

# Plaintiffs' Opposition to Individual Defendants' Motion to Dismiss

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## UNITED STATES DISTRICT COURT

### NORTHERN DISTRICT OF CALIFORNIA

In re NORTHPOINT COMMUNICATIONS )	Master File No. C-01-1473-WHA
GROUP, INC. SECURITIES LITIGATION )	
_____ )	<u>CLASS ACTION</u>
)	
This Document Relates To: )	PLAINTIFFS' OPPOSITION TO
)	INDIVIDUAL DEFENDANTS' MOTION
ALL ACTIONS. )	TO DISMISS
_____ )	
	DATE: December 13, 2001
	TIME: 8:00 a.m.
	COURTROOM:
	The Honorable
	William H. Alsup

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### I. INTRODUCTION

Before its 1/16/01 bankruptcy, NorthPoint Communications, Inc. ("NorthPoint" or the "Company") sold high-speed digital subscriber lines ("DSL"s), to Internet service providers ("ISPs"), broadband data service providers and telephone companies. ¶20. [\(1\)](#) The Complaint in this action alleges that NorthPoint and its top executives defrauded investors who bought NorthPoint stock between 8/8/00 and 11/29/00 (the "Class Period") by issuing false and misleading statements regarding its merger with Verizon Communications ("Verizon") and NorthPoint's financial status at the time.

On 8/7/00, Verizon agreed to give NorthPoint \$800 million in cash in exchange for 55% of NorthPoint's stock. ¶21. Under the agreement, Verizon's obligation to complete the merger was contingent on there being no "Material Adverse Effect" on NorthPoint's business or finances prior to completion. ¶¶22-28. The Complaint pleads with particularity how, through a series of false and misleading statements regarding NorthPoint's earnings, revenue, line installations and the viability of the merger itself, defendants maintained a healthy facade, when in fact, NorthPoint knew that its finances were spiraling downward.

The Complaint is supported by accounts of eight former high-ranking NorthPoint employees who confirm that customer collections had been a serious, on-going problem. These witnesses confirm that the non-collection on sales was documented in NorthPoint aging reports and emails that were provided to defendants Chief Financial Officer ("CFO") Glinsky and Chief Executive Officer ("CEO") Fetter. Defendants concealed that customers could not pay, or were so outraged at NorthPoint's inability to install promised DSL lines that they would not pay. ¶33.

Ultimately, these falsehoods collapsed under their own weight. By 11/ 20/00, NorthPoint admitted that it had overstated its 3Q00 revenue by \$6.1 million - or 25%. ¶5. Nevertheless, defendants falsely represented that the merger was "on track." *Id.* Just nine days later, Verizon announced its withdrawal from the merger, citing NorthPoint's false financial reporting and dismal financial condition. ¶6. Just over a month later, NorthPoint filed for bankruptcy, shielding its 2Q00 and 3Q00 financial results from a full audit by an outside auditor and leaving its shareholders with worthless stock.

Considered in their entirety, plaintiffs' allegations of accounting manipulation, the restatements, witness accounts, insider trading, defendants' access to information concerning delinquent accounts and their strong motive to complete the Verizon merger, plead a strong inference that defendants acted with actual knowledge, or at least deliberate recklessness, in falsifying financial results in order to conceal the Company's dire financial condition.

## II. SUMMARY OF THE COMPLAINT

### A. NorthPoint Made False Statements of Revenue, Earnings and Line Installations

On 8/8/00, NorthPoint publicly announced that its "results for the quarter ended June 30, 2000 [were] highlighted by *continued strong revenue and digital subscriber lines (DSL) subscriber growth*." ¶32. The Company reported revenue of \$24.4 million for 2Q00, "a 22 percent sequential increase" over revenue from 1Q00 and a "*nearly tenfold*" increase from 2Q99. *Id.* In the same release NorthPoint claimed "50 percent [growth in the number of lines ordered] in the second quarter of 2000." *Id.*

In fact, revenue was recognized and the lines were ordered from customers who (1) did not have the ability to pay, or (2) refused to pay because NorthPoint failed to install DSL lines. ¶33(b). These false statements were made to conceal NorthPoint's financial problems in order to assure the Verizon merger would close. ¶21.

The vast majority of NorthPoint's customers were in serious financial trouble. ¶33. Many are specifically identified in the Complaint by name and approximate amount owed. ¶¶33(a)-(c), 41(c), 69-89. Many of NorthPoint's customers - identified by name and approximate amount owed - were in serious financial trouble and had a history of not paying their bills. By 6/30/00, DSO's - a measure of the amount of time it took NorthPoint to collect on its receivables - increased from 70 days as of 1Q00 during the previous period, to an average of 102 days. ¶33(a)(i). Indeed by January 2001, several of NorthPoint's largest customers, FlashCom, Phoenix, PSN and Zyan, had declared bankruptcy.

NorthPoint executives had actual knowledge of the financial difficulties of its customers, as eight confidential witnesses ("CW\_\_"), all of whom were employees of NorthPoint, revealed. ¶33(b)(i)-(ix). CW5, a Business Development Director, revealed that seriously delinquent customers, including FlashCom, Zyan and Phoenix, were a "'huge' issue" at NorthPoint. ¶33(b)(vi). CW8, a former Account Supervisor, revealed that as of March 2000, FlashCom owed NorthPoint approximately \$5 million and was over 120 days delinquent on payments. ¶33(b)(ix). CW8 reported that by March, ten other customers were over 60 days delinquent. *Id.* According to CW4, a former Account Support Director, by October 2000, defendant Fetter and CW4 received an email that showed that FlashCom still owed approximately \$4 million, and Zyan and PSN each owed approximately \$2.5 million. ¶33(b)(v). Worse yet, NorthPoint propped up financially strapped customers with "marketing distribution funds." ¶33(b)(ii), (iv), (vi). CW8 disclosed that NorthPoint paid FlashCom \$500 per line *ordered*, despite the fact that it was *\$5 million in arrears*. ¶33(b)(ix). CW3, a Regional Sales Operations Manager, offered corroboration that NorthPoint gave market development funds to delinquent customers. ¶33(b)(iv). CW3 specifically recalled that this funding was all that kept NorthPoint customer DSLI in business.

### B. NorthPoint's Competitor Covad Revealed Its Own Customer Collections Problems, but NorthPoint Continued to Falsify and Conceal Its Collection Problems

While NorthPoint continued to boast about its increase in revenues and conceal its internal downward spiral, its main competitor, Covad, announced that by mid-October nine of its Internet customers, including FlashCom, could not afford to pay. ¶41(c) Covad and NorthPoint shared many of the same customers, including FlashCom. *Id.* Unlike NorthPoint, however, Covad announced in a 10/17/00 press release that it was not going to recognize revenue for its non-paying customers. *Id.* Covad later revealed that in October, FlashCom made only a partial payment of \$1.5 million out of \$9 million due, shortly thereafter stopped paying altogether. *Id.* CW8 later revealed that FlashCom (and other NorthPoint customers) resorted to a payment schedule with NorthPoint even earlier than with Covad - as early as

March, 2000. ¶33(b)(ix). As with Covad, FlashCom made only one or two token payments for the rest of the year. *Id.*

Meanwhile, NorthPoint tried desperately to keep up its facade. On 10/26/00, NorthPoint issued a rosy earnings statement to the public, announcing revenue for 3Q00 of "\$30.1 million, a 23% sequential quarterly increase." ¶40(d). In a conference call the same day, defendants further lulled analysts, who expressed concern about Covad's admitted revenue shortfall, with assurances that NorthPoint "is **comfortable with revenue estimates for the fourth quarter and the full year 2000.**" ¶42. But, in fact, orders were cancelled and bills were not collected. ¶33(b)(i)(ix). Only 25 days later, on 11/20/00, NorthPoint executives were forced to admit that the 3Q revenue statements exaggerated earnings by over \$6 million, because of customers' inability or unwillingness to pay. ¶47.

### **C. Defendants Made False and Misleading Statements Regarding the Doomed Merger with Verizon**

On 9/6/00 and again on 9/20/00, NorthPoint touted its imminent merger with Verizon. ¶¶34, 36. On 10/26/00, the Company stated, "**NorthPoint shareholders will receive \$350 million in cash or approximately \$2.50 per share.**" ¶40. Defendant Fetter, assured, "[w]e continue to be on track with our prior expectation of closing the transaction in the first half of 2001." *Id.*

Under the terms of the agreement, however, NorthPoint's financial condition was to remain materially unchanged from when it was represented to Verizon when the agreement was executed. ¶¶27, 33(e). Given the false portrayal of NorthPoint's financial stability, the merger was doomed from the start. ¶¶27, 33(e).

In light of the disparity between the actual state of NorthPoint and that portrayed to Verizon and the public, defendants knew or, but for their recklessness, should have known, that these statements were false and misleading. ¶¶31, 35, 37. In fact, defendants' actions betrayed knowledge that the merger statements were false, by foregoing what they touted to outsiders as a certain \$2.50 per share cash dividend, and instead sold over \$4 million in stock in August, just after the merger was announced. ¶113. Of course that \$2.50 per share vanished once Verizon found out the true state of NorthPoint's business. ¶64.

Inexplicably, even after their November 20th announcement of NorthPoint's \$6.1 million restatement of revenues and a dramatic decline in line installations, the Company again assured the public that the merger "**continue[d] to be on track.**" ¶56. Only nine days later, on 11/29/00, Verizon canceled the merger, stating that NorthPoint's previously undisclosed financial troubles were a "material adverse effect," breaching the contingency provision in the merger agreement. ¶64.

### **D. NorthPoint Violated Generally Accepted Accounting Principles (GAAP)**

On 10/26/00, NorthPoint announced \$30.1 million in revenue for 3Q00, falsely asserting that it had been applying a conservative revenue recognition policy. ¶40(a), (c), (d). In fact, defendants knew the Company's accounting practices were anything but conservative as NorthPoint was realizing revenue where collectibility was not reasonably assured, in violation of GAAP and SEC Accounting Bulletin (SAB) 101. ¶¶33(e)(vi)(b), 41.

Throughout the Class Period, defendants knew NorthPoint was unable to collect from many customers. ¶¶33, 69. For example, CW4 stated that in October, defendant Fetter was informed that FlashCom still owed approximately \$4 million. ¶33(b)(v). On 11/20/00 NorthPoint **admitted** it had improperly recognized revenues in violation of GAAP when it announced it was restating 3Q revenues by \$6 million. ¶¶56, 61. Moreover, defendants also admitted that 31% of NorthPoint's customers were delinquent and that collection from additional customers was doubtful. ¶62. In short, the specific documents received by

defendants and their 11/20/00 admissions establish NorthPoint improperly recognized revenue in violation of GAAP.

### III. STANDARD OF REVIEW

In considering the sufficiency of a complaint under Rule 12(b)(6), the Court must "accept [plaintiff's] allegations as true and construe them in the light most favorable to her." *In re Silicon Graphics Sec. Litig.*, 183 F.3d 970, 983 (9th Cir. 1999). A court will not grant a motion to dismiss unless it appears beyond doubt that plaintiffs can prove no set of facts in support of their claims which would entitle them to relief. *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957).

The PSLRA requires plaintiffs to "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)(B). The complaint must also "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. §78u-4(b)(2). "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)(B). The Complaint satisfies each of these requirements.

### IV. ARGUMENT

#### A. The Complaint Identifies Defendants' False and Misleading Statements with Sufficient Particularity

The Complaint is organized in a logical, coherent manner. The Complaint specifically explains that each of defendants' false statements is identified in bold. Complaint at 10:9-10. The additional portion of each statement is simply included to provide context.<sup>(2)</sup> Defendants cite *In re Autodesk, Inc. Sec. Litig.*, 132 F. Supp. 2d 833 (N.D. Cal. 2000), as holding that "highlighting parts of allegedly false statements [does not] save a defective pleading." Individual Defendants' Motion to Dismiss ("MTD") at 6:6-7. However, unlike in this case, in *Autodesk*, allegations were highlighted without an explanation that bold means false. ¶32. Defendants here are not "forc[ed] ... to guess which factual assertions are allegedly false." <sup>(3)</sup> MTD at 7:3-4.

#### B. The Complaint Alleges Particularized Facts Explaining Why the Challenged Statements Were False When Made

Defendants contend that plaintiffs have failed to allege specific facts explaining why defendants' challenged statements were false when made. MTD at 6-8. Defendants strangely ignore the detailed explanation of falsity in ¶33, containing 28 subparagraphs of supporting facts. After detailing the "Challenged Statements," the Complaint immediately follows with a section entitled "Reason Untrue or Misleading," including statements made by eight former NorthPoint employees (¶33(b)(i)-(ix)), establishing the undercapitalized nature of NorthPoint's own customers (¶¶69-90), and NorthPoint's own admission that it had improperly recognized \$6.1 million in revenue when actual revenues were only \$24.4 million (out of a total claimed revenue of \$30 million). ¶33(a)(iii), (iv), (vi). As analyzed *infra*, plaintiffs present contemporaneous negative facts which directly contradict defendants' positive statements. *In re GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541, 1548 (9th Cir. 1994) (*en banc*).

#### 1. The August 8, 2000 Press Release Falsely Stated Existing Revenue and Billable Line Installations for 2Q00

On 8/8/00, NorthPoint issued a press release announcing 2Q00 results touting "continued strong revenue

growth" and bragging about the benefits of the merger with Verizon. ¶32. A fair reading of the Complaint defeats defendants' contention that the Complaint fails to explain why this and other challenged statements were false. MTD at 7.

In the clearly marked, "Reason Untrue or Misleading" section following the 8/8/00 challenged statement, the Complaint unambiguously states, "[D]efendants' statements were misleading because they failed to disclose the deterioration in their business" (¶33(d)), and that "defendants knew that this deterioration would constitute a Material Adverse Effect that would allow Verizon to back out of the merger." (4) ¶33(e).

Six NorthPoint employees disclosed that NorthPoint customers could not or would not pay their bills. ¶33(b)(ii), (iii), (v), (vi), (vii) and (ix). The witnesses explained that NorthPoint's biggest customers were delinquent, including FlashCom, which owed NorthPoint \$5 million or 85% of NorthPoint's \$6.1 million accounting "revision". ¶33(b)(ix). According to CW6 and CW8, an Account Support Manager and an Account Supervisor, FlashCom was over 120 days late in March 2000. ¶33(b)(vii) and (ix). CW5, a NorthPoint Business Development Director, explained that several major accounts were delinquent, including Zyan, Phoenix and FlashCom and that this was a huge issue for NorthPoint. CW8 corroborates this assessment of scope, revealing that NorthPoint had a receivable problem across the country throughout Class Period. ¶33(b)(iv).

Similarly, as defendants were well aware, customer *orders* did not necessarily equal digital line *installations*. Defendants' statement that subscribers had increased 50% in 2Q00 to 62,000 was false and misleading because of installation delays. ¶33(b)(i), (iii), (viii), (ix). CW1, an Account Manager, revealed that customers refused to pay for digital lines due to these installation delays, causing NorthPoint ultimately to admit that it was decreasing its previously announced billable lines by 31%. ¶33(a)(v), (b)(1).

Recognizing revenues from these customers violated GAAP and SEC rules, because the customers were either not able or not willing to pay. ¶33. Under GAAP, payment must be reasonably certain to justify recognition. FASB Concepts No. 5 ¶83, SAB 107. The reported 2Q00 revenues of \$24.4 million and the 3Q00 revenues of \$30.1 million were false and misleading because they were based on improperly recognized revenue when there was no reasonable expectation that the customers could or would pay. *See Provenz v. Miller*, 102 F.3d 1484 (9th Cir. 1996) ("[R]evenue must be *earned* before it can be recognized.") (Emphasis in original); *Cooper v. Pickett*, 137 F.3d 616, 626 (9th Cir. 1998).

## 2. Defendants' Revenue Statements Were False

Defendants, citing to *Ronconi v. Larkin*, 253 F.3d 432 (9th Cir. 2001) and *In re Secure Computing Corp. Sec. Litig.*, 120 F. Supp. 2d 810 (N.D. Cal. 2000) incorrectly argue, that while plaintiffs plead facts showing a deteriorating business environment, those facts do not contradict defendants' actual recognition of revenue. MTD at 9. By contrast, plaintiffs allege, in detail, that defendants' revenue recognition was improper, and describe how. ¶33. Plaintiffs then provide eye witness accounts of collection problems (¶33(b)), the solvency status of many of NorthPoint's top customers (¶33(b)) and the delinquency of FlashCom since March 2000. NorthPoint's whose revenue was reversed in the November 20 restatement. Plaintiffs plead defendants' commission structure of paying the sales force upon the ordering of lines, not installation, suggests revenue recognition. ¶33(b)(1). NorthPoint's sudden change in its revenue recognition (¶33(a)(vi)(b)), and the 25% restatement, confirm NorthPoint was improperly recognizing revenue in violation of GAAP during the Class Period. These facts particularize the falsity of defendants' revenue statements when they were made.

*Ronconi* is inapposite. Unlike our case, the plaintiffs in *Ronconi* failed to provide *any* evidence in support of their allegation that defendants' statement of increased revenue was false when made. *Ronconi*, 253

F.3d at 431. Specifically, plaintiffs failed to "explain what the 'serious operational problems' were, what kind of 'substantial difficulties' were being experienced, and why these 'difficult problems' decreased revenue." *Id.* at 434. Here, as explained above, plaintiffs have pled numerous facts explaining what types of "serious operational problems" NorthPoint was having throughout the Class Period, and why these problems precluded revenue recognition.

*Secure Computing* is equally inapplicable under the facts of our case. In *Secure Computing*, the issue was whether defendants were **contractually** entitled to recognize revenues when they did. *Secure Computing*, 120 F. Supp. 2d at 820. The court held that plaintiffs did not provide evidence of the contract, and therefore, did not establish any basis to proceed to an analysis of whether there was a violation of GAAP. *Id.* Quite to the contrary, plaintiffs here allege that defendants violated GAAP in recognizing revenue where collectibility was not reasonably assured. Unlike in *Secure Computing*, defendants here **admit** to falsity in its \$6.1 million restatement. Conveniently, defendants fail to mention that the court ultimately **upheld** plaintiffs' Complaint in its entirety in a second motion to dismiss. *In re Secure Computing*, C99-01927, 2001 U.S. Dist. LEXIS 13563 (N.D. Cal. Aug. 21, 2001).

Defendants cite *In re FVC Com. Sec. Litig.*, 136 F. Supp. 2d 1031 (N.D. Cal. 2000) in an attempt to characterize their restatement as something other than an admission that their results were materially false when made. MTD at 9, n.18. Defendants' reliance on *FVC* is misplaced. The \$7 million restatement there was an admission that the previous revenue claim was false. The court held, however, that the restatement was not **fraudulently** false because the restatement was based on a subsequent event. Plaintiffs' appeal is pending in *FVC*, claiming that *FVC* knew of the event before the restatement.

Finally, SEC regulations require defendants to follow GAAP even in unaudited financial results. Sec. Reg. S-X, 17 C.F.R. §210.4-01(a)(1).

### **3. NorthPoint's Restatement Is an Admission that Their 3Q00 Financial Statements Were False When Made**

Defendants desperately seek to minimize the effect of their \$6.1 million restatement of NorthPoint's 3Q results by calling it an irrelevant revision. MTD at 2. There is nothing irrelevant about a company overstating its earnings by over 25%. ¶5. Despite defendants' characterization, a correction of overstated revenues in a previous press release is, by definition, a "restatement." *Wool v. Tandem Computers, Inc.*, 818 F.2d 1433, 1435 (9th Cir. 1987).

Under GAAP Accounting Principles Board Opinion ("APB") No. 20, no such retroactive restatement would have been required or allowed unless the revenue was materially misstated based on what defendants knew or, but for their deliberate recklessness should have known, about their customers' inability or unwillingness to pay. *See* APB 20 ¶¶7-14. GAAP provides that financial statements be restated under limited circumstances: where there is a change in reporting entity, a change in accounting principles or to correct an error. ¶¶41, 98-101. NorthPoint's 3Q00 revision was to correct material errors in its previously issued financial statements. By their revision, defendants have admitted that the first statement was materially false. <sup>(5)</sup> *Provenz*, 102 F.3d at 1489.

Contrary to defendants' assertion, the fact that this fraudulent financial statement was in a press release rather than an SEC filing does not save them. MTD at 9 n.18. Defendants are not free to announce false revenues as long as they do so in a press release. *Wool*, 818 F.2d at 1440 (false financial results in a press release constitutes fraud).

### **4. NorthPoint's GAAP Violation Is Pled with Sufficient Particularity**

Plaintiffs have pled with particularity the facts of NorthPoint's GAAP violations. Defendants recorded revenue where collectibility was not reasonably assured, in violation of SAB 101. Defendants also failed to record losses for uncollectible receivables (adequate debt reserves) in violation of FAS 5, ¶22. ¶¶102-05. Finally, defendants capitalized marketing funds provided to customers in violation of FAS Concept No. 5, ¶87. ¶¶106-08. As the Complaint alleges (¶95), SEC regulations require NorthPoint, as a publicly traded company, to maintain its financial reporting in accordance with GAAP. Sec. Reg. S-X, 17 C.F.R. §210.4-01(a)(1). Egregious violations of GAAP, like the ones here, serve as evidence of both material falsity and scienter. *Provenz*, 102 F.3d at 1489.

Defendants assert that plaintiffs must allege "some particular transactions where revenues were improperly recorded, including the names of the customers, the terms of specific transactions, when the transactions occurred, and the approximate amount of the fraudulent transactions." MTD 16. In the one case cited, however, the plaintiffs' claim was based on an allegation that defendants had falsified entire transactions. Accordingly, the district court required plaintiffs to present evidence of these sham transactions, which, logically, included specific customers, transactions and dates. *In re Oak Tech. Sec. Litig.*, Civil No. 96-20552 SW, 1997 U.S. Dist. Lexis 18503, at \*\*23, 29 (N.D. Cal. Aug. 1, 1997).

Unlike *Oak Tech*, the allegations in this case are not based on fabrication of entire transactions, but on improperly recognizing revenues. The Complaint specifically identifies ten customers whose collection issues were the basis of the GAAP violations. ¶¶33, 69. Plaintiffs establish, through confidential witnesses, that collectibility had been a concern since early 2000, and was the subject of emails, aging reports and meetings. ¶33(b). As of March 2000, FlashCom was \$5 million in arrears. ¶33(b)(ix). An October 2000 email to defendant Fetter indicated that FlashCom was still \$4 million behind in payments. ¶33(b)(v). As of October 2000, Zyan and PSN each owed at least \$2 to \$2.5 million. *Id.* Plaintiffs' Complaint provides sufficient detail identifying the delinquent customers, the dates during which collectibility was at issue, and the sources of the information including job titles.

Defendants seek to dismiss hard evidence of NorthPoint's undisclosed financial turmoil as "ordinary business challenges." The proper application of GAAP to defendants' financial statements raises issues of fact for trial. *Florida State Bd.*, 2001 U.S. App. Lexis 22921; *Provenz*, 103 F.3d at 1490; *Ganino v. Citizens Util. Co.*, 228 F.3d 154, 162 (2d Cir. 2000). At the pleading stage, plaintiffs get "the benefit of all reasonable inferences." *Silicon Graphics*, 183 F.3d 970, 983 (9th Cir. 1999). Under Sec. Regulation S-X (17 C.F.R. §210.4-01(a)(1)) financial statements prepared in violation of GAAP are presumed to be false and misleading.

### C. NorthPoint's Merger Statements Are Actionable

Beginning on August 8, and continuing throughout the class period, NorthPoint touted the benefits of its merger with Verizon. This merger would "creat[e] one of the world's best-positioned broadband service companies" and "a new national DSL leader." ¶¶32, 36. NorthPoint also promised that "shareholders **will receive** \$350 million in cash or approximately \$2.50 per share," and that shareholders "**will receive** one share in the 'new' NorthPoint for each share held as of the closing date." ¶40. Even after NorthPoint's devastating 11/20/00 earnings announcement, defendant Fetter assured that the merger "continued to be on track." ¶56.

Contrary to defendants' assertions (MTD at 19), a claim that the Company is "on track" is not a forward looking statement, it is a statement of **current** fact. *Secure Computing*, 120 F. Supp. 2d at 818. NorthPoint's statements reassuring the public that its merger was on track were false, in light of the information available to and known by defendants at the time. A contingency in the merger agreement

allowed Verizon to withdraw if there was an "adverse material effect" upon the business or finances of NorthPoint. ¶64. Defendants were aware that the contingency would be triggered once Verizon discovered NorthPoint's deception and the Company's true financial situation was revealed. The merger was not "on track" because the Company's finances - upon which the merger was contingent - were completely derailed. ¶31. NorthPoint's statements regarding the imminence of the merger, therefore, were false, in light of contrary information actually known by NorthPoint insiders at the time.

#### **D. Defendants' So-Called Forward-Looking Statements Are Actionable**

Defendants claim that four statements are non-actionable forward-looking statements:

- (1) "we believe we are well positioned to leverage this substantial market opportunity." ¶56.
- (2) "we look forward to the completion of the merger." ¶34.<sup>(6)</sup>
- (3) "at the end of the year on a pro forma basis, NorthPoint and Verizon will have a combined broadband network." ¶40.
- (4) "NorthPoint will become the nation's largest DSL-based broadband services provider." ¶50.

The first of these statements is certainly not forward-looking. That they were well positioned to leverage the merger was a false statement of existing fact. Even assuming that these statements were forward looking, they are still actionable.

#### **1. Defendants Had Actual Knowledge that the Merger Statements Were False or Misleading**

The PSLRA safe harbor provision does not shield forward-looking statements where defendants had actual knowledge that the statement was false or misleading. 15 U.S.C. 780.5, §21E(c)((1)(B)(i), (ii)(II). Projections such as these are a factual misstatement (and therefore actionable) "if (1) the statement is not actually believed, (2) there is no reasonable basis for the belief, or (3) the speaker is aware of undisclosed facts tending seriously to undermine the statement's accuracy." *Provenz*, 102 F.3d at 1487; *Kaplan v. Rose*, 49 F.3d 1363, 1375 (9th Cir. 1994) (citing *In re Wells Fargo Securities Litigation*, 12 F.3d 922, 930 (9th Cir. 1993) (emphasis added).

Each of these statements was made when contradictory facts existed. Statement one was made 9/6/00 (¶34), when confidential witnesses make clear that NorthPoint's finances were already in a shambles. ¶33(b)(i-ix). Additionally, the second, third and fourth statements were each made in close proximity - within a month - of the November 20th restatement of 3Q00 earnings. ¶40, 50, 56. An earnings restatement, certainly does not happen overnight, and would be known to jeopardize, and in fact was listed among the primary causes for the failure of, the merger. In it, NorthPoint admitted that it had previously overstated its revenue by \$6.1 million.

The evidence of defendants' actual knowledge of NorthPoint's financial turmoil, presented in the Complaint, and discussed in detail in the scienter argument, *supra*, strongly infer that NorthPoint was actually aware of undisclosed facts that seriously undermined the accuracy of each of these statements.

#### **2. The Statements Are Not Protected Under the PSLRA "Safe-Harbor" or "Bespeaks Caution" Defenses**

Even if considered forward-looking, such statements must be accompanied by "*meaningful*" cautionary statements. 25 U.S.C. §78u-5(c)(1). None of the boilerplate "cautionary language" accompanying

defendants' statements is sufficient to warrant protection under the PSLRA's Safe Harbor or "Bespeaks Caution" doctrine. Dismissal under the safe harbor defense is proper "only if the adequacy of the disclosure or materiality of the statement is 'so obvious that reasonable minds [could] not differ'" *Fecht v. Price Co.*, 70 F.3d 1078, 1081 (9th Cir. 1995). Here the disclosures were plainly inadequate. Defendants claim that the following "disclosure" entitles them to protection under the safe harbor doctrine:

"[risks and uncertainties include] the inability to obtain, or meet conditions imposed for, governmental approvals for the proposed merger with the Verizon Communications' DSL business, the failure of NorthPoint's stockholders to approve the merger, costs related to the merger, the risk that NorthPoint's and Verizon's DSL businesses will not be integrated successfully, the failure of NorthPoint to realize anticipated benefits of the merger." MTD at 3-4 n.4.

None of these warnings even arguably applies. The merger failed neither because of lack of governmental approval nor because NorthPoint's stockholders did not approve the merger, or because of integration problems between NorthPoint's and Verizon's businesses. The merger failed for two reasons: (1) because there was a clause in the merger agreement that allowed Verizon to cancel if there was a material change in NorthPoint's business (¶27) and (2) because NorthPoint fraudulently concealed the true desperate state of its business from Verizon and the public. ¶31.

In any event, as discussed in the scienter argument below, the safe-harbor defense is unavailable because defendants had actual knowledge that the statements were false and misleading.

#### **E. The Complaint Describes with "Great Detail" Its Sources, Fully Describing Witnesses and Corroborating Statements**

Defendants' argument that "the PSLRA and *Silicon Graphics* require plaintiffs to identify their alleged sources" is contrary to the law. MTD at 15. The PSLRA contains no requirements that plaintiff name its sources. 15 U.S.C. §78u-4(b)(1). While "[t]he precise amount of detail that they must reveal depends on the circumstances," the witness' "job position" may suffice. *Secure Computing*, 120 F. Supp. 2d at 817 (citing *Silicon Graphics*, 183 F.3d at 985). *Novak v. Kasaks*, 216 F.3d 300, 313-14 (2d Cir. 2000); *In re McKesson HBOC, Inc. Sec. Litig.*, 126 F. Supp. 2d 1248 (N.D. Cal. 2000).

Plaintiffs have provided "great detail" about their confidential sources. ¶33(b). Plaintiffs have provided a job title for each of their sources. The information provided by each confidential witness is listed, and pertains to knowledge of which an employee of that position would be aware. Statements from eight witnesses in different jobs and departments corroborate each other. As the Supreme Court aptly observed, "a piece of evidence, unreliable in isolation, may become quite probative when corroborated with other evidence." *Bourjaily v. U.S.* 483 U.S., 171, 179-80 (1987). Taken together, plaintiffs' witnesses are reliable and their information must be accepted at the pleading stage.

#### **F. The Complaint Alleges a Strong Inference of Scienter**

A complaint must be considered *in its entirety* to determine whether the facts alleged, considered *in combination*, give rise to a strong inference that defendants acted with deliberate recklessness in issuing false statements. *In re Silicon Graphics*, 183 F.3d at 985; *Ronconi*, 253 F.3d at 436 (courts look at the complaint, "taken as a whole," to determine whether defendants acted with deliberate recklessness). The allegations and inferences should not be viewed separately; rather, the question is whether reasonable inferences drawn in favor plaintiffs, "taken together" or "in combination," demonstrate that plaintiffs have alleged sufficient facts to support a strong inference of recklessness. *Rothman v. Gregor*, 220 F.3d 81, 92,

94 (2d Cir. 2000). As the Supreme Court explained: "The sum of an evidentiary presentation may well be greater than its constituent parts ... a piece of evidence, unreliable in isolation, may become quite probative when corroborated by other evidence." *Bourjaily*, 483 U.S. at 180.

Contrary to this standard, defendants attempt to improperly isolate facts and then suggest that each one taken separately, does not support a strong inference of deliberate recklessness. Plaintiffs here have pled a myriad of facts which, some taken individually, and others taken together, infer that defendants were not innocent bystanders of the corporate disaster. In particular, plaintiffs plead:

1. Admissions of Improper Revenue Policies. NorthPoint's multiple admissions of improper revenue recognition and misapplication of GAAP. ¶33(a)(i)-(vii), including an explicit revision of its revenue recognition policy to reflect GAAP. ¶33(a)(iv)(a) and (b);
2. Motive. NorthPoint's pressing need to consummate the merger to avoid bankruptcy (¶33(a)(vii)) and the individual defendants' motive to dump their shares prior to stockholders realizing the depth of NorthPoint's financial problems. ¶33(a)(viii);
3. Witness Accounts. Eight high-level eye-witness employees of NorthPoint who independently corroborate defendants' actual knowledge of the serious undisclosed problems with NorthPoint's business prior to and during the Class Period. ¶33(b)(i)-(iv);
4. Timing of Revelations with Scrutiny by Verizon and Auditors. The suspicious timing of the restatements, changes to revenue recognition policies, and revelations of delinquent customers with the year-end audit, and the Verizon due diligence effort in progress. ¶33(c);
5. Customer Information. The detailed allegations regarding NorthPoint's customers ¶33(d)(i), ¶¶69-91;
6. Defendant's Admitted Concern Re: Survivability of NorthPoint. Fetter's admission early in 2000, that she approached NorthPoint's competitors to consider merging, suggesting knowledge of NorthPoint's deteriorating customer base. ¶¶33(d)(iii);
7. In Court Allegations of Verizon. Verizon's termination of the merger citing a "material" deterioration in NorthPoint's business. ¶33(e);
8. In Court Admissions of NorthPoint. NorthPoint's public insistence that Verizon was aware of the facts in NorthPoint's October 26th and November 20th public disclosures. ¶33(f);
9. Size and Nature of Restatement. The nature and extent of NorthPoint's GAAP violations and false financial reporting. ¶¶91-112; and
10. Timing, Pattern and Nature of Insider Sales. Defendants' perfectly timed insider sales far in excess of

any comparable prior sales. ¶113.

11. Timing of NorthPoint's Bankruptcy. Within a month and a half of NorthPoint's admitted problems, NorthPoint filed bankruptcy and was swiftly liquidated showing the deep and serious nature of NorthPoint's business beyond that actually revealed. ¶68.

Taken together, these facts, obtained from top level employee eye-witnesses and other corroborating evidence, paint a clear picture of defendants' awareness of the falsity and misleading nature of their public statements.

### **1. The Complaint Relies upon Witness, Not Documents, to Draw a Strong Inference of Scienter**

In an attempt to divert the Court's attention away from this plethora of fact, defendants try desperately to turn this case into a case based on documents. Defendants attempt to insist that "plaintiffs must specify the who, what, where and when, of each report and document identified by witnesses" misses the point. MTD at 12. Eight Confidential Witnesses have come forward, revealing that delinquencies in customer payments, and delays in DSL line installations were the topic of many discussions, reports, team meetings, conference calls, as well as the October email. ¶33(b).

These witnesses corroborate one another, rendering all of plaintiffs' evidence probative. *Bourjaily*, 483 U.S. at 180("a piece of evidence, unreliable in isolation may become quite probative when corroborated by other evidence"). All have identified delinquent ISP's as an on-going concern throughout the Class Period. ¶33. For example, a Sales Consultant (CW2), and a Regional Sales Operations Manager (CW3), both revealed that account managers and sales staff were having serious difficulties collecting funds from delinquent ISP's and were accepting partial payment in satisfaction of their debt, both prior to and throughout the Class Period. ¶33(b)(ii), (iii). Also, an Account Supervisor, CW8, identified that as of March 2000, FlashCom was approximately \$5 million in arrears and over 120 days overdue. ¶33(b)(ix). Similarly, a former Business Development Director, CW5, identified that team meetings were held bi-weekly, wherein, throughout July 2000, FlashCom and Zyan's extreme delinquencies were discussed. ¶33(b)(vi). Further, a former Account Supervisor, CW8, identified that there were phone calls between defendant Glinsky and FlashCom's CEO regarding FlashCom's serious delinquencies. ¶33(b)(ix). This witness specified more than one phone call, as well as the general subject matter, identifying that Glinsky had *actual knowledge*.<sup>(7)</sup> *Id.* These confidential eye-witnesses corroborate one another, and therefore are *all* reliable.

Defendants argue that the witness accounts merely show NorthPoint's keen awareness and "adher[ence] to proper business practices" misses the mark. (MTD at 13:12-13.) While NorthPoint's practice of tracking delinquencies may be prudent, failing to *disclose* to the public material internal shortcomings based on that tracking is *fraud*. Unbeknownst to the trading public, the results of NorthPoint's internal tracking secretly led to the Company's bankruptcy. The witnesses' accounts of these team meetings, telephone conferences, aging reports and emails, viewed as a whole, provides an accurate picture of NorthPoint during the Class Period, a NorthPoint which was on its way to failure.

### **2. The Witnessed October 2000 Email Is Adequately Described and Corroborated**

Defendants deny the damning effect of the October 2000 email by alleging that plaintiffs have failed to provide sufficient detail about this email from which the reliability of this evidence may be determined. MTD at 14-15. This is false. An Account Support Director, CW4, confirmed that defendant Fetter had

actual knowledge of the ISP delinquencies through the October 2000 email which both CW4 and Fetter received tracking NorthPoint's delinquent customers. ¶33(b)(v). CW4 informed plaintiffs that this email identified that FlashCom was over \$4 million in arrears, and PSN and Zyan each were \$2-2.5 million in arrears. *Id.*

Plaintiffs are *not* required to provide an enumerated list of facts before reliability of CW4 is deemed established, but must only provide "some specifics" from which reliability may be determined. *Silicon Graphics*, 183 F.3d at 985. Notably *Silicon Graphics*, from which defendants derive their argument that plaintiffs must identify the "who, what, when and where" for the information provided by each witness, did not address the reliability of witnesses, but of documents. There were no witnesses in *Silicon Graphics* or *In re Splash Tech. Holdings Sec. Litig.*, No. C 99-00109 SBA, 2000 U.S. Dist. LEXIS 15369 (N.D. Cal. Sept. 29, 2000) upon which defendants rely. *Id.* Even assuming that the rule in *Silicon Graphics* applies, this Complaint identifies CW4, who then provides "some specifics" from which reliability of CW4 and the information provided is established. As an account supervisor, CW4 was among the list of recipients of emails pertaining to collections. ¶33(b)(v). CW4 sufficiently describes the contents of this email received by Fetter.

The fact that CW4 cannot give the exact date in October 2000 that the email was sent has no adverse impact on the reliability of the document or its damning effect. The sheer magnitude of the delinquencies as revealed to Fetter in October demonstrates that NorthPoint's dire financial situation had been a problem of which defendants were aware *prior to October*. Because such a delinquency does not come about overnight, this email, identifying that NorthPoint is short over \$8 million in payments, undermines defendants' optimistic claims of increased revenue. *Fecht v. Price Co.*, 70 F.3d at 1088; *Cooper v. Pickett*, 137 F.3d, 616, 626 (9th Cir. 1998) (allegations of specific problems undermining a defendants' optimistic claims suffice to explain how the claims are false; thus, "when the complaint alleges with particularity the circumstances constituting fraud ... then generally it will also have set forth facts from which an inference of scienter may be drawn").

### **3. Defendants' GAAP Violations and \$6.1 Million "Restatement" Support a Strong Inference of Deliberate Recklessness**

Allegations of financial fraud, combined with other circumstances, provide strong circumstantial evidence of knowledge. *Provenz*, 102 F.3d at 1490. "When combined with other circumstances suggesting fraudulent intent, [GAAP] violation[s] may be used to show scienter." *Cherednichenko v. Quarterdeck Corp.*, [1998 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶90,108 at 90,145 (C.D. Cal. 1997) (citing *Marksman Partners, L.P. v. Chantal Pharm. Corp.*, 927 F. Supp. 1297 (C.D. Cal. 1996)).

Defendants' \$6.1 million 3Q revision constitutes an admission that it had been erroneously recognizing revenue. A company that "substantially overstates its revenues" clearly makes a "false" statement. *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1418 (9th Cir. 1994). The sheer magnitude of the improper revenue recognition supports a strong inference that defendants had actual knowledge of the falsity of its financial statements. *Gelfer v. Pegasystems, Inc.*, 96 F. Supp.2d 10, 16 (D. Mass. 2000) (magnitude and frequency of accounting errors help create a strong inference of scienter).

Defendants admit that they failed to comply with GAAP and SAB 101, stating in their 2Q Form 10-Q filed with the SEC that "the company will continue to evaluate the impact of SAB 101 on its financial statements and related disclosures." ¶33(a)(vi)(a). SAB 101 mandates that revenues are not to be reported unless collectibility is reasonably assured. ¶¶98, 99; Defs' Req. Jud. Not., Ex. D. Ironically, SAB 101 states explicitly that it did not alter GAAP in any manner, but instead, simply reinforced the rules already in effect. *Id.* By "evaluating the impact of SAB 101," and altering their results as a consequence, defendants

admit to non-compliance with SAB 101.

As discussed above, the Complaint provides hard evidence from eight witnesses that NorthPoint insiders acted at least with deliberate recklessness in recognizing revenue in violation of GAAP and the SEC rules. Plaintiffs' witnesses reveal that NorthPoint held meetings, circulated e-mail and prepared aging reports all addressing the ISP's serious payment delinquencies and NorthPoint's inability to collect. ¶33(b). NorthPoint reported in its 2Q Form 10-Q an increase in DSO from 70 days to 102 days. ¶33(a)(i). With virtually all of its customers seriously delinquent in payments, it is reasonable to infer that defendants were recognizing revenue where collectibility was not reasonably assured. Under *In re PeopleSoft, Inc. Sec. Litig.*, [2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶91,035, at ¶94,807 (N.D. Cal. 2000), discussed below, this is exactly the type of "core" business knowledge which is imputed to defendants.

On 10/26/00, NorthPoint stated that "it has consistently applied what it believes is a conservative revenue recognition policy," noting that "it *may* be that a few of NorthPoint's customers will have difficulty raising the capital required... ." ¶40(d). Thus, NorthPoint "*has chosen* to recognize revenue for lines installed for these few customer only when the customers' financial outlook improves." *Id.* Yet, as explained *supra*, NorthPoint already had been affected by its ISP customers financial deficiencies, which far exceed normal "internal management challenges" as defendants contend. MTD at 22:5-8. NorthPoint's cautionary statement is of no import, for, "[t]o warn that the untoward may occur when the event is contingent is prudent; to caution that it is only possible for the unfavorable events to happen when they already have occurred is deceit." *In re Convergent Tech. Sec. Litig.*, 948 F.2d 507, 515 (9th Cir.1991).

#### **4. FlashCom's Registration Statement and Covad's Press Releases Corroborate the Strong Inference of Deliberate Recklessness Because NorthPoint's "Core" Operations Are Presumed to Be Known by Defendants**

Plaintiffs' eight confidential witnesses, FlashCom's registration statement and Covad's press release all support a strong inference that defendants acted, at least, with deliberate recklessness in failing to learn of NorthPoint's delinquent customers. NorthPoint's customers were the vehicle through which its product was sold. ¶¶2, 14. The collections from its customers, therefore, are at the heart of NorthPoint's business operations.

Defendants make the dubious claim that there is no evidence that NorthPoint insiders actually knew or acted with deliberate recklessness in failing to learn of NorthPoint's customers' failing financial situations. MTD 14. In *PeopleSoft*, this Court held, "[b]y virtue of his [defendant's] key position and key role in management, the Court presumes that [the defendant] knew the foregoing alleged facts," noting that "a major customer ... refused to buy the manufacturing module in April 1998, which had to be a significant setback known in the highest of circles." *PeopleSoft*, Fed. Sec. L. Rep. (CCH) at ¶94,807 (N.D. Cal. May 2000). Generally, "facts critical to a business's core operations ... are so apparent that their knowledge may be attributed to the company and its key officers." *Epstein v. Itron*, 993 F. Supp. 1314 (E.D. Wash. 1998); *Cosmas v. Hassett*, 886 F.2d 8 (2d Cir. 1989). Defendants cannot claim lack of knowledge of NorthPoint's collections issues, which are at the core of its business.

Nor can Defendants claim ignorance of FlashCom and Covad's press releases and financial statements. In its May 2000 registration statement, FlashCom candidly admitted, "[w]e expect losses for the foreseeable future," and that "we continue to depend on sources other than our internal operations, including subsidies from suppliers." ¶¶71, 73. Consistent therewith, Covad, NorthPoint's largest competitor, disclosed in October that it was not going to recognize revenue for over \$7 million attributable to FlashCom. ¶41(b)(i). Defendants cannot argue lack of knowledge of the financial difficulties affecting its largest competitor and client. In accordance with *PeopleSoft, supra*, this type of core business knowledge is imputed to

defendants. When analyzed in combination with the statement of the eight witnesses, Covad's press release and FlashCom's statement support a strong inference that defendants acted with deliberate recklessness.

### **5. Defendants' Insider Trading Is Unusual and Suspicious and Presents Strong Evidence of Deliberate Recklessness**

Insider trading is not required to establish a strong inference that defendants acted with deliberate recklessness. *Florida State Bd.*, 2001 U.S. App. LEXIS 22921; *In re Hi/fn Sec. Litig.*, No. C99-4531 SI, 2000 U.S. Dist. LEXIS 11631, at \*32 n.4. However, several unique characteristics of Defendants' stock sales provide additional evidence to support of a finding of scienter in this case. *Bourjaily*, 483 U.S. at 180. ("The sum of an evidentiary presentation may well be greater than its constituent parts ... a piece of evidence, unreliable in isolation, may become quite probative when corroborated by other evidence.")

#### **a. Defendants' Perfectly Timed and Coordinated Sales Give Rise to an Inference of Scienter**

The timing of Defendants' sales provides circumstantial evidence that Defendants' insider trading was suspicious. In particular, defendants *began their brief 20-day selling spree within three days of announcing the merger with Verizon*. ¶113. Defendants traded when NorthPoint's shares were trading at the highest price during the class period, which was *after* the trading public had had the opportunity to react to the news of the merger, but *before* the expedited completion of the merger. ¶¶8, 21, 113, 40(d), 24. The suspiciousness of these trades is compounded by the fact that NorthPoint's stock price began to slide immediately after these sales, falling below \$10 by early September and below \$5 by mid-October. ¶8.

Curiously, by selling their shares *before* the expected completion of the merger, defendants gave up their rights to the "guaranteed" \$2.50 dividend per share. A reasonable inference for this court to draw is either (1) that defendants knew the merger would not occur and thus weren't actually losing the \$2.50 per share or, (2) that they knew that NorthPoint stock would collapse before the merger date. Interestingly, both of these events occurred (¶¶6, 8, 40) providing additional evidence to support a strong inference of scienter. *Bourjaily*, 483 U.S. at 180.

Notably, defendants traded in a coordinated fashion, waiting from February until August to sell their shares. Def. Req. Jud. Not. Ex. I. Then within a short twenty day period, defendants made 13 transactions selling 330,000 shares. Indeed, 2/3 of shares were sold by Malaga & Fetter on the same exact three days, August 29, 30, 31st. The possibility that this could have occurred by chance, absent coordination is so remote as to be outside the realm of the possible. In *Secure Computing*, U.S. Dist. LEXIS at\*22), the court held that the individual defendants' coordinated sales was sufficient to find that defendants' trading was unusual and suspicious. Hence, the coordination of defendants' sales is further evidence that defendants' trading was part of a larger coordinated fraud. ¶113.

#### **b. Defendants' Sales Were Significantly Greater During the Class Period than in the Equivalent Prior Period**

The amounts of shares sold and Defendants' prior trading history, further establish that defendants' trades were, in fact, suspicious. Even by defendants' own calculations, defendants had no prior trading history of the magnitude found during the Class Period. MTD at 24. Indeed, defendants themselves admit that they made *zero* sales during 2Q00, the equivalent period immediately prior to the Class Period. *Id.* (8) Even using a comparison with early periods, Defendants sold approximately 50% more during the Class Period quarter than in 4Q99 or 1Q00.

## **6. Defendants' Pending Merger with Verizon Provides a Strong Motive and Supports a Strong Inference of Deliberate Recklessness**

Defendants' \$800 million merger with Verizon provides a strong motive for NorthPoint to intentionally falsify statements regarding both the merger and the Company's finances. While motive, alone, is insufficient to establish the requisite scienter, it is circumstantial evidence that strongly supports an inference of intent. ¶¶20-31. *Florida State Bd.*, U.S. App. LEXIS at \*\*40, 45; *Howard*, 228 F.3d at 1064; *Rothman*, 220 F.3d at 92-93. Motive is one factor to consider under the "totality of the circumstances" approach to establish that defendants have acted with deliberate recklessness. In order to plead motive as an inference of scienter, plaintiff must provide "concrete benefits that could be realized by one of more of the false statements." *Id.* The merger was a concrete \$800 million benefit to defendants. ¶24.

The complaint alleges that merger was contingent on NorthPoint's financial condition remaining materially the same as at the time the agreement was entered into. ¶¶27, 33. As explained above, NorthPoint insiders had actual knowledge that the Company's customers were seriously delinquent in their payments. ¶33(b), (i)-(ix). This merger provides a strong motive for NorthPoint to conceal its inability to collect on its accounts receivables, violate GAAP and issue false financial statements. When viewed in combination with all other reasonable inferences drawn, plaintiffs have established a strong inference that Defendants acted with at least deliberate recklessness in issuing false and misleading statements.

## **7. The Proximity Between Defendants' Misrepresentations and the Disclosure of NorthPoint's Financial Difficulties Bolsters a Strong Inference of Deliberate Recklessness**

The close proximity between the revelation of the bad news (on 11/20/00) and defendants' false statements on November 13 and 15, is significant circumstantial evidence that "bolsters" the allegations that defendants *knew* their positive statements were false when made. *Fecht v. Price Co.*, 70 F.3d 1078, 1083-1084 (9th Cir. 1995); *Yourish v. California Amplifier*, 191 F.3d 983, 997 (9th Cir. 1999). This Court aptly observed, "[t]emporal proximity of an allegedly false statement by a defendant and a later corrective disclosure can be used together to bolster a complaint," and support an inference of scienter. *In re Hall, Kinion & Associates, Inc. Sec. Litig.*, No. C99-02943 (N.D. Cal. Apr. 25, 2000). On 11/13/00, defendants boasted, "NorthPoint ... continues to be successful among the most formidable names in leading companies this century." ¶45. On 11/15/00, NorthPoint filed with the SEC for a 5-day extension to submit its Form 10-Q "in light of the Company's rapid growth." ¶52. Merely five days later, on 11/20/00, NorthPoint shocked the trading public with the news that it was revising its 3Q earnings downward by over \$6 million. ¶54. Scienter is strongly inferred by the fact that defendants continued to make misrepresentations until a few days before the truth was revealed.

## **G. Non-speaking Defendants Are Liable Under the Group Publication Doctrine**

Defendants assert that the Group Publication Doctrine does not apply to defendants Malaga and Bluestein.<sup>(9)</sup> The complaint alleges that all defendants were corporate insiders involved in NorthPoint's day to day activities, including involvement in the dissemination of financial information. *See Wool v. Tandem Computers, Inc.*, 818 F.2d 1433, at 1440 (9th Cir. 1987). ¶19. More specifically, the Complaint quotes Fetter, explaining how she and Glinsky guide the street, tell the "NorthPoint story" and keep the Board of Directors about their actions. *Id.* At this stage it is incontestable that the statements were group published and each defendant fell within the circle described by Fetter.

Similarly, under §20(a), non-speaking defendants may be held liable as control persons where plaintiff establishes: (1) a primary violation of the federal securities laws; and (2) that the defendants have exercised actual power or control over the primary violator (here, NorthPoint). *Howard v. Everex*, 228

F.3d 1057 (9th Cir. 2000). The SEC has defined control person to mean "the possession, direct or indirect, of power to direct or cause the direction of the management..." 17 C.F.R. §230.405. The defendants in this case are the Chief Executive Officer Elizabeth Fetter, Founder and Chairman of NorthPoint Michael Malaga, Chief Financial Officer Michael Glinsky, Chief Development Officer Herman Bluestein. ¶¶15-18. As pled in the complaint, these defendants, individually and collectively, had the power to direct NorthPoint's business operations, through their positions with the company. ¶19. In fact, Bluestein and Fetter's duties explicitly are "to devote substantially all of his [or her] time and attention to the business and affairs of the company." Req. Jud. Not.; NorthPoint 12/31/99 10-K. With a company of just over 1,000 people (*Id.*) it is reasonable to infer that these named defendants, by virtue of their positions with the company, did, indeed, control NorthPoint. Regardless "Whether [the defendant] is a controlling person 'is an intensely factual question,'" of which the jury should resolve. *Kaplan*, 49 F.3d at 1382. [\(10\)](#) Defendants' argument against application of §20(a) must fail.

#### **H. If Dismissed, Leave to Amend Should Be Given**

While plaintiffs disagree with defendants' arguments, if the Court finds any merit to them plaintiffs can amend and restructure the Complaint to address any of the Court's concerns. Leave to amend should be freely granted when "it appears at all possible that the plaintiffs can correct the defect." *Lopez v. Smith*, 203 F.3d 1122, 1130 (9th Cir. 2000). Dismissal without leave to amend is inappropriate "unless it is clear that the complaint could not be saved by any amendment." *Silicon Graphics*, 183 F.3d at 991 (quoting *Polich v. Burlington Northern, Inc.*, 942 F.2d 1467, 1472 (9th Cir. 1991)).

#### **V. CONCLUSION**

Based on the foregoing, defendants' Motion to Dismiss should be denied. In the alternative, if this Court is inclined to grant defendants' motion, plaintiffs should be granted leave to amend.

DATED: November 15, 2001

Respectfully submitted,

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Lead Counsel for Plaintiffs

DECLARATION OF SERVICE BY FACSIMILE  
PURSUANT TO NORTHERN DISTRICT LOCAL RULE 23-2(c)(2)

I, the undersigned, declare:

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and a resident of the County of San Francisco, over the age of 18 years, and not a party to or interest in the within action; that declarant's business address is 100 Pine Street, 26th Floor, San Francisco, California 94111.

2. That on November 15, 2001, declarant served by facsimile the PLAINTIFFS' OPPOSITION TO INDIVIDUAL DEFENDANTS' MOTION TO DISMISS to the parties listed on the attached Service List and this document was forwarded to the following designated Internet site at:

**<http://securities.milberg.com>**

3. That there is a regular communication by facsimile between the place of origin and the places so addressed.

I declare under penalty of perjury that the foregoing is true and correct. Executed this 15th day of November, 2001, at San Francisco, California.

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JERRY COHEN

1. All paragraph ("¶\_\_") references are to the Consolidated Complaint ("Complaint") unless otherwise noted.
2. Further, the remaining portions are also misleading to the extent that they omit important corrective information.
3. It is true that the false statements are grouped and overlapping. That is because often defendants made several "overlapping" statements on related subjects in the same press release. It is hypocritical for defendants to criticize the "overlapping" nature of their own statements.
4. NorthPoint claims to have disclosed the true state of its finances to Verizon when the merger agreement was signed, and throughout the class period. MTD at 2, n.2. If so, the fact that they would tell one "true" story to Verizon and maintain the financial fiction for the public only highlights their fraud on the market. In any case, whether, when or what NorthPoint disclosed to Verizon raises questions of fact not properly addressed at the motion to dismiss stage. *Florida State Bd. of Admin. v. Green Tree Fin. Corp.*, No. 99-3536, No. 99-3586, No. 99-3587, 2001 U.S. App. Lexis 22921 at \*50 (8th Cir. Oct. 25, 2001).
5. But for the bankruptcy, NorthPoint's 2Q and 3Q results would have been subjected to a full year-end outside audit.
6. The remainder of the false statement referenced in ¶34 of the Complaint apparently goes unchallenged as to safe harbor and bespeaks caution.
7. Defendants' proffer of testimony from Glinsky (MTD at 14 n.26) is improper on a motion to dismiss and should be disregarded. Fed. R. Civ. P. 12(b)(6); *Suez v. Investors Equity, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 100 (2d Cir. 2001); *In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 74 (2d Cir. 2001).
8. Defendants' arguments that they were "legally prohibited" from trading during 2Q cannot be considered by this Court, insofar as this claim is unsubstantiated, and constitutes an attempt by defendants to demand that this court make a factual finding in Defendant's favor. *Suez v. Investors Equity, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 100 (2d Cir. 2001); *In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 74 (2d Cir. 2001); *Cooper*, 137 F.3d at 622-623.
9. Defendants apparently concede group-pleading liability for defendants Fetter and Glinsky for all statements except two, described in ¶¶42 and 38 of the complaint.
10. NorthPoint is liable for fraud even if the individual defendants are not. The Company is not before the Court and cannot be dismissed. Defendants assert, in a footnote, that the dismissal of individual defendants automatically results in dismissal of NorthPoint. MTD 1, fn 1. The cases cited by defendants fail even to mention in passing the proposition for which defendants rely on these cases.