Monica S. Call (USB No. 11361)
Email: monica.call@stoel.com
STOEL RIVES LLP
201 S. Main St, Suite 1100
Salt Lake City, UT 84111-4904
Telephone: (801) 578-6988
Facsimile: (801) 578-6999

Matthew C. Baltay (*pro hac vice* pending)
Email: mbaltay@foleyhoag.com
Kevin J. Conroy (*pro hac vice* pending)
Email: kjconroy@foleyhoag.com
FOLEY HOAG LLP
155 Seaport Blvd.
Boston, MA 02210
Telephone: (617) 832-1000
Facsimile: (617) 832-7000

Attorneys for Defendants Skullcandy, Inc., Seth Darling, Jason Hodell, and Richard P. Alden

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF UTAH, CENTRAL DIVISION

MELANIE DAVIS, Individually and on Behalf of All Others Similarly Situated, Plaintiffs, v. SKULLCANDY, INC., SETH DARLING, JASON HODELL, and RICHARD P. ALDEN, Defendants,	**DEFENDANTS' MOTION TO DISMISS PLAINTIFFS' AMENDED COMPLAINT AND BRIEF IN SUPPORT** Case No. 2:16-CV-00121-RJS-PMW Judge Robert J. Shelby Magistrate Judge Paul M. Warner

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes

Other Authorities

Pursuant to Rules 12(b)(6) and 9(b) of the Federal Rules of Civil Procedure and Section 21D of the Private Securities Litigation Reform Act of 1995 ("PSLRA"), 15 U.S.C. § 78u-4, *et seq.*, Defendants Skullcandy, Inc. ("Skullcandy" or the "Company"), Seth Darling ("Darling"), Jason Hodell ("Hodell"), and Richard P. Alden ("Alden") hereby file this Motion to Dismiss Plaintiffs' Consolidated Amended Class Action Complaint (the "Complaint") on the grounds that it fails to meet the heightened pleading standards of the PSLRA.

I. INTRODUCTION AND STATEMENT OF RELIEF SOUGHT

This is a securities class action alleging violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78t(a), and Securities & Exchange Commission ("SEC") Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder. Plaintiffs allege that on May 5, 2015, May 8, 2015, August 6, 2015, August 7, 2015, November 5, 2015, and November 9, 2015, Defendants made false and misleading public statements regarding the Company's sales, forecasts, and opportunities in China. Plaintiffs then allege that the "truth emerged" when the Company lowered its earnings forecast and announced that the Company had taken a $1.6 million bad debt allowance for previous sales in China.

Plaintiffs' case is built on two unrelated circumstances. First, Plaintiffs point to the $1.6 million bad debt reserve announced in January 2016 and attempt unsuccessfully to make a case of illicit channel stuffing whereby the Company and its top executives supposedly knew some eight months earlier that these sales were improper and that the small portion of earnings guidance related to the $1.6 million bad debt reserve was overstated throughout the class period. Second, Plaintiffs highlight a series of stock sales by Alden, a director of the Company, as evidence of the supposed fraud.

While Section 10(b) of the Exchange Act is designed to protect the integrity of the markets, the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), and more than two decades of

jurisprudence thereunder, guards against the all-too-frequent strike suits that public companies face following unanticipated drops in their stock prices. Pursuant to the PSLRA's heightened pleading requirements, a plaintiff bringing Section 10(b) claims must allege with particularity (1) each alleged misstatement and why each is false and misleading and (2) a strong inference of scienter. Plaintiffs fail to satisfy these heightened pleading requirements. The fact that a bad debt reserve was taken and guidance was adjusted downwards simply does not amount to fraud.

Regarding actionable misstatements, Plaintiffs allege none. Plaintiffs first claim that the Company's 2015 sales figures announced quarterly throughout the class period were misstated but fail to allege with the requisite particularity why that is the case. To make out such accounting misstatements, Plaintiffs must allege that the sales were not legitimate sales and should not have been recognized when they were. Plaintiffs fail to do that. That a relatively small bad debt accounting reserve was recognized some eight months later amounts to nothing more than fraud by hindsight. Plaintiffs next allege that the Company's full year 2015 earnings forecasts made during the class period were misstated. But those future forecasts constitute non-actionable forward-looking statements, and Plaintiffs fail to allege with particularity that Defendants did not honestly believe those forecasts when they were made. Lastly, turning to Plaintiffs' allegations regarding the Company's statements that the market in China represented a real opportunity, Plaintiffs do not adequately allege those statements constitute statements of concrete fact or that they were in any way untrue. Thus, Plaintiffs fail to allege with the requisite particularity that the Defendants made any actionable misstatements.

Nor do Plaintiffs meet the pleading requirements for making out scienter on the part of the Defendants. Notwithstanding vague statements attributed to anonymous former employees, Plaintiffs fail to allege with particularity that any of the Defendants knew in 2015 that the Company would need to take a $1.6 million bad debt reserve in early 2016, that the 2015 actual

sales figures were inaccurate in any way when they were reported, or that the Defendants in fact knew that the Company's projections were false when made. Lastly, the allegations that Rick Alden, a board member with no alleged involvement with China or Company sales or projections, sold a portion of his stock over an extended period pursuant to a trading plan does not establish that the CEO or CFO Defendants, or the Company, acted with scienter. The relevant circumstance that Plaintiffs downplay, or ignore altogether, is that the CEO and CFO Defendants did not sell a single share of Company stock during the class period. In fact, CEO Darling made several stock ***purchases*** during the class period. This is hardly the behavior of a fraudster. Rather, this behavior affirmatively undercuts any inference of scienter.

In the end, Plaintiffs fail to plead fraud. The PSLRA therefore mandates dismissal. Defendants hereby move that Plaintiffs' case be dismissed. Because Plaintiffs have now tried twice to plead a fraud case where there is none, Defendants seek dismissal with prejudice.

II. STATEMENT OF ALLEGED FACTS[1]

Skullcandy is a Delaware corporation with its principal place of business in Park City, Utah. Consolidated Amended Class Action Complaint ("Compl.") ¶ 8. Skullcandy was founded in 2003 and was a publicly traded company from 2011 until October 2016. *Id*. ¶¶ 18, 19. Skullcandy sells a variety of headphones, speakers, and audio accessories in the United States and internationally. *Id*. ¶¶ 18, 26. Defendant Darling was Skullcandy's CEO (and President) from March 2013 through October 2016. *Id*. ¶ 21. Defendant Jason Hodell was Skullcandy's Chief Financial Officer ("CFO") from October 2013 to October 2016 and was also Skullcandy's Chief Operating Officer from November 5, 2015 through October 2016. *Id*. ¶ 22. Defendant Richard P.

[1] The "facts" set forth herein are principally derived from the allegations of the Consolidated Amended Class Action Complaint, except where otherwise noted. On a motion to dismiss, well-pled factual allegations, but not conclusory assertions, are assumed to be true for purposes of the motion to dismiss only. *Adams v. Kinder-Morgan, Inc.*, 340 F.3d 1083, 1088 (10th Cir. 2003).

Alden founded Skullcandy and served as its Chief Executive Officer ("CEO") until March 2011, and again as the Company's interim CEO for one month in 2013. *Id.* ¶ 23. In 2015 and early 2016, the time period relevant to Plaintiffs' claims, Alden was a member of the Company's Board of Directors but not an officer. *Id.* In addition to owning shares personally, Alden exercises control over the Alden Irrevocable Trust, which is the sole member of Ptarmigan, LLC, which owned shares of Skullcandy. *Id.* ¶ 24. The beneficiaries of the Alden Irrevocable Trust are Alden's spouse and children. *Id.* On June 5, 2015, Alden established trading plans pursuant to SEC Rule 10b5-1(c) for himself and Ptarmigan pursuant to which Alden and Ptarmigan would sell shares on a preset basis. *Id.* ¶ 141; Skullcandy, Inc. Form 8-K, filed Sep. 9, 2015 ("Sep. 8, 2015 8-K").[2] Pursuant to these plans, Alden sold 25,000 shares of Skullcandy stock each month from September 2015 through August 2016, and Ptarmigan sold 37,500 shares of Skullcandy stock each week for 53 weeks from September 10, 2015 through September 8, 2016. Sep. 8, 2015 8-K.

A. MAY 2015 STATEMENTS

Throughout 2015 and early 2016, following the end of each quarter, Skullcandy provided updates to its investors in the form of press releases, earnings calls, and SEC Forms 10-Q. The first updates relevant to Plaintiffs' claims came after the end of the Company's first fiscal quarter of 2015. On May 5, 2015, the Company issued a press release announcing its financial results for the first quarter. Compl. ¶ 35. The press release described an 18 percent growth on a year-over-year basis, attributable in part to increased sales in China. *Id.* Skullcandy also forecasted 13–15

---

[2] Plaintiffs base the allegations in the Complaint on various Skullcandy SEC filings. *E.g.* Compl. ¶ 139 n.45 (referencing Form 8-K filed on September 8, 2015 concerning Alden and Ptarmigan's 10b5-1 trading plans). Accordingly, these SEC filings are properly before the court and may be considered for purposes of this motion to dismiss. *Karacand v. Edwards*, 53 F. Supp. 2d 1236, 1246 (D. Utah 1999). Transcripts of the quarterly earnings calls are likewise properly before the court because Plaintiffs rely on statements made in the calls and the authenticity of the transcripts is not in dispute. *Id.* at 1245–46.

percent growth in net sales for 2015 over 2014. *Id.* The press release repeated the previous prediction of earnings per share ("EPS") in the range of $0.36 to $0.40 for the full 2015 year. *Id.* ¶ 78.

On the same day, Skullcandy held a conference call to discuss the results of the first quarter. *Id.* ¶¶ 36, 79. On the call, CEO Hodell reported a 17 percent increase in international net sales, and attributed the increase in first quarter sales to strong gains in China, South Korea, Japan, India, and Latin America. *Id.* ¶¶ 36, 80; Skullcandy, Inc., First Quarter Fiscal 2015 Earnings Conference Call (May 5, 2015), https://seekingalpha.com/article/3144446-skullcandy-inc-skul-ceo-hoby-darling-on-q1-2015-results-earnings-call-transcript?part=single (last visited July 6, 2017) ("First Quarter Earnings Call Transcript"). Darling indicated that China had grown at the fastest pace of all the Company's regions and that China was a "huge opportunity" for the Company. Compl. ¶¶ 37, 81.

Three days later, on May 8, 2015, Skullcandy filed its Form 10-Q quarterly report with the SEC. *Id.* ¶ 82. The quarterly report set forth, amongst other information, the financial results provided in the press release and conference call, and attributed the increase in international net sales to results in China, India, Latin America, Japan, and South Korea. *Id.* ¶ 82; Skullcandy, Inc. Form 10-Q, filed May 8, 2015 at 20.

B. AUGUST 2015 STATEMENTS

On August 6, 2015 after the close of the Company's second fiscal quarter, Skullcandy issued a press release regarding the results of the second quarter of 2015. Compl. ¶ 39. The press release indicated that net sales for the second quarter had increased by 8 percent over the second quarter of the prior year, and that international sales had increased by 16 percent, in part due to increased sales in China and other regions. *Id.* ¶ 87; Skullcandy, Inc. Form 8-K, filed Aug. 6, 2015 ("Second Quarter Press Release"). Skullcandy also announced that it was increasing its predicted

EPS to $0.41 to $0.43 for the full year. Compl. ¶ 87.

Skullcandy also held a conference call on August 6, 2015 to discuss the quarterly results. *Id*. ¶ 88. On that call, Darling indicated that international sales had grown by 25 percent on a constant currency basis and that China had performed strongly, along with other regions. *Id*. ¶ 88; Skullcandy, Inc., Second Quarter Fiscal 2015 Earnings Conference Call (Aug. 6, 2015), https://seekingalpha.com/article/3412766-skullcandys-skul-ceo-hoby-darling-on-q2-2015-results-earnings-call-transcript?part=single (last visited July 6, 2017) ("Second Quarter Earnings Call Transcript"). Hodell reported that international net sales had increased by 16 percent from the prior year, and also attributed the increase to strong gains in China and other regions. Compl. ¶ 88; Second Quarter Earnings Call Transcript. Hodell also discussed the increase in EPS guidance and predicted a growth in net revenue of 13 to 15 percent for the year. Compl. ¶ 89. In connection with the discussion of increasing the EPS guidance, Hodell warned listeners of the complexity of assessing future earnings and revenue growth and identified some risk factors that might prevent the Company from meeting its target. Second Quarter Earnings Call Transcript. Skullcandy filed its Form 10-Q for second quarter on August 7, 2015. Compl. ¶ 90. The August 7 Form 10-Q reaffirmed the financial results announced on August 6, 2015. *Id*. ¶ 90.

C. NOVEMBER 2015 STATEMENTS

Following the end of the third quarter of 2015, Skullcandy issued a press release on November 5, 2015. *Id*. ¶ 93. The press release announced a 16 percent growth in third quarter net sales compared to the third quarter of the prior year, and an increase of 3 percent in international net sales. *Id*. ¶ 93. The growth in international sales was attributed to increased sales of audio products in India, Australia, China and increased gaming product sales in Europe. Skullcandy, Inc. Form 8-K, filed Nov. 5, 2015 ("Third Quarter Press Release") at 1. The Company also updated its EPS guidance for both the fourth quarter of 2015 and the full year, lowering predicted EPS to

$0.38 to $0.40 for the fourth quarter and $0.37 to $0.39 for the full year. Compl. ¶ 94.

The Company held a conference call on the same day to discuss the financial results. On the call, the Company disclosed some challenges that it was facing, including in the international market. *Id.* ¶ 95. Darling indicated that the Company still saw China as a "huge opportunity" and that it was experiencing positive results where it was selling directly to consumers. *Id.* ¶ 96. Hodell indicated that the Company had increased international net sales by three percent and attributed the growth to India, Australia, China, and Europe. *Id.* ¶ 97; Skullcandy, Inc. Form 10-Q, filed Nov. 9, 2015. Skullcandy filed its third quarter Form 10-Q on November 9, 2015 and reaffirmed the financial results announced on November 5, 2015. Compl. ¶ 98.

D. JANUARY 2016 AND SUBSEQUENT STATEMENTS

On January 11, 2016, Skullcandy issued another press release with an updated fourth quarter outlook. *Id.* ¶ 57; Skullcandy, Inc. Form 8-K, filed Jan. 11, 2016 ("Jan. 2016 Press Release"). The January 2016 press release disclosed that the Company had disappointing holiday sales results, and that its gross margin was lower than predicted due to a shift in the mix of product sales. Jan. 2016 Press Release. The press release also indicated that the Company had taken a $1.6 million pre-tax allowance for bad debt charge related to challenges with its Chinese distributor. *Id.* The Company informed investors that it was minimizing sales to discount channels to protect its brand and that it continued "clean-up work" with its Chinese distributor as it shifted to a more direct distribution model. *Id.* The Company revised its projection of fourth quarter EPS from a range of $0.38 to $0.40 to a new range of $0.20 to $0.22 ($0.25 to $0.27 excluding the $0.05 per share bad-debt charge). *Id.* The Company also lowered its expected net sales for the year and predicted that they would be approximately flat with 2014 levels. *Id.*

On March 4, 2016, Skullcandy filed its Form 10-K annual report for 2015. Skullcandy did not restate its financial statements in connection with the bad debt charge it disclosed on January

11, 2016. *See* Skullcandy, Inc. Form 10-K, filed Mar. 4, 2016. Ernst & Young LLP audited Skullcandy's internal control over financial reporting and opined that Skullcandy "maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015." *Id.* at 35. Ernst & Young also audited Skullcandy's consolidated balance sheet as of December 31, 2015 and related financial statements and expressed an unqualified opinion thereon. *Id.* at 35, F-2.

E. ALLEGED MISSTATEMENTS

Plaintiffs allege that statements made by Skullcandy, Darling and Hodell in May, August, and November 2015 were false and misleading. *See* Compl. ¶¶ 85–86, 91–92, 100–101. Specifically, Plaintiffs claim that the statements concerning actual quarterly sales results were false and misleading because they failed to disclose an alleged "channel stuffing" scheme in which Plaintiffs claim Skullcandy shipped excess inventory to its Chinese distributor. *Id.* ¶¶ 85, 91, 100. For the same reason, Plaintiffs assert that (1) the EPS guidance offered by the Company was false, and (2) the various statements concerning growth in China and the opportunity China represented for the brand were also false and misleading. *Id.* ¶¶ 85–86, 91–92, 100–101. Also related, Plaintiffs allege that the Company misrepresented its compliance with GAAP by recording revenue relating to sales to the Chinese distributor that Plaintiffs assert lacked the support necessary for revenue recognition. *Id.* ¶ 112. Finally, Plaintiffs assert that the Company violated Item 303 of Regulation S-K by failing to disclose facts relating to the alleged channel stuffing scheme. *Id.* ¶¶ 118–119.

III. ARGUMENT

A. PLAINTIFFS FAIL TO STATE A CLAIM UNDER SECTION 10(B) AND RULE 10B-5

1. The PSLRA Sets "Very Stringent Pleading Standards"

Federal Rules of Civil Procedure Rule 12(b)(6) mandates dismissal of a complaint that fails to state a claim. In assessing a complaint on a Rule 12(b)(6) motion, the court does not credit a complaint's legal conclusions, deductions or opinions couched as facts, *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007), or consider allegations that are conclusory, or that "do not allege the factual basis" for the claim, *Brown v. Zavaras*, 63 F.3d 967, 972 (10th Cir. 1995).

Plaintiffs' primary claim is for securities fraud pursuant to Section 10(b) and Rule 10b-5, which require in connection with the purchase or sale of securities: (1) a misstatement or an omission, (2) of a material fact, (3) made with scienter, (4) on which the plaintiffs relied, and (5) that proximately caused the plaintiff's injury. *Adams v. Kinder-Morgan, Inc.* 340 F.3d 1083, 1095 (10th Cir. 2003).

In 1995, Congress passed the Private Securities Litigation Reform Act (the "PSLRA") "as part of a bipartisan effort to curb abuse in private securities lawsuits." *In re Zagg Secs. Litig.* 797 F.3d 1194, 1201 (10th Cir. 2015). The PSLRA requires that plaintiffs "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed." 15 U.S.C. § 78u-4(b)(1). The PSLRA also requires that plaintiffs "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind," *i.e.*, scienter. 15 U.S.C. § 78u-4(b)(2)(A). The PSLRA imposes "a very stringent pleading standard for securities plaintiffs." *City of Phila. v. Fleming Cos.* 264 F.3d 1245, 1259 (10th Cir. 2001). Plaintiffs fail to clear these high

pleading hurdles.

2. Plaintiffs Fail To Plead Sufficient Facts To Establish That Defendants Made Any Actionable Misstatements

Under the exacting pleading standards of the PSLRA, plaintiffs must "specify each statement alleged to have been misleading [and] the reason or reasons why the statement is misleading." 15 U.S.C. § 78u-4(b)(1). Where an allegation is made on information and belief, the complaint must "state with particularity all facts on which that belief is formed." *Id.* This high standard requires "an evaluation of: (1) the level of detail provided by the facts stated in a complaint; (2) the number of facts provided; (3) the coherence and plausibility of the facts when considered together; (4) whether the source of the plaintiff's knowledge about a stated fact is disclosed; (5) the reliability of the sources from which the facts were obtained; and (6) any other indicia of how strongly the facts support the conclusion that a reasonable person would believe that the defendant's statements were misleading." *Adams*, 340 F.3d at 1099.

a. Plaintiffs' Allegations Relating to Sales Figures Are Inadequately Plead

Plaintiffs base their claim on a series of 2015 quarter-end press releases, earnings call comments, and SEC filings that they assert were misleading or omitted material facts. The statements that the Plaintiffs identify primarily concern actual Company sales figures. *See* Compl. ¶¶ 78–80, 87–89, 93, 96–97. Despite several conclusory assertions that the sales figures were false, Plaintiffs do not allege any facts that would establish that the sales figures that the Company reported were fraudulent or inaccurate. Nowhere in the Complaint do the Plaintiffs allege that the Company recorded revenue from sales that were not legitimate sales or that the sales (and commensurate growth in sales) that were reported at the end of each quarter were inaccurate on their face.

Instead, Plaintiffs attempt to show that the Company perpetrated a "channel stuffing"

scheme to "force[] its key distributor in China . . . to take product it did not want and could not sell." *Id.* ¶ 85. According to Plaintiffs' theory, the statements concerning sales figures and the description of the Company's performance in China were misleading because the Company failed to disclose the supposed channel stuffing scheme. Numerous courts have considered allegations of channel stuffing and recognized that the underlying conduct sometimes characterized as channel stuffing is not inherently improper. *See, e.g.*, *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 709 (7th Cir. 2008) ("A certain amount of channel stuffing could be innocent and might not even mislead – a seller might have a realistic hope that stuffing the channel of distribution would incite his distributors to more vigorous efforts to sell the stuff lest it pile up in inventory."); *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 202 (1st Cir. 1999) ("There is nothing inherently improper in pressing for sales to be made earlier than in the normal course"). Channel stuffing only crosses the line into fraud when it is used to book revenues on sales that are not genuine sales, but rather sales on consignment because of a favorable right of return offered to the buyer. *Tellabs*, 513 F.3d at 709; *see also Phillips v. Sci.-Atlanta, Inc.*, 489 F. App'x 339, 340 n.1 (11th Cir. 2012) (unpublished) (defining channel stuffing as a means of pulling sales from future fiscal periods by way of encouragement, discounts or incentives, and recognizing it is only improper when done to mislead investors); *United States v. Gluk*, 831 F.3d 608, 611 (5th Cir. 2016) (discussing channel stuffing as fraudulent scheme involving a "co-conspirator" taking product to allow the company to book fictitious sales that are subsequently returned); *Bielski v. Cabletron Sys. (in Re Cabletron Sys.)*, 311 F.3d 11, 25–26 (1st Cir. 2002) (discussing channel stuffing as promising an unconditional right of return). Plaintiffs do not allege that Skullcandy conspired with its Chinese distributor, that Skullcandy offered any favorable right of return to the distributor, or that Skullcandy offered any discounts or incentives of any kind to the distributor. Instead, Plaintiffs allege without any particularity or detail whatsoever that Skullcandy somehow coordinated with or

"forced" the distributor to take excess inventory. Compl. ¶¶ 44, 85, 91, 100.

Where a plaintiff relies on an alleged channel stuffing scheme to establish that a statement was misleading or contained a material omission, the complaint must include specific details of the alleged scheme. *In re Trex Co., Inc. Sec. Litig.*, 212 F. Supp. 2d 596, 611 (W.D. Va. 2002) ("Courts require significant specificity when a plaintiff bases a claim on allegations of channel stuffing or other misleading revenue recognition"); *Fitzer v. Sec. Dynamics Techs.*, 119 F. Supp. 2d 12, 35 (D. Mass. 2000) (requiring "at minimum" allegations of particular transactions, their terms, when they occurred and the approximate amount of the fraudulent transactions). The Complaint fails to allege any details of the supposed channel stuffing scheme other than the name of the distributor in question. The Complaint does not identify any particular transactions in which Skullcandy shipped the Chinese distributor more inventory than it requested or needed, and does not identify what, if any, inducements, discounts or rights of return Skullcandy allegedly offered the distributor to accomplish the alleged channel stuffing. Another significant omission is any particularized allegations of when such excessive shipments occurred and the volume of excess inventory shipped. Without these critical details, it is impossible to evaluate either when the alleged channel stuffing scheme is supposed to have begun or the magnitude of the alleged inventory build-up when any of the allegedly misleading statements were made. Instead, the Complaint includes only conclusory allegations that the company was "fraudulently coordinating" with the distributor, Compl. ¶ 44, "arranged" for the distributor to take excess product, *id.* ¶ 76, or "forced" the distributor to take inventory it didn't want, *id.* ¶¶ 85, 91, 100. These wholly conclusory *ipse dixit* allegations do not satisfy the heightened pleading standards.

Instead of alleging any details of the alleged channel stuffing scheme, Plaintiffs attempt to rely on the $1.6 million bad debt charge that the Company took in January 2016 to suggest that the reported sales figures and characterizations of the Company's international performance were

inaccurate when they were made months earlier. *Id.* ¶¶ 85, 91, 100. This is an impermissible attempt to allege "fraud by hindsight." *See Fleming*, 264 F.3d at 1260 ("Plaintiffs should not be allowed to proceed with allegations of 'fraud by hindsight'"). Understatement of bad debt reserves can sometimes support a securities fraud claim, but only where "no reasonable accountant would have made the decision [regarding the bad debt reserve] if confronted with the same facts.'" *Knox v. Yingli Green Energy Holding Co.*, No. 2:15-cv-04003-ODW(MRWx), 2017 U.S. Dist. LEXIS 37223, at *34 (C.D. Cal. Mar. 15, 2017) (unpublished) (citing *Alaska Elec. Pension Fund v. Adecco S.A. (In re Adecco S.A.)*, 371 F. Supp. 2d 1203, 1213 (S.D. Cal. 2005)). To prevail on such a theory, a plaintiff must allege particular facts that show that the initial prediction was a falsehood, including "details about… when and to what level the allowance should have been changed" and "why the allowance made by the corporation was unreasonable." *Alaska Elec. Pension Fund v. Adecco S.A.*, 434 F. Supp. 2d 815, 823 (S.D. Cal. 2006) (citing *In re Loewen Grp. Inc. Sec. Litig.*, No. 98-6740, 2004 U.S. Dist. LEXIS 16601, at *34 (E.D. Pa. Aug. 18, 2004)); *see also In re Apollo Grp., Inc. Sec. Litig.*, No. CV-10-1735-PHX-JAT, 2012 U.S. Dist. LEXIS 87223, at *32 (D. Ariz. June 22, 2012) (unpublished) (finding plaintiffs failed to make specific allegations necessary to infer defendants knew prediction of bad debt reserve would turn out to be wrong). As one federal court explained in a similar situation, "it is not enough to allege that the bad debt reserves were inadequate, because even reasonable predictions turn out to be wrong." *Kane v. Madge Networks N.V.*, NO. C-96-20652-RMW, 2000 U.S. Dist. LEXIS 19984, at *16 (N.D. Cal. May 25, 2000) (unpublished).

Here, Plaintiffs do not allege any facts that would permit an inference that any of the Defendants knew that the Company's bad debt reserve was understated at the time of any of the statements of which Plaintiffs complain. Plaintiffs' attempt to establish fraud by hindsight and should be rejected.

b. Plaintiffs' Allegations Regarding Earnings Per Share Forecasts Are Not Actionable Misstatements

Aside from the sales figures, Plaintiffs allege that the quarterly statements concerning forecasts of earnings per share were false and misleading. Compl. ¶¶ 79, 87, 89, 94. These allegations are not actionable because earnings predictions are forward-looking statements and meaningful cautionary language was provided. The PSLRA provides a safe harbor for forward-looking statements to the extent they are identified as such and accompanied by "meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement." 15 U.S.C. § 78u-5(c)(1)(A). A "forward-looking statement" includes "a statement containing a projection of revenues, income (including income loss), [or] earnings (including earnings loss) per share." 15 U.S.C. § 78u-5(i)(1)(A). A cautionary statement is "meaningful" when it conveys information about factors that may cause results to differ from those projected. *Karacand v. Edwards*, 53 F. Supp. 2d 1236, 1243 (D. Utah 1999). It is not necessary that the statement anticipate the precise factor that ultimately causes the outcome to differ from the prediction. *Id.*

Each of the statements that Plaintiffs identify in connection with the earnings per share projections – the first quarter press release, the second quarter press release, the second quarter earnings call, and the third quarter press release – properly identified the statements as forward-looking. Each of the press releases in question contained the following language: "statements regarding the Company's anticipated future financial and operating results and any other statements about the Company's future expectations, beliefs or prospects expressed by management are forward-looking statements." First Quarter Press Release; Second Quarter Press Release, Third Quarter Press Release at 2. Additionally, each of the press releases clearly characterizes the earnings per share numbers as part of the "financial outlook." First Quarter Press

Release; Second Quarter Press Release, Third Quarter Press Release at 2. The second quarter earnings call included, at the outset, a caution from the Company's chief legal officer that the call would contain forward-looking statements. Second Quarter Earnings Call Transcript. The discussion of the earnings per share and other financial guidance contained another express warning:

> In putting forth this new outlook, we want to remind everyone of the complexity of accurately assessing future earnings and revenue growth given the competitive nature of the industry, the difficulty in predicting sales of our products by key retailers, changes in technology, sourcing costs, trends in consumer preferences . . . . *Id.*

Each of the relevant statements also directed investors to the discussion of risk factors that could impact the Company's future performance contained in the Company's 2014 Form 10-K, filed March 13, 2015. First Quarter Press Release; Second Quarter Press Release, Second Quarter Earnings Call Transcript, Third Quarter Press Release at 2. The 2014 10-K specifically warned that the company may be unable to achieve future growth or continue the increase in its net sales, and that such future growth would depend on factors including "the strength of our brand image, market demand for our current and future products, competitive conditions, . . . and the implementation of our growth strategy." Skullcandy, Inc. Form 10-K, filed Mar. 13, 2015 at 10. Because the EPS predictions are forward-looking statements, appropriately identified as such and accompanied by meaningful cautionary language, they fall within the PSLRA's safe harbor and are not actionable.

To the extent Plaintiffs argue in their anticipated opposition to this motion to dismiss that the safe harbor is inapplicable because Plaintiffs allege that the Defendants "had actual knowledge that the particular forward-looking statement was materially false or misleading" at the time the statement was made, Compl. ¶ 150, such attempt would fail for two separate reasons.

First, pursuant to the express language of the safe harbor provision of the PSLRA, forward-

looking statements that are accompanied by cautionary language are simply not actionable pursuant to the plain language of the PSLRA regardless of the defendant's knowledge or state of mind. The PSLRA, which was intended to encourage companies to offer projections, provides a safe harbor for:

> any forward-looking statement, whether written or oral, if and to the extent that--
> (A) the forward-looking statement is--
> (i) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement; or
> (ii) immaterial; or
> (B) the plaintiff fails to prove that the forward-looking statement--
> (i) if made by a natural person, was made with actual knowledge by that person that the statement was false or misleading; or
> (ii) if made by a business entity;[,] was--
> (I) made by or with the approval of an executive officer of that entity; and
> (II) made or approved by such officer with actual knowledge by that officer that the statement was false or misleading. 15 U.S.C. § 78u-5(c)(1).

Every Circuit Court to have considered the issue has concluded that the statutory language is disjunctive and that "the plaintiff's inability to show knowledge of falsity [of forward-looking statements] is only relevant if the defendant is unable to produce meaningful cautionary statements or evidence of immateriality." *Edward J. Goodman Life Income Trust v. Jabil Circuit, Inc.*, 594 F.3d 783, 795 (11th Cir. 2010); *Slayton v. American Express Co.*, 604 F.3d 758, 766 (2nd Cir. 2010) (same); *OFI Asset Mgmt. v. Cooper Tire & Rubber*, 834 F.3d 481, 502–503 (3d Cir. 2016) (same); *Southland Sec. Corp. v. INSpire Ins. Solutions Inc.*, 365 F.3d 353, 371–72 (5th Cir. 2004) (same); *Miller v. Champion Enters. Inc.*, 346 F.3d 660, 672 (6th Cir. 2003) (same); *In re Cutera Sec. Litig.*, 610 F.3d 1103, 1112–1113 (9th Cir. 2010) (same; "The investors' proposed conjunctive construction of the safe harbor is not only inconsistent with the statutory language, but has been rejected by all of our sister circuits to consider the question").

Second, even if the actual knowledge of the Defendants is relevant in the forward-looking statement context, Plaintiffs have not alleged adequately that any of the projections was false when

made or that Defendants had actual knowledge of any falsity. The only facts that Plaintiffs offer that the EPS predictions were "false" is that the full-year 2015 earnings per share only turned out to be $0.20, rather than the higher figures that had been predicted earlier. This is not sufficient to find that the predictions were false when made because it would amount to impermissible fraud by hindsight.

Plaintiffs rely on various allegations about what the Plaintiffs allegedly should have known. Compl. ¶ 124 (alleging "it would not have been difficult for Defendants to obtain" information about the Chinese distributor); *id.* ¶ 126 (alleging that the Company had information management software that Plaintiffs speculate would have allowed Defendants to see inventory backing up); *id.* ¶ 132 (alleging that Defendants "knew or recklessly disregarded" alleged lack of potential in China). But, allegations that defendants were reckless and should have known certain facts falls short when forward-looking statements are at issue. The PSLRA requires that plaintiffs allege that each forward-looking statement "was made with actual knowledge by that person that the statement was false or misleading." 15 U.S.C. § 78u-5(c)(1)(B); *Tellabs*, 513 F.3d at 705 (inference of recklessness not sufficient for forward-looking statements).

Also fatal to the attempt to show actual knowledge of any of the Defendants is the Plaintiffs' failure to distinguish between the Individual Defendants. *E.g.* Compl. ¶ 128 ("the Individual Defendants directly participated in meetings and in the setting and reporting of Skullcandy's financials and guidance"). This attempt to demonstrate scienter by "group pleading" fails the particularity requirements and is not permitted. *In re Thornburg Mortg. Sec. Litig.*, 695 F. Supp. 2d 1165, 1200 (D.N.M. 2010) (Pursuant to the PSLRA, the court will only credit allegations of knowledge "that are specific as to an actor.").

c. Plaintiffs' Allegations Regarding Opportunity in China Are Not Actionable

Lastly, Plaintiffs identify statements that China remained a "huge opportunity for the brand long-term" and claim that those statements were false or misleading. Compl. ¶ 95; *see also id*. ¶¶ 7, 37, 45, 53 81, 122. Plaintiffs do not, however, allege any facts that would suggest that Skullcandy did not have a genuine opportunity for growth in the Chinese market. Instead, they summarily assert that "China was not a 'huge opportunity for the brand long term.'" *Id.* ¶ 100 (emphasis in original). This is not sufficient to establish that the statements were false when made. Moreover, "vague statements of corporate optimism" are not materially misleading. *Grossman v. Novell, Inc.*, 120 F.3d 1112, 1119 (10th Cir. 1997); *see also In re Level 3 Communs. Sec. Litig.*, 667 F.3d 1331, 1340 (10th Cir. 2012) (same). Accordingly, Plaintiffs cannot rely on the statements concerning the opportunity in the Chinese market to establish their claim.

d. Plaintiffs Do Not Allege Any Statements Made by Alden

Putting aside that Plaintiffs have failed to allege any misstatements as to any Defendant, Plaintiffs also fail to allege a single statement or misstatement by Defendant Alden anywhere in the 174 paragraph Complaint. Plaintiffs instead lump together all Defendants as supposed speakers. For example, in Paragraph 122 of the Complaint, Plaintiffs allege "The Individual Defendants' [sic] spoke repeatedly about the Company's China growth throughout the Class Period," and cross-reference seven additional paragraphs. Compl. ¶ 122. Those cross-referenced paragraphs describe statements made by Hodell and Darling as well as statements contained in Skullcandy's press releases. *See Id.* ¶¶ 35–37; 39–40; 53–54.

To the extent that Plaintiffs seek to hold Alden liable for statements made by Skullcandy under the "group pleading" or "group publication" doctrine, such an effort would also fail. The group pleading doctrine permits "plaintiffs to rely on a presumption that statements in group-

published information are the collective work of those individuals with direct involvement in the everyday business of the company." *In re SemGroup Energy Partners, L.P.*, 729 F. Supp. 2d 1276, 1294 (N.D. Okla. 2010) (citing *In re Pfizer Inc. Sec. Litig.*, 584 F. Supp. 2d 621, 637 (S.D.N.Y. 2008)). With respect to outside directors, the presumption only applies when an outside director participates in the day-to-day corporate activities of the company. *See Steinbeck v. Sonic Innovations, Inc.*, No. 2:00-CV-00848PGC, 2003 U.S. Dist. LEXIS 2378, at *26 (D. Utah Feb. 10, 2003) (unpublished); *see also Decker v. GlenFed, Inc. (In re GlenFed, Inc. Sec. Litig.)*, 60 F.3d 591, 593 (9th Cir. 1995) (complaint must allege participation in day-to-day corporate activities "such as participation in preparing or communicating group information at particular times"). The Complaint does not plead sufficient facts to find that Alden was involved in the day-to-day operations. Plaintiffs allege only two facts that potentially relate to the nature of Alden's relationship with the company: (1) Alden founded the company 12 years prior to the alleged statements at issue and (2) Alden served for one month as the company's Interim CEO two years prior to the statements at issue. *See* Compl. ¶ 23. Neither of these facts is probative of whether Alden was involved in the day-to-day operations of the Company in 2015 when the alleged misstatements were made. *See Dresner v. Utility.com, Inc.*, 371 F. Supp. 2d 476, 494 n.9 (S.D.N.Y. 2005) (status as co-founder, even in combination with conclusory and vague allegation of control, not sufficient to render defendant an insider for purposes of group pleading doctrine).

Plaintiffs make a single allegation that Alden, along with the company's CEO and CFO, "had direct involvement in the day-to-day operations of the Company in reviewing and managing its regulatory and legal compliance, and in its accounting and reporting functions." Compl. ¶ 169. Conclusory allegations of this nature are not sufficient to bring outside director defendants within the group pleading doctrine. *See D.E. & J L.P. v. Conaway*, 284 F. Supp. 2d 719, 732 (E.D. Mich. 2003) ("conclusory allegations that the defendant was 'involved in the day to day operations' are

insufficient."); *SEC v. Yuen*, 221 F.R.D. 631, 637 (C.D. Cal. 2004) ("purported general involvement with the day-to-day activities, and alleged participation in disclosure of public statements" not sufficient to apply group pleading doctrine); *In re Baan Co. Sec. Litig.*, 103 F. Supp. 2d 1, 18 (D.D.C. 2000) (plaintiffs must allege "specific facts illustrating the involvement" of outside director defendants in drafting, reviewing or dissemination of group published statement); *Abokasem v. Royal Indian Raj Int'l Corp.*, No. C-10-01781 MMC, 2011 U.S. Dist. LEXIS 14727, at *30 (N.D. Cal. Feb. 11, 2011) (unpublished) (conclusory allegations regarding authorizing and directing preparation of press releases not sufficient). Accordingly, Plaintiffs fail to allege that Alden made any statements or misstatements. He must be dismissed.

3. Plaintiffs Do Not Adequately Allege Scienter

While Plaintiffs fail to allege adequately any actionable misstatements thereby mandating dismissal, the Complaint must also be dismissed for the separate reason that Plaintiffs fail to satisfy the pleading standards for scienter. The PSLRA requires that for "each act or omission alleged" to be false or misleading, the plaintiff must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind," *i.e.*, scienter. 15 U.S.C. § 78u-4(b)(2); *see also In re Zagg*, 797 F.3d at 1200–01; *Level 3*, 667 F.3d at 1333. Scienter is defined as an "intent to deceive, manipulate, or defraud or recklessness" in which the "danger of misleading buyers or sellers" is either "known to the defendants or so obvious that the defendants must have been aware of the danger." *Anderson v. Spirit AeroSystems Holdings, Inc.*, 827 F.3d 1229, 1236–37 (10th Cir. 2016) (internal quotations omitted). Recklessness, under the scienter standard, requires an extreme departure from standards of ordinary care. *Fleming*, 264 F.3d at 1258. It is not sufficient to show that the defendant acted negligently or even grossly negligently. *Dronsejko v. Thornton*, 632 F.3d 658, 668 (10th Cir. 2011). To be sufficiently "strong" to survive a motion to dismiss, "the inference of scienter must be more than merely 'reasonable' or 'permissible' – it must

be cogent and compelling." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 324 (2007). "A complaint will survive, we hold, only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." *Id.* Where a claim is based on non-disclosure of a material fact information, the plaintiff must show both that the defendant had knowledge of the material fact omitted and knew that the failure to reveal that fact would be likely to mislead investors. *Fleming*, 264 F.3d at 1261.

When analyzing allegations of scienter, courts in the Tenth Circuit consider the allegations of scienter as to each individual defendant, and determines whether the complaint "adequately pleads scienter as to him." *See Adams*, 340 F.3d at 1105.

a. Plaintiffs Do Not Adequately Allege That Darling or Hodell Acted with Scienter

The Complaint does not allege (other than through unsupported conclusory allegations) that Darling or Hodell had direct knowledge of the alleged problems in the Chinese market at the time of any of the relevant statements. The lack of such an allegation is particularly notable where the Complaint describes occasions when Darling and/or Hodell might have been informed of such alleged problems if they had been known to anyone in the Company. For example, Paragraph 128 describes an annual forecasting meeting each November at which domestic and international sales were discussed, and indicates that sales managers had quarterly opportunities to correct or fix mistakes in their forecasting. Compl. ¶ 128. This allegation does not indicate that any sales manager for the Chinese market, either at the annual meeting in November 2014 or at any time thereafter, provided information to Darling or Hodell that would contradict or cast doubt on the sales results and growth figures the Company reported in the quarter-end statements. *See id*.

The only allegation that suggests any direct knowledge of potential problems in China by either Darling or Hodell is an allegation that describes a meeting that took place in January 2016 at

which Darling discussed year-end results, including a drop in performance in China. *Id.* ¶ 131. This January 2016 meeting, however, would have occurred *after* all of the allegedly misleading statements and literally on the eve of the January 11, 2016 corrective disclosure. Nothing in the Complaint indicates that Darling had this information prior to January 2016. Far from supporting an inference of scienter, this sequence of events is consistent with the Defendants being entirely truthful and forthright in their public disclosures.

Instead of alleging direct knowledge of any problems in China, Plaintiffs attempt to demonstrate that Hodell and Darling could have or should have known about the alleged problems. For example, Plaintiffs allege that China "was critical to the Company," *id.* ¶¶ 122–23, that the problems existed at a single, important distributor (rather than a large network of distributors) making an inquiry easier, *id.* ¶ 124, that the Company had a sophisticated inventory management system, *id.* ¶¶ 125–26, and that the Company held meetings and calls on which sales results were discussed, *id.* ¶¶ 127–131. None of these circumstances provides a sufficient basis to draw a strong inference that Hodell and/or Darling were aware of the alleged inventory and sales problems.

Plaintiffs' allegations concerning the importance of the Chinese sales to the company's performance are not sufficient to support a strong inference that Hodell or Darling knew of any underlying inventory or sales problems. While the "core operations" doctrine sometimes permits an inference that senior executives knew of alleged misconduct where it occurs in an operation significant to the company, it still requires "detailed and specific allegations" showing that the defendants were actually exposed to the relevant information. *Jun Zhang v. LifeVantage Corp.*, No. 2:16-CV-965 TS, 2017 U.S. Dist. LEXIS 92507, at *24 (D. Utah June 15, 2017) (unpublished) (citing *City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Align Tech., Inc.*, 856 F.3d 605, 620 (9th Cir. 2017)). A high bar applies to the core operations doctrine; a plaintiff must make specific allegations of the defendant's involvement in the minutia of the company's operations.

Police Ret. Sys. v. Intuitive Surgical, Inc., 759 F.3d 1051, 1062–63 (9th Cir. 2014) (rejecting application of the core operations doctrine). The core operations doctrine may also apply in "rare circumstance[s]," where "it would be 'absurd' to suggest that management" did not know about the information in question. *Id* at 1063. (citing *S. Ferry LP, No. 2 v. Killinger*, 542 F.3d 776, 786 (9th Cir. 2008)).

Even assuming that the Chinese market was sufficiently significant to Skullcandy to qualify as a "core operation," which Plaintiffs have not established, Plaintiffs still have not alleged sufficient facts to support a strong inference that Hodell or Darling must have known about any inventory build-up at the Chinese distributor. Nothing in the Complaint suggests that Hodell or Darling would have any reason to look beyond the sales and revenue figures showing the Company's sales to its distributor and scrutinize the inventory management or sales performance of its distributor. For the same reason, the allegations regarding the supposed ease of inquiring about the details of the distributor's performance or the availability of "sophisticated and comprehensive information management system" are not sufficient to support a strong inference of scienter without additional information to show that Hodell and/or Darling ever made such inquiries or delved into the minutia of the information management system to track the distributor's inventory status rather than focusing on the reports of Skullcandy's sales to the distributor.[3]

The allegations concerning weekly calls with sales representatives also do not support a strong inference of scienter because they do not contain particularized allegations of what Darling or Hodell learned or when they learned such facts in relation to the statements at issue. Such facts

[3] Furthermore, while the Complaint alleges that "Skullcandy's software systems are integrated with its third-party logistics warehouses that manage inventory and fulfillment activities worldwide," Compl. ¶ 126, it is not clear from the Complaint whether this integration extends to the Chinese distributor in question, or only to warehouses from which the shipments to the distributor would be fulfilled.

are necessary to support a strong inference that Darling and/or Hodell acted with scienter. *See In re FX Energy, Inc.*, No. 2:07-CV-874 CW, 2009 U.S. Dist. LEXIS 54551, at *30 (D. Utah June 25, 2009) (unpublished) (finding statements attributed to confidential witness lacked necessary details about what the defendants learned); *see also Anderson*, 827 F.3d at 1246 ("mere attendance at meetings does not contribute to an inference of scienter") The Complaint does not attempt to provide any specific details about what was said during any of the weekly calls about the Chinese distributor's performance. *See* Compl. ¶ 129. Instead, the Complaint alleges that one former employee, at some point, formed the impression that "China was performing below par." *Id* at ¶ 130. This is not sufficient to infer that Darling or Hodell knew that their statements about performance or opportunity in the Chinese market were false. There is no way of knowing from the Complaint what level of performance the former employee perceived as "par," how far "below par" the Chinese market was actually performing, what discussions may have ensued about the reasons for the alleged underperformance, or what ideas may have been considered to correct the alleged underperformance. *See Wolfe v. AspenBio Pharma, Inc.*, 587 F. App'x 493, 498 (10th Cir. 2014) (unpublished) ("vague and global" remarks not helpful as a benchmark for scienter and do not satisfy requirement that facts be stated with particularity).

Plaintiffs have failed to establish a strong inference of scienter. The more plausible inference is that Darling and Hodell were provided sales figures and projections and had every reason to believe they were accurate.

b. Plaintiffs Do Not Adequately Allege that Alden Acted with Scienter

Plaintiffs also fail to plead sufficient facts to support a strong inference that Alden acted with scienter (to the extent he can be held liable for any of Skullcandy's statements). Plaintiffs' attempt to demonstrate that Alden acted with scienter relies primarily on stock sales made by him and Ptarmigan. *See* Compl. ¶¶ 134–141. These are the only allegations that pertain explicitly to

Alden. This Court has held that allegations of stock sales by an insider can, in certain circumstances, demonstrate that the insider had a motive and opportunity to commit securities fraud, but that such sales do not have independent significance and cannot independently show that a defendant knowingly made false statements. *FX Energy*, 2009 U.S. Dist. LEXIS 54551, at *31 (unpublished) (citing *Caprin v. Simon Transp. Servs.*, 112 F. Supp. 2d 1251, 1259 (D. Utah 2000)); *Kapur v. USANA Health Scis., Inc.*, No. 2:07-CV-00177DAK, 2008 U.S. Dist. LEXIS 58955, at *50 (D. Utah July 23, 2008) (unpublished) (allegations of stock sales are "standing alone, insufficient to show scienter"); *see also Fleming.*, 264 F.3d at 1262 (allegations of motive and opportunity "are typically not sufficient in themselves to establish a 'strong inference' of scienter"). In order for allegations of stock sales to be relevant, plaintiffs "must allege that the trades were made at times and in quantities that are suspicious enough to support the necessary strong inference of scienter." *In re Qwest Communs. Int'l, Inc. Secs. Litig.*, 396 F. Supp. 2d 1178, 1195 (D. Colo. 2004). The trading activity alleged by Plaintiffs does not give rise to a strong inference of scienter.

i. Alden's trades were pursuant to 10b5-1 trading plans

First, Alden and Ptarmigan made the trades at issue pursuant to 10b5-1 trading plans established on June 5, 2015. Compl. ¶ 139; Sep. 8, 2015 8-K. Pursuant to these plans, beginning in September 2015 (three months after the plans were established), Alden sold 25,000 shares each month for 12 months, and Ptarmigan sold 37,500 shares each week for 53 weeks. Compl. ¶ 39; Sep. 8, 2015 8-K. Plaintiffs do not allege that Alden ever altered the plans or that his or Ptarmigan's trades ever deviated from the plans in any way. "It is well established that trades under 10b-5-1 plan[s] do not raise a strong inference of scienter." *Glaser v. The9, Ltd.*, 772 F. Supp. 2d 573, 592 (S.D.N.Y. 2011); *see also Elam v. Neidorff*, 544 F.3d 921, 928 (8th Cir. 2008) (trades pursuant to 10b5-1 plans raise inference that trades were prescheduled and not suspicious).

Plaintiffs attempt to avoid this well-established principle by alleging that the class period began on May 5, 2015 – one month before the trading plans were established. This attempt also fails. The Court is not required to accept Plaintiffs' decision of when to allege the class period began when considering the significance of the 10b5-1 plans. *See Harrington v. Tetraphase Pharms., Inc.*, No. 16-10133-LTS, 2017 U.S. Dist. LEXIS 71274, at *22 (D. Mass. May 9, 2017) (unpublished) (finding that alleged fraudulent scheme did not begin prior to adoption of trading plans, contrary to plaintiff's class period allegations). Plaintiffs only basis for asserting that the class period begins on May 5, 2015 is a series of optimistic statements in a press release and conference call concerning first quarter results and in a Form 10-Q filed on May 8, 2015. *See* Compl. ¶¶ 78–86. The next alleged misstatements are alleged to have occurred in August 2015 – approximately two months after Alden established the 10b5-1 plans. *See Id.* ¶¶ 87–92. Plaintiffs allege that these statements were false or misleading in light of an alleged channel stuffing scheme with the Company's Chinese distributor. But Plaintiffs fail to allege with any degree of particularity when such scheme began, or the degree to which the alleged problem had manifested as of May 5 or May 8, 2015. *Cf. Id.* ¶¶ 50, 76, 112 (each alleging only that issues began "at least as early as May 2015"). Therefore, the Court should not accept Plaintiffs' assertion that the alleged scheme began on May 5, 2015, or at any time prior to Alden's adoption of the 10b5-1 trading plans.

Plaintiffs also fail to make any allegations concerning what Alden knew at the time he established the trading plans. Even where 10b5-1 plans are established after the start of the class period, to negate the defense that a 10b5-1 plan provides, plaintiffs must sufficiently allege that the purpose of the plan was to take advantage of an inflated stock price. *See Emps.' Ret. Sys. v. Blanford*, 794 F.3d 297, 309 (2d Cir. 2015) ("When executives enter into a trading plan during the Class Period and the Complaint sufficiently alleges that the purpose of the plan was to take advantage of an inflated stock price, the plan provides no defense to scienter allegations"); *see also*

Yates v. Mun. Mortg. & Equity, LLC, 744 F.3d 874, 891 (4th Cir. 2014) (finding trading plan entered into during class period but before alleged knowledge of wrongdoing still mitigates inference of improper motive); *Mogensen v. Body Cent. Corp.*, 15 F. Supp. 3d 1191, 1222 (M.D. Fla. 2014) (plaintiff must allege, with particularity, facts showing knowledge of adverse information at time plan was adopted); *In re Nutrisystem Sec. Litig.*, 653 F. Supp. 2d 563, 576 (E.D. Pa. 2009) (assessing whether plan was adopted prior to becoming aware of material non-public information). Nothing in the Complaint demonstrates what, if anything, Alden knew about the alleged issues in the Chinese market as of the time he adopted the 10b5-1 trading plans. Nor can Plaintiffs rely on Alden's status as a director of the Company to argue that Alden "must have known" of adverse information. *See Adams*, 340 F.3d at 1107 (rejecting attempt to impute knowledge based on role as director).

ii. The timing of Alden's trades does not support an inference of scienter

The timing of Alden's trading activity also does not support any inference of scienter. Plaintiffs characterize the trades as "rushed," Compl. ¶ 140, but the facts alleged show that the trades were anything but rushed. Alden waited for a month after the allegedly misleading quarter-end disclosures to establish 10b5-1 trading plans for himself and Ptarmigan. Sep. 8, 2015 8-K. Those plans incorporated a three-month delay before any trading would take place, which placed the first trades one month after the company's August earnings release and disclosures. *Id*. Even once trades began pursuant to the plans, Alden and Ptarmigan did not trade their shares all at once, but spread the trades out in regular weekly or monthly intervals over a one-year period. *Id.* This timeline does not support the notion that Alden "rushed" the trades to take advantage of an inflated stock price.

Stock sales are more likely to be probative of scienter when they take place shortly before

the disclosure of adverse information and/or shortly after the allegedly false statement. *See In re Take-Two Interactive Sec. Litig.*, 551 F. Supp. 2d 247, 279 (S.D.N.Y. 2008) (lapse of three months between alleged false statement and sale, and four months between sale and corrective disclosure "inescapably attenuates any inference of scienter"); *In re KeySpan Corp. Sec. Litig.*, 383 F. Supp. 2d 358, 385 (E.D.N.Y. 2003) (four to six week gap between falsely positive announcement and sale "tends to negate any inference that defendants sought to reap the immediate benefit" of false statement (internal quotation omitted)). Here, Alden and Ptarmigan's sales began four months after the first allegedly false statements and approximately four weeks after the second set of allegedly false statements. The sales also began four months prior to the January 11, 2016 corrective disclosure. This delay, both before and after the sales began, undercuts any inference of scienter that could be drawn from the timing of the sales. Additionally, both Alden and Ptarmigan continued to make trades pursuant to the 10b5-1 trading plans for nine months after the January 11, 2016 disclosure and the corresponding drop in price, completing the 10b5-1 plans initiated in June 2015 without deviation. *Cf. In re Countrywide Fin. Corp. Derivative Litig.*, 554 F. Supp. 2d 1044, 1068–69 (C.D. Cal. 2008) (finding amendment of 10b5-1 plans based on stock price probative of scienter). Taken in its entirety, this course of dealing is not consistent with the suggestion that Alden attempted to maximize his profit by benefitting from statements he knew to be false.

iii. The volume of Alden's trading is not indicative of scienter

Plaintiffs also attempt to characterize Alden and Ptarmigan's stock sales as suspicious based on the number of shares sold during the class period. But this focus exclusively on the number of shares sold omits critical context – the relative percentage of Alden and Ptarmigan's holdings that were sold during the class period. Retention of a substantial percentage of the defendant's holdings can rebut the inference of scienter that might otherwise be drawn. *In re Level 3*, 667 F.3d at 1346–47. Here, Alden's class-period trades amounted to 10.4 percent of his

holdings immediately prior to the first trade at issue. *See* Skullcandy, Inc. Form 4 (Alden) filed Sep. 10, 2015.[4] Ptarmigan's class-period trades amounted to 13 percent of its holdings immediately prior to the first trade at issue. *See* Skullcandy, Inc. Form 4 (Ptarmigan) filed Sep. 14, 2015.[5] This level of trading is within the bounds of what other courts have found does not raise an inference of scienter. *See Acito v. IMCERA Grp.*, 47 F.3d 47, 54 (2d Cir. 1995) (finding sale of less than 11 percent did not give rise to inference of scienter); *KeySpan Corp.*, 383 F. Supp. 2d at 382–83 (sale of less than 20 percent did not give rise to inference of scienter); *In re Gentiva Sec. Litig.*, 971 F. Supp. 2d 305, 336 (E.D.N.Y. 2013) (sale of 12 percent did not support inference of scienter); *In re Gildan Activewear, Inc.*, 636 F. Supp. 2d 261, 271 (S.D.N.Y. 2009) (rejecting inference of scienter based on sale of 22.5 percent).

iv. Stock purchases and lack of sales by other defendants and insiders is not indicative of scienter

Any inference of scienter that could be drawn from Alden's trading activity is further diminished by the trading activity, and lack thereof, of the other named Individual Defendants and the other Skullcandy directors and officers not named as defendants. The absence of sales by other insiders, particularly those insiders who are alleged to have made most of the misstatements, substantially undercuts any inference of scienter. *See In re eSpeed, Inc. Sec. Litig.*, 457 F. Supp. 2d 266, 289 (S.D.N.Y. 2006) (lack of stock sales by defendant who made most of alleged misstatements and was well-positioned to reap profits from insider knowledge undercuts motive allegations); *see also Acito*, 47 F.3d at 54 (lack of sales by other defendants undermines inference

---

[4] The Form 4 filed to disclose Alden's first sale under the plan shows that, after selling 25,000 shares, Alden held 933,597 shares, meaning that he had 958,597 shares prior to the sale. His sale of a total of 100,000 shares during the class period represents 10.4% of his prior holdings.

[5] The Form 4 filed to disclose Ptarmigan's first sale under the plan shows that, after selling 37,500 shares, Ptarmigan held 5,141,886 shares, meaning that it had 5,179,386 shares prior to the sale. Ptarmigan's sale of 675,000 shares during the class period represents 13% of its prior holdings.

of scienter); *Gildan Activewear*, 636 F. Supp. at 271–72 (same); *In re First Union Corp. Sec. Litig.*, 128 F. Supp. 2d 871, 899 (W.D.N.C. 2001) (lack of sales by non-defendant CFO "fatal to Plaintiffs' effort to establish scienter through stock sales").

The Complaint is silent on any sales by Darling and Hodell or any other Skullcandy officer or director. This alone should be fatal to any inference that could otherwise be drawn from Alden and Ptarmigan's sales. Furthermore, SEC filings in the public record show that while Darling made no sales during the class period, he ***purchased*** shares on two separate occasions during the class period. On May 8, 2015, just days after having made allegedly false statements on an earnings call, Darling purchased 12,000 shares at an average price of $8.1693. Skullcandy, Inc. Form 4 (Darling) filed May 11, 2015. This purchase increased his holdings by 12.7 percent. *Id.* Six months later, on November 12, 2015 Darling purchased an additional 5,000 shares at an average price of $4.34, representing a 4.7% increase in his holdings. Skullcandy, Inc. Form 4 (Darling) filed Nov 12, 2015. Additional purchases were made during the class period by Patrick Grosso, Skullcandy's Chief Legal Officer (3,230 shares on November 10, 2015), Skullcandy, Inc. Form 4 (Grosso) filed Nov. 12, 2015, and Heidi O'Neill, a director (5,000 shares on May 11, 2015), Skullcandy, Inc. Form 4 (O'Neill) filed May 11, 2015. There is no reason to believe that these other insiders, particularly Darling, who is alleged to have been an integral part of the fraudulent scheme, would permit Alden to profit from allegedly nefarious trades, while they not only sat idly by, but actively purchased additional stock at supposedly inflated prices.

v. Plaintiffs' non-trading allegations do not suggest that Alden acted with scienter

Other than the allegations concerning trading activity, Plaintiffs make little attempt to show that Alden acted with the requisite scienter to establish their claim. None of the non-trading allegations specifically refer to Alden. *See* Compl. ¶¶ 121–133. Instead, they refer generically to

"Defendants" or "Individual Defendants." *Id.* Even assuming that Plaintiffs intended to include Alden within each instance of "Defendants" or "Individual Defendants," these allegations are not sufficient to draw a strong inference that Alden acted with scienter.[6] These non-trading allegations also lack the degree of particularity required by Rule 9(b) and the PSLRA.

The non-trading allegations generally concern the importance of the Chinese market to Skullcandy and the type of information that would have been available to Alden and the other defendants. *E.g.*, *id.* ¶ 122 (alleging China was critical to the company); *id.* ¶ 124 (the Chinese distributor at issue was important to the company); *id.* ¶ 125 (the company had a sophisticated inventory management system). As shown above with respect to Darling and Hodell, none of the non-trading allegations establish what Alden knew or even could have known about the alleged Chinese sales issues. To the extent the allegations rely on what information Alden could have known, Plaintiffs fail to demonstrate why Alden, an outside director of the company with no alleged management or day-to-day operations role, would have reason to investigate such issues. Accordingly, Alden must be dismissed.

c. Scienter Cannot Be Attributed to Skullcandy

Because Plaintiffs fail to establish the necessary strong inference of scienter with respect to Darling, Hodell, Alden, or any other director or officer of Skullcandy, they also fail to establish a strong inference of scienter with respect to the Company itself. When a plaintiff establishes the necessary inference that a senior controlling officer of a corporation acted with scienter, and

---

[6] The Complaint provides reason to doubt whether Plaintiffs actually intend to, or have the requisite basis to, include Alden within each instance of "Individual Defendants." For example, Paragraph 131 indicates that a former employee "confirmed the Individual Defendants' hands-on role at the Company" but then proceeds to only describe Darling's role. Compl. ¶ 131. Similarly, Paragraph 122 claims that the Individual Defendants "spoke repeatedly" about the company's growth in China, but Plaintiffs are unable to allege a single statement made by Alden and instead recite statements by Darling and Hodell. *Id.* ¶ 122.

establishes that the officer was acting within the scope of his or her apparent authority, that inference of scienter can be attributed to the company itself. *Adams*, 340 F.3d at 1106–07. Plaintiffs have not done so here. Nor is this a situation in which there can be a strong inference that some unnamed corporate official must have had knowledge that the Company's statements were false. *Cf. Tellabs*, 513 F.3d at 710 (suggesting that in certain circumstances an announcement could be so dramatic that it must have been approved by officials sufficiently knowledgeable about the company to know that they were false). Defendants do not identify any other individuals who were involved in developing or approving the statements in Skullcandy's various quarter-end statements or any facts that would suggest that such officials were aware of any facts contradicting those statements. Therefore, the claim against Skullcandy under Section 10(b) and Rule 10b-5 should be dismissed.

B. PLAINTIFFS' CLAIM UNDER SECTION 20(A) ALSO FAILS

In addition to the claims under Section 10(b) and Rule 10b-5, Plaintiffs bring claims against Darling, Hodell, and Alden under Section 20(a) of the Exchange Act alleging that they are liable as controlling persons for Skullcandy's alleged violation. Compl. ¶¶ 166–172. To state a claim for control person liability, the plaintiff must show "(1) a primary violation of the securities laws and (2) 'control' over the primary violator by the alleged controlling person." *Maher v. Durango Metals*, 144 F.3d 1302, 1305 (10th Cir. 1998). Because, as shown above, Plaintiffs fail to show any primary violation of Section 10(b), they cannot establish a claim against Darling, Hodell or Alden under Section 20(a) and those claims should be dismissed. *See, e.g.*, *Spiegel v. Tenfold Corp.*, 192 F. Supp. 2d 1261, 1269 (D. Utah 2002).

Plaintiffs' control person liability claim against Alden also fails for the additional reason that they have not plead facts establishing that Alden has the necessary control over Skullcandy. Establishing that a defendant had control over the primary violator requires "facts which indicate

that the defendants had 'possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.'" *Adams*, 340 F.3d at 1108 (quoting *Maher v. Durango Metals*, 144 F.3d 1302, 1305 (10th Cir. 1998)). Membership on the company's board of directors is not sufficient to establish control over the company. *Id.* Plaintiffs must also show that the director "individually exerted control or influence over the day-to-day operations of the company." *Id.*; *see also Burgess v. Premier Corp.*, 727 F.2d 826, 832 (9th Cir. 1984) (requiring showing of actual participation in operations or some influence). Plaintiffs' conclusory allegation that "Alden had direct involvement in the day-to-day operations of the company," Compl. ¶ 169, without more fails as a matter of law. *See In re Thornburg Mortg. Secs. Litig.*, 824 F. Supp. 2d 1214, 1284–85 (D.N.M. 2011) (rejecting "conclusory, vague and threadbare group allegations" concerning control); *JHW Greentree Capital, L.P. v. Whittier Tr. Co.*, 2005 U.S. Dist. LEXIS 27156, at *29–30 (S.D.N.Y. Nov. 10, 2005) (unpublished) (attendance at board meetings involving general affairs of the company not sufficient to establish control with respect to activities giving rise to alleged fraud). Accordingly, the Court should dismiss Plaintiffs Section 20(a) claim against Alden for the additional, independent reason that Plaintiffs fail to show that he was a controlling person.

IV. CONCLUSION

Because Plaintiffs have failed to satisfy the PSLRA's pleading requirements, their Complaint must be dismissed. Because Plaintiffs have now tried twice to plead a fraud case where there is none, dismissal should be with prejudice.

Dated: July 7, 2017.

STOEL RIVES LLP

/s/ Monica S. Call

Matthew C. Baltay (*pro hac vice* pending)
Kevin J. Conroy (*pro hac vice* pending)
FOLEY HOAG LLP

Attorneys for Defendants Skullcandy, Inc., Seth Darling, Jason Hodell, and Richard P. Alden

CERTIFICATE OF SERVICE

I hereby certify that, on July 7, 2017, I filed the foregoing in the U.S. District Court for the District of Utah through the Court's CM/ECF system. All parties were served electronically.

Dated: July 7, 2017.

/s/ Stacy Kamaya