to "the company's admission in its restatement that some options had been backdated, defendants' responsibility for approving stock option grants, defendants' certification of the company's financial reports, and defendants' receipt and exercise of backdated stock options" could "equally support the inference that stock options had been backdated through innocent bookkeeping error." No. C 07-04578 SI, ___ F. Supp. 2d ___ , 2008 WL 1734763, at *6 (N.D. Cal. Apr. 14, 2008). This is particularly true when, as here, the plain-

tiff does not plead the total number of grant dates "to place these grant dates [at issue] in context." *Id.*

In *Desimone*, the Delaware Chancery Court analyzed this issue extensively, and it outlined various scenarios in which directors could approve backdated options:

> In the first, which I will call 'Scenario I,' the compensation committee, although not acting with reasonable diligence, approves the option grants without realizing that the grants violate the terms of the stock option plan and without realizing that the corporation is accounting for them improperly. In fact, they are advised by the corporation's general counsel, HR director, and CFO that the grants were appropriate under the plan. The committee knew who was getting them, the incentives for performance they were intended to create, and the economic terms of the options, but it did not dig into the details, such as the actual date of the grants or the stock's trading price on those dates, after receiving reports from the key officers. Even assume that the committee signed a written consent or two, circulated to them by company counsel.

924 A.2d at 932–33. The court reasoned that in this scenario, "there is a serious argument that the directors," assuming they are protected by an exculpatory charter provision like ePlus's, "cannot be held liable in damages for breach of any duty." *Id*. at 933. Because of the charter provision, the directors could be liable only if they acted with a state of mind that is disloyal, and that "would likely require a finding that the compensation committee *knew* that the options violated the stock option plan and that the options were being accounted for in a manner that was improper, or that their failure to obtain that information resulted from their knowing abdication of their directorial duties." *Id*. (emphasis added; footnote omitted). Because the plaintiffs alleged only that certain defendants "administered" stock option plans, the court held that the plaintiff failed to overcome the demand requirement:

> The complaint alleges that the Incentive plan was 'administered by the Compensation Committee,' which consisted of two of the Outside Directors . . . . I accept this allegation as true, as I must. Nonetheless, that vague and conclusory statement does not suggest in any way that the Compensation Committee was involved in or had knowledge of any backdating.

Id. at 938 (footnote omitted).

In this case, Plaintiff relies entirely on the very same inadequate allegations that certain Defendants sat on committees that "administered" stock options plans. Tr. 34 (citing Compl. ¶ 61). These allegations fail to demonstrate here, as they failed to demonstrate in *Desimone*, that ePlus's options were mispriced other than through negligence. And since ePlus's directors are exculpated for negligence claims, Plaintiff has failed to show that he can proceed with this derivative lawsuit without first making a demand on ePlus's board. *See* Mot. 20–31; Reply 16–21.

CONCLUSION

For the foregoing reasons, and for the reasons stated in the Motion to Dismiss and its supporting memoranda, Defendants respectfully request that this Court dismiss the Amended Complaint.

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Respectfully submitted,

/s/ F. Joseph Warin

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