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AUG 12 1998

RICHARD W. WIEKING
CLERK, U.S. DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE DIVISION

IN RE READ-RITE CORP. SECURITIES
LITIGATION

Case No. C-98-20434

ORDER¹ GRANTING MOTION TO
DISMISS WITH LEAVE TO AMEND

This Document Relates to:
All Actions

[Docket Nos. 52, 55, 83, 87]

Defendants' motion to dismiss and plaintiffs' motion to
strike were heard on August 4, 1998. For the following reasons
the motion to dismiss will be granted, with leave to amend. For
reasons also discussed below, the Court declines to rule on the
motion to strike.

¹ This disposition is not appropriate for publication and
may not be cited.

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1 I. BACKGROUND

2 A. Procedural History

3 *Ferrari v. Read-Rite Corp, et al.*² was filed in January
4 1997, with the Milberg Weiss firm representing plaintiffs.
5 Shortly thereafter *McDaid v. Read Rite Corp., et al.* was filed
6 alleging similar wrongs and an overlapping class period, with
7 Berger & Wolen and local counsel Gold, Bennett & Cera
8 representing plaintiffs. Defendants moved to consolidate. In what
9 appears to have been an attempt to avoid being squeezed out as
10 lead counsel. the Berger and Gold firms then filed *Nevius v.*
11 *Read-Rite, et al.*, and moved to dismiss *McDaid*. Unlike *McDaid*,
12 the *Nevius* class period did not overlap that of *Ferrari*.

13 Judge Whyte granted plaintiffs' motion to dismiss *McDaid*,
14 but consolidated *Nevius* and *Ferrari* and confirmed lead
15 plaintiffs' choice of Milberg Weiss as lead counsel in the
16 consolidated action. Judge Jenkins denied a motion by the Berger
17 and Gold firms to reconsider the lead plaintiff/counsel ruling.

18 Plaintiffs filed what is nominally a consolidated complaint,
19 but which in essence is a 97 page *Ferrari* complaint with an 18
20 page *Nevius* complaint tacked on. Similarly, plaintiffs'
21 "consolidated" opposition to the motion is essentially a *Ferrari*
22 brief followed by a *Nevius* brief, complete with a separate
23 general description of defendants' business. The two "groups" of
24 plaintiffs each expressly decline to join in the assertions of
25 the other "because of potential conflicts between the classes."

26 _____
27 ² The case numbers of these consolidated actions have
28 changed each time the cases have been reassigned. For brevity,
case numbers will be omitted from this discussion.

1 **B. The Allegations**

2 The *Ferrari* portion of the complaint alleges that in April
3 1995, defendants embarked a campaign to inflate the price of
4 Read-Rite's stock. Plaintiffs allege that between April 1995 and
5 January 1996, defendants made a variety of positive and
6 optimistic statements to stock analysts and to the public
7 regarding demand for Read-Rite's products and the status of Read-
8 Rite's product development efforts. Plaintiffs allege that the
9 positive statements were false and misleading and that optimistic
10 projections were unwarranted, given the actual status of demand
11 levels and development efforts.

12 After close of business on January 22, 1996, Read-Rite
13 reported disappointing results for first quarter fiscal 1996, and
14 projected that future quarters would also disappoint. The next
15 day Read-Rite's stock fell from over \$26 per share to \$20 per
16 share.

17 The *Nevius* portion of the complaint alleges that defendants
18 made several public statements in March and April of 1996,
19 regarding the company's business prospects and the status of
20 product development. Plaintiffs allege that the statements were
21 false and misleading given the actual status of customer
22 relationships and product development. On June 26, 1996, Read-
23 Rite issued a press release predicting that third quarter fiscal
24 1996 sales would be even lower than second quarter sales. In the
25 five days following this announcement, Read-Rite's stock price
26 fell from approximately \$17 per share to approximately \$12 per
27 share.

28

1 II. DISCUSSION

2 A. Basis of pleading

3 The *Ferrari* section of the complaint and the *Nevius* section
4 of the complaint each contain a paragraph stating that many of
5 the allegations of the complaint are based on the investigation
6 of counsel. ¶¶ 117, 157. The *Ferrari* paragraph asserts that
7 substantial evidentiary support "will" exist after a reasonable
8 opportunity for discovery; the *Nevius* paragraph states that
9 plaintiffs "believe" substantial evidentiary support will exist
10 after a reasonable opportunity for discovery. Defendants complain
11 that these paragraphs are insufficient to meet the Reform Act's
12 requirement that plaintiff's "state with particularity" all facts
13 supporting any pleading on information and belief. See 15 U.S.C.
14 78u-4(b) (1) (B). Plaintiffs respond that the allegations are not
15 made on "information and belief" and that therefore the
16 particularity requirement is inapplicable.

17 Judges in this district have viewed paragraphs like these
18 somewhat differently, but none seem to have viewed them with
19 favor. Compare *Howard Gunty Profit Sharing v. Quantum Corp., et*
20 *al.*, C-96-20711-SW, Order dated 4/6/98 (treating complaint as not
21 pleaded on information and belief) with *Hockey v. Medhekar., et*
22 *al.*, 1998 U.S. Dist. LEXIS 4297 (Judge Patel) (treating complaint
23 as pleaded on information and belief).

24 The Court concludes that the complaint here is pleaded on
25 information and belief. The paragraphs regarding the
26 investigation of counsel establish conclusively that plaintiffs
27 are not pleading matters within their own personal knowledge;
28 rather, plaintiffs have been *informed* by counsel (who may not

1 have personal knowledge either) that the allegations are true,
2 and plaintiffs believe what counsel has told them.

3 The paragraphs regarding the investigation of counsel are
4 not purposeless, however. The paragraphs serve as a first step in
5 fulfilling the requirement of stating "all facts" on which
6 plaintiffs' belief is based. Nonetheless, plaintiffs cannot evade
7 the requirement of stating all facts with particularity simply by
8 giving a generalized description of counsel's investigation.

9 Plaintiffs still must state in detail the facts those
10 investigations uncovered. Accordingly, the Court must examine the
11 balance of the pleading.

12 B. The Impact of the Reform Act

13 Plaintiffs contend that the Reform Act pleading requirements
14 do not apply to the majority of this complaint because almost all
15 of the alleged misrepresentations occurred prior to the enactment
16 date. Plaintiffs note the general presumption against statutes
17 having retroactive effect absent express provisions to the
18 contrary. See, *Hughes Aircraft Co. v. U.S.*, 520 U.S. 939, 117
19 S.Ct. 1871, 1876 (1997) ("the legal effect of conduct should
20 ordinarily be assessed under the law that existed when the
21 conduct took place . . .").

22 The flaw in plaintiffs' argument is that it is not the
23 timing of underlying alleged conduct of defendants which matters.
24 To the extent the Reform Act imposes new *pleading* standards, the
25 issue is when the pleading was made; the "conduct" is the
26 drafting of the complaint, not the alleged wrongs. The Reform Act
27 expressly provides it does not apply to actions commenced before
28 December 22, 1995. This action was filed after that and thus the

1 standards of the Reform Act apply.

2 The parties agree that the Reform Act imposes a heightened
3 standard for pleading scienter. Under pre-Reform Act Ninth
4 Circuit precedent, scienter could be pleaded generally—"that is,
5 simply by saying that scienter existed." *In Re Glen Fed, Inc.*
6 *Securities Litigation*, 42 F. 3d 1541, 1547 (9th Cir. 1994). Under
7 the Reform Act, in contrast, plaintiffs must "state with
8 particularity facts giving rise to a strong inference" of
9 scienter. 15 U.S.C. 78u-4(b)(2).

10 The parties hotly debate whether the Reform Act raised the
11 pleading standard in any other respect. There can be no doubt
12 that the general intent of the Reform Act was to make non-
13 meritorious actions more difficult to bring. That does not mean,
14 as defendants suggest, that pre-Reform Act Ninth Circuit
15 precedents are now irrelevant in determining what is sufficient
16 pleading. First, as defendants likely would admit, prior
17 precedents at least set an initial hurdle—if a pleading is
18 insufficient under prior precedents, it is necessarily
19 insufficient under any heightened requirements imposed by the
20 Reform Act.

21 Second, even assuming the Reform Act "has somewhat altered
22 the standard for pleading false and misleading statements,"
23 *Hockey*, at * 15, the standards cannot be reduced to precise
24 formula—the requisite "amount" of specificity is not subject to
25 scientific quantification under either prior precedent or the
26 Reform Act. Accordingly, even if the standards are now "somewhat"
27 higher, the Court must still make what is fundamentally a
28 judgment call. Prior precedents and the general intent of the

1 Reform Act can serve to inform that judgment, but each case must
2 stand on its own alleged facts.

3 C. Misrepresentations

4 1. Ferrari

5 The *Ferrari* portion of the complaint contains lengthy
6 summaries of what defendants allegedly said to analysts in
7 conference calls and presentations, followed by lengthy
8 quotations from analysts' reports. Also included are lengthy
9 quotations from press releases and other public statements of
10 defendants. The summaries and quotations are presented
11 chronologically. Interspersed every few pages are paragraphs with
12 lettered subparts which purport to show why the preceding
13 representations were false or misleading. The lettered
14 subparagraphs are largely identical each time they appear, with
15 only a few time period-specific additions.

16 This pleading is deficient for several related reasons.
17 First, the complaint does not identify adequately what portions
18 of the representations plaintiffs believe were false or
19 misleading. In some places it appear plaintiffs may have used
20 underscoring to identify what they find problematic within
21 representations, but in other places it is clear that plaintiffs
22 use underscoring for emphasis, not identification. (See, e.g. ¶
23 93, first underscore, statement that analysts visited with top
24 management presumably not a misrepresentation.)

25 Second, the complaint does not identify adequately why any
26 of the representations are false or misleading—the largely
27 repetitive lettered subparagraphs are overly generalized and
28 inadequately tied to the specific representations.

1 Third, and more fundamentally, the complaint does not allege
2 sufficiently specific facts regarding the alleged negative
3 conditions or specific facts showing that defendants had
4 knowledge of those conditions. For example, the frequently
5 repeated general assertion that "demand was softening" is, at
6 this point, a hindsight conclusion, rather than a fact-specific
7 description of then-existing and known conditions.

8 Contrary to defendants' argument, however, the existing
9 complaint is not exclusively about alleged failures on
10 defendants' part to predict the future accurately. For example,
11 plaintiffs allege that defendants represented that they had
12 received assurances from Conner Peripheral and/or Seagate that
13 Conner would continue to buy from Read-Rite after its acquisition
14 by Seagate. Plaintiffs allege that, in fact, Conner/Seagate had
15 already told defendants that Conner would not continue to
16 purchase from Read-Rite. While the question of what Conner would
17 or would not do relates to a future event, any representation
18 that defendants had been told one thing, if in fact they were
19 told the opposite, would be a misrepresentation of a past or
20 then-existing fact, not a failure to predict the future.³

21 2. Nevius

22 By virtue of its brevity, the *Nevius* portion of the
23 complaint avoids some of the problems of the *Ferrari* portion—it
24 is more clear what plaintiffs contend was false and why.

26
27 ³ As presently set forth, however, the allegations regarding
28 what Seagate\Conner actually said (and when), and what defendants
actually represented about what was said, are impermissibly
vague.

1 Furthermore, the allegations include an alleged misrepresentation
2 that is not forward looking—a claim that development of the
3 TriPad III product was “complete” as of April 1996. Plaintiffs
4 allege that the company subsequently “admitted” that it had
5 learned prior to April 1996 that “to participate in new customer
6 programs” its products needed to incorporate a feature called
7 “undershoot reduction,” which it had not even begun to develop.

8 What is missing, however, are allegations of fact which
9 would tend to show that the company could not reasonably
10 characterize development of the product as “complete” if, in
11 fact, its original design specifications had been met. The fact
12 that the company may have known at least one customer wanted an
13 additional feature would only render the statement false if the
14 company had already realized that the product would not be viable
15 unless it were redesigned to incorporate that feature. A
16 *subsequent* realization that feature was critical to the product’s
17 success or a *subsequent* decision to add the feature would not
18 render the statement that development was complete false when
19 made.⁴

20 Likewise, the representation that Read-Rite’s products were
21 “being designed into some Conner products right now” would be a
22 misrepresentation of then-existing fact *if* the speaker knew that
23 Read-Rite products were *not* being designed into Conner products.
24 Plaintiffs have failed to allege, however, that the statement was
25 false when made; they allege in essence only that Conner ended up
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27 ⁴ Plaintiffs have also failed to allege non-conclusory facts
28 showing that the individual defendants had knowledge of the
alleged new feature requirement.

1 not using Read-Rite products. It is certainly possible that the
2 statement was true when made, but that Conner's designs and plans
3 subsequently changed.⁵

4 D. The Motion to strike

5 Plaintiffs seek to strike 1) a chart attached to defendants'
6 opening papers which purports to summarize defendants' stock
7 holdings and sales, and 2) various SEC filings submitted by
8 defendants. Although plaintiffs brought this a separate motion,
9 their argument that consideration of these materials is improper
10 could have been raised as part of their opposition. The only
11 "relief" plaintiffs seek in the separate motion is for the Court
12 not to consider the documents in ruling on defendants' motion. As
13 the above analysis reflects, the Court did not reach defendants'
14 submissions. Accordingly, there is no need to "strike" those
15 documents or expressly to grant or deny plaintiff's motion.

16 Because the issue is likely to recur on any subsequent
17 motion to dismiss, however, the Court notes that consideration of
18 the SEC filings would appear to be proper for the limited purpose

19
20 ⁵ In view of the Court's conclusions as to both portions of
21 the complaint, it does not reach defendants' argument that they
22 are immune from liability for forward-looking representations
23 under the statutory safe-harbor and/or the "bespeaks caution"
24 doctrine. Should any true forward-looking representations remain
25 at issue on a subsequent motion to dismiss, those arguments can
26 be addressed then.

27 Similarly, the Court does not reach defendants' argument
28 that certain individual defendants are not alleged to have made
any misrepresentations. The Court notes, however, that even
assuming liability can be imposed under plaintiffs' "disclose or
abstain" theory or any similar basis, plaintiffs will have to
plead sufficient non-conclusory facts to establish that non-
speaking defendants had knowledge of the allegedly negative
information.

1 of determining what representations were made in those documents,
2 assuming those representations were relevant. See *Kramer v. Time*
3 *Warner, Inc.*, 937 F. 2d 767, 774 (2d Cir. 1991). Thus, if the
4 complaint alleged misrepresentations were made in an SEC filing,
5 the Court could consider the entire filing to determine whether
6 the representations were misleading in context. *Id.*

7 Here, defendants have offered SEC documents for two
8 purposes. First, defendants argue that disclosures in some of the
9 documents immunize them under the "bespeaks caution" doctrine.
10 Because this relates to *what* was said, rather than the truth of
11 the representations, consideration of the documents would appear
12 proper.⁶

13 Defendants offer other documents in an attempt to show that
14 defendants' stock holdings and sales differed from what is
15 alleged in the complaint. This goes to the *truth* of the matters
16 asserted in the SEC filings, an improper subject for judicial
17 notice. The Court is aware that some district court cases tend to
18 support defendants' position that such matters may be considered
19 on a motion to dismiss. Absent controlling precedent approving
20 the practice, however, this Court is inclined to disregard any
21 attempt to offer SEC filings on a motion to dismiss for the
22 purpose of establishing defendants' stock holdings or sales.

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27 ⁶ Whether "bespeaks caution" can immunize defendants where
28 the alleged cautionary statements were not made in the same
documents or context as the alleged misrepresentations is a
separate question.

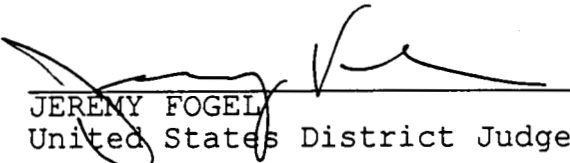
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III. ORDER

Defendants' motion to dismiss is granted. Within 30 days of the date of this Order, plaintiffs may file an amended complaint. Any amended complaint shall, 1) omit hyperbole and argument, 2) identify the *specific* representations plaintiffs contend were false or misleading, and 3) for each alleged misrepresentation, identify what facts render the representation false or misleading.

Plaintiffs' motion to strike is hereby ordered off-calendar.

DATED: 8-12-98


JEREMY FOGEL
United States District Judge

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THIS IS TO CERTIFY THAT COPIES OF THIS ORDER HAVE BEEN MAILED TO:

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Counsel is directed to serve this order upon all other counsel (not noticed above) of record and upon any unrepresented parties who have appeared. This Order is not effective until such service is made.

DATED: August 12, 1998

RICHARD W. WIEKING
CLERK OF THE COURT

By: Margaret Halstead-Shick
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DEPUTY CLERK