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8 UNITED STATES DISTRICT COURT
9 NORTHERN DISTRICT OF CALIFORNIA

10
11 IN RE SIPEX CORPORATION
SECURITIES LITIGATION
12

13
14 This Document Relates To:
15 ALL ACTIONS

Master File No. 05-CV-00392 (WHA)

CLASS ACTION

**DEFENDANT WALID MAGHRIBI'S
NOTICE OF MOTION AND MOTION TO
DISMISS CONSOLIDATED AMENDED
CLASS ACTION COMPLAINT;
MEMORANDUM OF POINTS AND
AUTHORITIES**

Date: September 29, 2005
Time: 8:00 a.m.
Courtroom: 9

The Honorable William H. Alsup

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1 1314 (E.D. Wash. 1998), which the Ninth Circuit limited in *In re Read-Rite Corp. Sec.*
2 *Litig.*, 335 F.3d 843 (9th Cir. 2003), there is no basis to assume that CEOs such as Mr.
3 Maghribi are omniscient about everything that happens in a corporation, even in its “core
4 operations.” Section IV(C), *infra*.

- 5 • Mr. Maghribi’s resignation as the CEO and a director of Sipex is not alleged to have
6 occurred under troublesome circumstances. Section IV(D), *infra*.
- 7 • The Complaint does not allege that Mr. Maghribi sold Sipex stock while he was an officer
8 or director. Indeed, the public record discloses that he bought Sipex shares and did not
9 sell them. This counsels against any inference of scienter, let alone the strong inference
10 required under the Reform Act. Section IV(E), *infra*.

11 **II. STATEMENT OF FACTS**

12 Mr. Maghribi incorporates by reference the “Statement of Facts” section of the
13 Memorandum of Points and Authorities In Support of Defendant Sipex’s Motion to Dismiss
14 (“Sipex Mem.”). As that section indicates, Mr. Maghribi’s resignation as the CEO and a director
15 was reported on December 6, 2004, before Sipex announced its intention to restate its financials
16 in the future. Complaint ¶¶ 153, 154, 157; *see also* Section IV(D), *infra*. Mr. Maghribi has no
17 knowledge of the basis (if any) of the future restatement, other than what Sipex has reported.¹

18 **III. ISSUE TO BE DECIDED**

19 Does the Complaint plead particularized facts giving rise to a strong inference of scienter
20 on the part of Mr. Maghribi?

21 **IV. ARGUMENT: THE COMPLAINT DOES NOT PLEAD A STRONG INFERENCE** 22 **OF SCIENTER**

23 The Complaint purports to allege a securities fraud claim under Securities Exchange Act
24 of 1934 Section 10(b), 15 U.S.C. §78j(b). The elements of the claim include scienter, or the
25 mental state of an intent to defraud. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). With
26

27 ¹ Thus, Mr. Maghribi’s incorporation by reference of Sipex’s brief does not include its statement
28 that its accounting regarding the matters to be addressed in the future restatement was erroneous.
Plaintiffs appropriately do not characterize the Company’s restatement as an admission on the
part of any defendant other than Sipex. *See, e.g.*, Complaint at 23:2-3.

1 respect to this element, the Reform Act requires that a securities complaint “state with
2 particularity facts giving rise to a strong inference that the defendant acted with the required state
3 of mind,” at penalty of dismissal. 15 U.S.C §§ 78u-4(b)(2), (b)(3)(A). This “requires plaintiffs to
4 plead, at a minimum, particular facts giving rise to a strong inference of deliberate or conscious
5 recklessness.” *In re Silicon Graphics, Inc. Sec. Litig.*, 183 F.3d 970, 979 (9th Cir. 1999). In
6 assessing whether a securities complaint meets this standard, “the court must consider *all*
7 reasonable inferences to be drawn from the allegations, including inferences unfavorable to the
8 plaintiffs.” *Gompper v. VISX, Inc.*, 298 F.3d 893, 897 (9th Cir. 2002) (emphasis in original). The
9 Court also must assess whether a complaint pleads sufficient facts regarding the basis of
10 knowledge of all anonymous sources cited therein, as is required to satisfy the statutory duty to
11 plead all facts underlying allegations made on information and belief. 15 U.S.C § 78u-4(b)(1).

12 The Complaint makes several allegations pertaining to Mr. Maghribi. None of them,
13 considered individually or in concert, plead a strong inference of an intent to defraud.

14 **A. SP207 Transaction**

15 The Complaint refers to Mr. Maghribi in connection with a transaction in the “summer of
16 2003” or “June or September 2003.” Complaint ¶¶ 50, 54, 173. CW1, identified as a sales
17 person based in Europe (*id.* ¶ 49), alleges that Mr. Maghribi and Ralf Muenster asked CW1 to ask
18 a distributor, CW2, to place an order for \$350,000 worth of part number SP207. *Id.* ¶ 50.
19 Supposedly, the parts were intended for Selectron, which intended to use them in a product it was
20 manufacturing for a British company called Pace, but Pace had not yet qualified Selectron to
21 provide the Sipex part. *Id.* Messrs. Maghribi and Muenster informed CW1 that the parts would
22 be shipped to a freight forwarder in Munich, but would not be sent from the freight forwarder to
23 CW2. *Id.* ¶ 51. Instead, according to CW1, “the transaction would subsequently be reversed and
24 the shipment returned to Sipex.” *Id.* However, the shipment erroneously was forwarded to CW2,
25 which rejected it or returned the product (the Complaint alleges both) and did not pay for it. *Id.*
26 ¶¶ 52, 174. This is the only transaction challenged in the Complaint. *But see id.* at 2:21
27 (claiming that the problems at Sipex included “sham transactions”) (emphasis added).

1 These allegations do not plead scienter on the part of Mr. Maghribi. The first defect in the
2 allegations is that CW1's account is not corroborated. Where, as here, a securities plaintiff elects
3 to rely on anonymous sources to fulfill its pleading obligations under the Reform Act, the sources
4 must be described "with sufficient particularity to support the probability that a person in the
5 position occupied by the source would possess the information alleged," *and* the complaint must
6 contain "adequate corroborating details." *In re Daou Systems, Inc. Sec. Litig.*, 397 F.3d 704, 712
7 (9th Cir. 2005) (quotations omitted). Here, there is no documentary corroboration for CW1's
8 allegations. The Complaint refers to e-mails (*id.* at 17:1-2), but does not quote from the e-mails
9 or describe the dates or circumstances in which they were sent. *Silicon Graphics* found wanting
10 similarly vague allegations of internal documents. 183 F.3d at 985; Sipex Mem. at 8:8-10.

11 In lieu of documentary support, the Complaint proffers CW2 as corroboration for CW1.
12 Complaint at 17:26. CW2, however, does not corroborate Mr. Maghribi's alleged involvement in
13 the transaction. At most, CW2 states that CW1 told him or her that Mr. Maghribi was involved.
14 *Id.* at 18:2-3. Indeed, while CW1 opines that he "believed" that Mr. Maghribi spoke to CW2 (*id.*
15 at 17:2-3), CW2 does not confirm this allegation, but rather alleges that he or she spoke to CW1
16 regarding the transaction.² As a result, CW2's reliance on CW1 means that CW2 does not have
17 the *firsthand* knowledge required to serve as a valid source, *In re Northpoint Communications*
18 *Group, Inc. Sec. Litig.*, 221 F. Supp. 2d 1090, 1097-98 (N.D. Cal. 2002); and it means that the
19 allegation regarding Mr. Maghribi attributed to CW2 amounts to but another statement from
20 CW1, not corroboration of CW1's story. CW2 also does not corroborate CW1's allegation
21 regarding a right of return. According to the Complaint, CW2 repeatedly requested Sipex "to
22 reverse the sale and revenue recognized in the sale." Complaint at 17:19-21; *but see id.* at 54:3-5
23 (attributing request to CW1, not CW2). The logical inference from this allegation is that the sale
24 was legitimate and that CW2 had no right of return; if CW2 had a right of return, then, according
25 to Plaintiffs' view of the accounting rules (*see id.* ¶¶ 169-170), there would be no *bona fide* sale
26 for Sipex to reverse. CW2 later alleges that CW1 asked him or her to "participate in a sham

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28 ² *Accord*, Sipex Mem. at 9:4-9; *Dresner v. Utility.com, Inc.*, 371 F. Supp. 2d 476, 500 (S.D.N.Y. 2005) ("These allegations are contradictory and therefore not properly particular.").

1 transaction” and that the order would be cancelled “after the quarter cleared.” *Id.* at 18:1-3.
2 CW2, however, does not allege that he or she was given a *right* to return or cancel. Moreover, as
3 described in the Complaint itself, the transaction was not a “sham” or pretext at all: a real
4 company (Selectron) had a real need (manufacturing for Pace) for the SP207 part.

5 Another deficiency with the CW1 allegations is that the Complaint does not allege that
6 this source, who is identified as a sales person, had any basis to know about or assess the
7 propriety of the accounting for the SP207 transaction. *See* Sipex Mem. at 7:11-13; *id.* at 6:13-7:3.
8 As a corollary, the characterization of the transaction as being done “to inflate the Company’s
9 quarterly revenue” (Complaint at 16:26) is incomplete. Regardless of whether CW1 or Plaintiffs
10 added the verb “inflate” (it is not clear from the Complaint), legitimate transactions “inflate” –
11 that is, increase – a company’s revenue. In light of CW1’s lack of alleged knowledge of the
12 accounting for the transaction, it is not possible to conclude that any increase in revenue arising
13 from the it was illegitimate. In the same manner, the characterization of the alleged request by
14 Messrs. Maghribi and Muenster for CW2 to “do a ‘favor’” by placing an order (*id.* at 16:25) does
15 not plead illegitimate behavior. Whenever a customer places an order, it is a benefit to the seller.

16 In sum, the CW1 allegations fail for insufficient pleading of a factual basis. The ancillary
17 circumstances regarding the SP207 transaction also do not contribute to any inference of
18 wrongdoing on the part of Mr. Maghribi (or Sipex). Plaintiffs attempt to cast suspicion by
19 alleging that Pace had not yet qualified Selectron to provide the Sipex SP207 part to Pace.
20 Complaint ¶ 50. But the Complaint does not allege that it was Sipex’s obligation to qualify the
21 SP207 part, as distinguished from Selectron’s obligation. Indeed, given that Pace’s alleged
22 relationship was with Selectron, not Sipex, the logical inference is that it was *not* Sipex’s
23 obligation to qualify the part. The rational corollary is that if Selectron was intent on using the
24 SP207 part to fulfill its manufacturing contract for Pace – as the Complaint alleges – then
25 qualifying the part was a task and a risk that Selectron was willing to take, not a barrier or
26 necessary step to Sipex supplying the part to Selectron.³ For that matter, even if it had been up to

27 _____
28 ³ The presence of the qualification risk also explains why a distributor would be involved in the
transaction: distributors are intermediaries whose function it is to assume the risks of completing

1 Sipex qualify the part, Sipex was entitled to assume that any issues regarding qualification (none
2 of which are pleaded) would be solved in time for Selectron to provide the part to Pace.⁴
3 Plaintiffs also attempt to cast suspicion by averring that it was a mistake that the parts were
4 shipped from a freight forwarder based in Germany to CW2. *Id.* ¶ 52. If the parts were intended
5 for Selectron (as the Complaint alleges), then it would be logical that they would be forwarded to
6 Europe for ultimate shipment to Selectron. Physical shipment to CW2 would be consistent with
7 how that shipment is characterized in the Complaint – as a mistake – rather than with fraud.⁵

8 Taken together, the Complaint’s allegations describe a transaction that was quite real,
9 rather than suspicious or pretextual. *In re Commtouch Software Ltd. Sec. Litig.*, No. C 01-00719
10 WHA, 2002 WL 31417998, *12 (N.D. Cal. July 24, 2002) (transaction not suspicious where
11 innocent interpretation derivable from complaint’s allegations). Selectron had not yet qualified
12 the SP207 part, but wanted to start using it to fulfill its contract with Pace. Selectron would have
13 needed a large initial quantity of the SP207 part because it was ramping up its use of the part.
14 *Accord*, Sipex Mem. at 7:13-19 & n.2 (refuting suspicious inference from large size of transaction
15 on other grounds). From Sipex’s perspective, there was a real customer with a real need, and
16 Sipex acted consistent with its belief in the validity of the transaction by manufacturing the parts
17 and shipping them to Europe. For reasons CW1 chooses not to explain (*e.g.*, Selectron changed
18 its mind about using the part), the transaction broke down later. That is why CW1 or CW2 urged
19 Sipex to “reverse the sale” – asked to return the product, or for some other type of
20 accommodation – when CW2 refused to pay (*see* Complaint at 64:4-6). Elsewhere in the
21 Complaint, Plaintiffs fault Mr. Maghribi for allegedly agreeing to accept product returns. *See*
22 Section IV(B), *infra*. Hence, if Sipex did not agree to such a request in the SP207 transaction, it
23 transactions between suppliers and ultimate customers.

24 ⁴ *See In re Syntex Corp. Sec. Litig.*, 95 F.3d 922, 930 (9th Cir. 1996) (even if company knew of
25 problems in drug testing procedure, it could conclude that it would remedy problems and obtain
26 FDA approval on schedule); *May v. Borick*, No. CV 95-8407 LGB (EX), 1997 WL 314166, *14
27 (C.D. Cal. Mar. 31, 1997) (“knowledge of problems does not make predicting an end to those
28 problems fraud.”); *see also Read-Rite*, 335 F.3d at 847 (rejecting claim that company knew it
could not provide product feature allegedly requested by customer where complaint did not plead
that defendants knew that they would not be able to meet any customer deadline).

⁵ Shipment to CW2 also could have been a mistake for other reasons that do not cast suspicion on
the transaction; for example, it could have led to unwanted customs or tax consequences.

1 hardly can be suspicious.

2 **B. Distributor Agreements and Product Returns**

3 The Complaint also attempts to taint Mr. Maghribi by alleging that he was involved in
4 distribution agreements and product returns. To this effect, it alleges that Mr. Maghribi approved
5 all distribution agreements (Complaint at 7:15-17), certain of which provided for “price
6 protection, stock rotation and/or return rights” which supposedly precluded revenue recognition.
7 *Id.* at 7:17-19. To similar effect, the Complaint alleges that all returns over \$5,000 had to be
8 approved by Mr. Maghribi *or* the Chief Operating Officer. *Id.* at 7:26-8:3, *id.* ¶¶ 59, 62, 179.
9 Plaintiffs leap to the inference that Mr. Maghribi “therefore” personally was aware that products
10 were returned pursuant to price protection, stock rotation and/or return rights, or because they had
11 been preshipped. *Id.* at 8:3-8; *id.* ¶ 178.

12 These allegations have no import on scienter because they rely on a disjunctive syntax that
13 fails to distinguish between legitimate transactions and unspecified improper returns. There is
14 nothing inherently wrong with rights of return. Indeed, Sipex informed investors that its
15 distributors had stock rotation rights, which allowed them to return parts. *See* Sipex Mem. at
16 12:7-8.⁶ The Complaint’s allegation that Mr. Maghribi knew or approved “price protection, stock
17 rotation *and/or* return rights” (emphasis added) does not segregate the proper and disclosed types
18 of returns from other types of returns that may be improper. Hence, the allegation does not allege
19 impropriety. In *Gavish v. Revlon, Inc.*, No. 00 Civ. 7291 (SHS), 2004 WL 2210269, (S.D.N.Y.
20 Sept. 30, 2004), the court considered an allegation that a company engaged in fraud by shipping
21 products that “had not been ordered or which had been requested to be shipped at a later date.”
22 *Id.* at *13. The court reasoned that “the complaint’s use of the disjunctive ‘or’ greatly diminishes
23 its probative value, as shipping a shipment early is entirely different than shipping an unordered
24 shipment.” *Id.*

25 The Complaint also proffers speculation and opinion from CW5 regarding stock rotation

27 ⁶ *Accord*, Complaint ¶ 64 (according to CW5, stock rotation rights was a standard contract term
28 during his or her tenure at Sipex). Sipex also disclosed that it estimated product returns and
established reserves based on that analysis. Sipex Mem. at 12:7-8.

1 returns without offsetting orders. CW5 “believes” that Mr. Maghribi *or* the Vice President of
2 Sales entered into agreements with some distributors allowing them to return products without
3 making offsetting orders, as was required under their contracts. Complaint ¶ 66. CW5 “opined”
4 (*id.* at 22:12) that this violated “accounting principles” because returns are improper *per se*. This
5 is the only way to interpret CW5’s comment that “[i]f you allowed them to return stuff based on a
6 side agreement, you have violated the rules of accounting so therefore you were not entitled to
7 recognize that revenue because you knew you didn’t have to keep it.” *Id.* at 22:12-15. There is
8 no basis for CW5’s opinion in GAAP, as returns are not *per se* improper. Moreover, all that CW5
9 asserts – upon his or her “belief,” not knowledge⁷ – is that returns were allowed at the time of the
10 returns. CW5 does not allege that return rights were given at the time of the sale and revenue
11 recognition. In opining as to the accounting for the transactions, CW5 merely assumes that if
12 returns occurred at a later time, they must have been authorized from the outset (and, for that
13 matter, not reserved against). This is a logical fallacy, and neither CW5 nor any other anonymous
14 source alleges that rights of return were granted at the outset.

15 These are not the only deficiencies with the distributor agreement \ return allegations.
16 First, the Complaint fails to allege the amount, nature, customer, or other particulars of *any*
17 improper return. *See Exodus Communications*, 2005 WL at *27, *28, *30, *31, *37 (rejecting
18 allegations of several types of accounting fraud for failure to name customers involved therein).
19 Second, the Complaint makes an unsupported leap that the reasons for requested returns (which
20 the Complaint does not plead) were represented accurately on the RMA forms presented to Mr.
21 Maghribi or the Chief Operating Officer. Third, Plaintiffs claim that the very existence of rights
22 of return precludes revenue recognition. This is the only logical interpretation of paragraphs 169
23 and 170 of the Complaint, which aver that “[t]he price protection, stock rotation and/or right of
24 return agreements between Sipex and certain distributors preclude the Company from being able
25 to ‘reasonably estimate’ future returns,” and that as a result the revenue recognition criteria of
26 Statement of Financial Accounting Standard No. 48 were not satisfied. But this is neither GAAP

27
28 ⁷ *See In re Exodus Communications, Inc. Sec. Litig.*, Nos. C 01-2661 MMC *etc.*, 2005 WL
186289, *33 (N.D. Cal. Aug. 5, 2005) (rejecting allegation based on anonymous witness’ belief).

1 nor the law. For all of these reasons, the allegations regarding distributor agreements and product
2 returns do not support any inference of Mr. Maghribi’s scienter.

3 **C. Status as Chief Executive Officer**

4 The Complaint contains a section alleging Mr. Maghribi’s “Hands-On Approach.”
5 Complaint at 13:10 *et seq.* It includes five e-mails between Mr. Maghribi and an employee in
6 Japan, all of which are dated prior to the class period, regarding prices or products to be offered in
7 potential transactions. *Id.* ¶¶ 40-44.⁸ It also includes two other e-mails, also dated prior to class
8 period, regarding distributors. *Id.* ¶ 45 (Tim Goodnow opines that Mr. Maghribi would want
9 update on Microtek transaction); *id.* ¶ 46 (David Lee lists stock rotation orders). Plaintiffs claim
10 that the messages evidence Mr. Maghribi’s involvement in and knowledge of Sipex’s
11 “arrangement with its distributors,” a topic discussed in the previous section. *Id.* at 15:23-25.
12 Plaintiffs further leap to the conclusion that the allegations show that Mr. Maghribi was “well
13 aware of the illicit activities at the Company” – regardless of the nature, location, and other
14 particulars of those activities. *Id.* ¶ 176; *see also id.* at 64:21-24 (making same allegation from
15 Mr. Maghribi’s pre-class period statement that he would personally accelerate progress in all
16 functional areas of Sipex and drive Company on the road to recovery). Plaintiffs are seeking an
17 inference that because they have alleged Mr. Maghribi’s level of involvement as Sipex’s CEO at
18 one point in time (before the class period), his knowledge of *everything* that occurred at Sipex –
19 including the circumstances leading to the future restatement – must be accepted as a given.

20 These allegations do not plead a strong inference of scienter. Mr. Maghribi is aware that
21 in *In re PeopleSoft, Inc. Sec. Litig.*, No. C 99-00472 WHA, 2000 WL 1737936 (N.D. Cal. May
22 25, 2000), the Court allowed certain inferences regarding senior officers’ knowledge of adverse
23

24 ⁸ Plaintiffs characterize one of the e-mails as involving “customer stock rotation rights *and*
25 channel-stuffing” (Complaint at 14:25) (emphasis added). The referenced communication (*id.*
26 ¶ 43) makes no reference, direct or indirect, to “channel stuffing,” a pejorative term regarded by
27 courts with great suspicion because it is used to characterize the legitimate practice of making
28 sales to customers. *See, e.g., Steckman v. Hart Brewing, Inc.*, 143 F.3d 1293, 1298 (9th Cir. 1998) (characterizing “channel stuffing” claims as “speculation made in hindsight”); *Greebel v. FTP Software*, 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”). Rather, the e-mail refers to stock rotation rights, which as explained above are legitimate and were disclosed.

1 undisclosed facts “critical to a business’s core operations or an important transaction” *Id.* at
2 **3-4. For this proposition, the Court relied on *Epstein v. Itron, Inc.*, 993 F. Supp. 1314, and two
3 Second Circuit cases discussed below. The Ninth Circuit, however, rejected *Epstein* in *In re*
4 *Read-Rite Corp. Sec. Litig.*, 335 F.3d 843. The plaintiffs in *Read-Rite*, quoting *Epstein*, argued
5 that “facts critical to a business’s core operations or an important transaction generally are so
6 apparent that their knowledge *may* be attributed to the company and its key officers,” and hence
7 give rise to a strong inference that the defendants knew about the alleged problems with the
8 company’s key products. *Id.* at 848 (emphasis in original). The Ninth Circuit replied that this
9 argument “predates *Silicon Graphics*, which clarified the requirement that a plaintiff must plead
10 with particularity and which is the law of our circuit.” *Id.* Thus, the fact that allegations of fraud
11 concern a company’s core business can **at most** contribute to an inference of scienter (*id.*),
12 depending on the circumstances of the particular case; the fact that allegations concern a
13 company’s core business or an important transaction cannot create a strong inference of scienter.⁹

14 The circumstances to be assessed in order to determine whether to draw an inference of
15 knowledge of adverse information regarding the core operations of a company must include the
16 predicate of the fraud itself. In other words, a complaint must identify what it is that the officers
17 supposedly knew, but did not disclose, before an inference of their knowledge of those facts may
18 be drawn. Hence, in *PeopleSoft*, the alleged fraud was that the company would not achieve its
19 public forecasts, and the Court inferred the officers’ knowledge of the loss of large, key
20 customers and defects in the company’s flagship product – predicate facts that precluded the
21 company from achieving its forecasts. 2000 WL 1737936 at *2, *4.

22 In this case, the alleged factual predicate of the fraud is not the type of information that a
23 CEO may be assumed to know. The future restatement that was announced at the end of the class
24

25 ⁹ See *Alaska Elec. Pension Fund v. Adecco, S.A.*, 371 F. Supp. 2d 1203, 1217 (S.D. Cal. 2005)
26 (“Rather than presume individual officer and director defendants must have known about a fraud
27 by virtue of their positions within the defendant company, ‘the persuasive force of each situation
28 must be evaluated individually.’”), quoting *PeopleSoft*, 2000 WL 1737936 at *4; *PeopleSoft*,
2000 WL 1737936 at *4 (“Rote allegations about ‘hands-on’ managers and ‘important’
transactions should not, by themselves, be enough to demonstrate a strong inference of scienter.
Each set of ‘important transactions’ must be assessed based on the specificity alleged.”).

1 period and that precipitated this lawsuit was explained by Sipex to have been caused by
2 transactions for which rights of return were granted but not properly accounted for. *See*
3 Complaint ¶¶ 154, 157. Sipex did not suggest that the improper accounting was deliberate, or
4 that any return rights had been granted improperly. *Accord*, Sipex Mem. at 2 (Complaint does
5 not explain why any accounting at Sipex was the product of fraud). Even assuming the contrary,
6 there is no logical basis to assume that if rights of return that somehow preclude revenue
7 recognition are given to a customer, the facts and circumstances of the matter necessarily are
8 known to senior management. To the contrary, the circumstances need not involve management
9 at all – all it takes is for a sales person to speak to the customer, and maintaining the secrecy of
10 that communication is vital to its effectiveness. A company’s decision to reverse the revenue
11 recognition on a transaction also may be a matter of the precise accounting treatment or legal
12 interpretation given to a contract. This is the stuff of accountants, lawyers and other specialists –
13 not CEOs. Thus, in *In re Metawave Communications Corp. Sec. Litig.*, 298 F. Supp. 2d 1056
14 (W.D. Wash. 2003), the court held that plaintiffs had not pleaded that two senior officers
15 (Hunsberger and Fuhlendorf) knew of alleged side letters that subordinate employees had given to
16 customers and that precluded revenue recognition. *Id.* at 1077-78. In so holding, the court
17 rejected plaintiffs’ contention “that Hunsberger and Fuhlendorf can be presumed to know of the
18 side letters because they were important to Metawave’s core business operations.” *Id.* at 1078.

19 There is no warrant to leap from a CEO’s knowledge of certain facts about a company
20 arising from his or her status as the CEO, to a CEO’s *omniscience* about *everything* that happens
21 at the company – even everything that pertains to its “core operations.” *See Wilson v. Bernstock*,
22 195 F. Supp. 2d 619, 641 (D. N.J. 2002) (“generalized imputations of knowledge” regarding core
23 business “do not suffice to establish that Defendants possessed knowledge and information
24 regarding specific aspects of the company’s business.”). Such a leap would be irreconcilable with
25 the Reform Act, and with the Ninth Circuit’s rejection of *Epstein* in *Read-Rite*. When a company
26 does not achieve its objectives, by definition, the failure typically arises from issues with its core
27 business or product. If these facts alone support a viable claim, plaintiffs could plead scienter in
28 every case without pleading (or knowing) anything about what the defendants actually knew at

1 the time of their public statements. The Court did not support such a broad-brush method of
2 pleading in *PeopleSoft*: rather, it limited its inference of scienter to the particular circumstances
3 and alleged adverse facts of that case. The two Second Circuit cases cited by *PeopleSoft* also do
4 not support a leap from a CEO's status as an officer to his omniscience about the company's core
5 operations or transactions. In *Cosmas v. Hassett*, 886 F.2d 8 (2d Cir. 1989), a company allegedly
6 issued forecasts that depended on continuing to make sales to key customers in China. The
7 complaint was sustained, not based on a presumption that the defendants must have known every
8 detail regarding the company's relationship to China because China was key to its business, but
9 rather because the adverse information that the defendants allegedly knew was an objective and
10 absolute legal barrier to sales to China.¹⁰ *Cohen v. Koenig*, 25 F.3d 1168 (2d Cir. 1994), rejected
11 the theory that scienter must be pleaded with "great specificity," and required that plaintiffs plead
12 merely a "minimal factual basis for their conclusory allegations of scienter." *Id.* at 1173. This is
13 not the pleading standard recognized by the Reform Act, *Silicon Graphics*, and *Read-Rite*.

14 In sum, there can be no inference from Mr. Maghribi's role as CEO that the alleged fraud
15 in this case was known to him. When a securities complaint alleges that an employee knows or
16 does something, courts do not assume that his or her boss knows the same thing. *In re Alparma*
17 *Inc. Sec. Litig.*, 372 F.3d 137, 150 (3d Cir. 2004) (scienter not attributed to officer from person
18

19
20 ¹⁰ Subsequent cases have distinguished *Cosmas* on this basis. See *In re Carter-Wallace, Inc. Sec.*
21 *Litig.*, 220 F.3d 36, 42 (2d Cir. 2000) (*Cosmas* "readily distinguishable" because in that case, "the
22 defendants represented that sales to China would be 'an important new source of revenue' even
23 though import restrictions, of which the defendants were presumably aware, belied the statement."
24 . . . Here, by contrast, there can be no presumption that [defendant] was aware of a statistically
25 significant connection between Felbatol and aplastic anemia before August 1, 1994."); *In re*
26 *Suprema Specialties, Inc. Sec. Litig.*, 334 F. Supp. 2d 637, 655 (D.N.J. 2004) (rejecting core
27 business presumption where plaintiffs lacked specifics but instead relied on allegations that senior
28 officers knew of and approved challenged practices); *In re Nice Sys., Ltd. Sec. Litig.*, 135 F. Supp.
2d 551, 585 (D.N.J. 2001) (distinguishing *Cosmas* on similar basis). Other courts have rejected
Cosmas in its entirety. See *In re Livent, Inc. Noteholders Sec. Litig.*, 151 F. Supp. 2d 371, 422-23
(S.D.N.Y. 2001) (even under Second Circuit's liberal interpretation of Reform Act, *Cosmas* has
been abrogated); *In re Ashworth, Inc. Sec. Litig.*, No. 99 CV0121-L(JAH), 2000 WL 33176041,
*11 (S.D. Cal. July 18, 2000) (*Cosmas* argument "relies on inapplicable law and cannot be
reconciled with *Silicon Graphics*' standard for pleading scienter"); *Sakhrani v. Brightpoint, Inc.*,
No. IP99-0870-C-H/G, 2001 WL 395752, *18 (S.D. Ind. Mar. 29, 2001) (argument that senior
officers possess scienter regarding core operations of a company "is the essence of fraud by
hindsight and will not sustain a securities fraud claim.").

1 who directly reported to officer).¹¹ The Reform Act, as interpreted by the Ninth Circuit, does not
2 permit one to stretch the chain of inference even further and assume that the boss (CEO) of all the
3 employees in the corporation knows everything that every employee does or says. Neither logic
4 nor the Complaint justify this stretch, either.

5 **D. Resignation as Chief Executive Officer**

6 On December 6, 2004, Sipex issued a press release announcing that Mr. Maghribi had
7 resigned as CEO and as a director. Complaint ¶ 153. The Complaint not-so-subtly implies that
8 this was connected to the purported fraud, as the paragraph presenting the announcement is the
9 first in a section titled “The Truth Begins to Emerge and is Disclosed.” *Id.* at 56:1.

10 Management changes “are not in and of themselves evidence of scienter. Most major
11 stock losses are often accompanied by management departures, and it would be unwise for courts
12 to penalize directors for these decisions.” *In re Cornerstone Propane Partners, L.P.*, 355
13 F. Supp. 2d 1069, 1092 (N.D. Cal. 2005). Here, the press release, which is quoted in the
14 Complaint, did not draw any connection between Mr. Maghribi’s resignation and any
15 wrongdoing. The Complaint does not contain any specific (or general) allegations pertaining to
16 the resignation, other than what Sipex itself disclosed.

17 Thus, the alleged resignation does not support any inference of scienter. To the contrary,
18 the record on this topic cuts against an inference of scienter. Sipex informed investors that it had
19 agreed to pay Mr. Maghribi a severance package, which included accelerated vesting of certain
20 options. *See* Form 8-K/A dated Dec. 23, 2004 & attached Exhibit 99.2 (Separation Agreement
21 and Release between Sipex and Walid Maghribi dated December 17, 2004), enclosed as Exhibit
22 A to the accompanying Declaration of David Banie.¹² These are not the announcements of a
23 company that dismissed its CEO because it believed he had engaged in fraud. Moreover, Sipex
24 disclosed that Mr. Maghribi had resigned due to “disagreements with the Board over growth and
25

26 ¹¹ *See also Kushner v. Beverly Enters., Inc.*, 317 F.3d 820, 828 (8th Cir. 2003) (same).

27 ¹² Judicial notice of this document and the other SEC filings attached as Exhibits to the
28 Declaration of David Banie is requested in the separate Request For Judicial Notice. The Court
may consider matters that are subject to judicial notice in a motion to dismiss. *Hal Roach
Studios, Inc. v. Richard Feiner & Co.*, 896 F.2d 1542, 1555 n.19 (9th Cir. 1989).

1 prospects for the company.” Complaint at 56:8-10. This, too, does not indicate a separation
2 resulting from wrongdoing. If anything, Mr. Maghribi should be commended for resigning and
3 not seeking to maintain his executive position at all costs, which is a common allegation that
4 securities plaintiffs make in order to suggest a motive to defraud. *See, e.g., In re Federated Dep’t*
5 *Stores, Inc. Sec. Litig.*, No. 00 Civ. 6362 (RCC), 2005 WL 696894, *3 (S.D.N.Y. Mar. 25, 2005)
6 (motive to maintain executive position is a standard and insufficient scienter allegation).

7 **E. Stock Sales (or the Opposite Thereof)**

8 The Complaint is striking for what it does not allege of Mr. Maghribi. The Complaint
9 does not allege that he sold any Sipex stock during the time frame in which he supposedly was
10 intent on misleading investors in order to inflate the stock price. To the contrary, Mr. Maghribi
11 purchased 10,500 shares of Sipex stock during the class period. *See* Banie Decl. Ex. B (Form 4
12 dated May 20, 2004, reporting purchases on May 18, 2004). The absence of stock sales, by itself,
13 does not always negate scienter. However, the Ninth Circuit has advised that a complaint’s
14 scienter and anti-scienter allegations must be assessed in their entirety in determining whether
15 scienter is pleaded. *See Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, No. 03-35374, 2005
16 US App. LEXIS 15815, *13 (9th Cir. Aug. 2, 2005); *Gompper*, 298 F.3d at 896-97. Mr.
17 Maghribi’s increase in stock ownership during the time he was employed at Sipex is a powerful
18 factor in determining that the Complaint’s allegations, considered as a whole, do not rise to the
19 level of a strong inference of scienter. *See* Sipex Mem. at 14:10-16 & n.9. Also relevant to this
20 determination are the negative announcements regarding the Company’s performance issued
21 under Mr. Maghribi’s tenure – news that was reflected in a stock price that steadily declined
22 during the class period. *Id.* at 16:19-17:8. This, too, is inconsistent with an intention to report
23 falsely positive news in order to inflate the stock price.

24 **F. Other Allegations**

25 The Complaint makes a few other references to Mr. Maghribi. None pleads his scienter.

26 First, Plaintiffs fault Mr. Maghribi for reporting on improvements to Sipex’s accounting
27 function and personnel. *See* Complaint ¶ 113 (February 18, 2004 analyst call discussion on
28

1 accounting for gross margins) (“So it’s required a much more meticulous accounting structure
2 that (*sic*) we had in the past”); *id.* ¶¶ 108, 116 (earnings press release of same day) (referring to
3 actions taken to strengthen Sipex accounting function and personnel). Plaintiffs allege that these
4 statements somehow misrepresented Sipex’s internal controls, which the Company later
5 criticized; and that Mr. Maghribi must have known that the statements were false because he had
6 been involved in the effort to improve controls. *Id.* ¶ 181. The Complaint does not allege any
7 facts showing that Mr. Maghribi knew of any undisclosed internal control problems at the time of
8 the statements. *See also* Sipex Mem. at 10:5-10 (Complaint does not allege deficiencies in
9 accounting or closing procedures in earlier restatement, or in the future restatement announced at
10 end of class period). Nor does the Complaint deny that the improvements to Sipex’s accounting
11 reported by Mr. Maghribi (and Sipex) were genuine.

12 Second, Plaintiffs challenge Mr. Maghribi’s quarterly certifications under Section 302 of
13 the Sarbanes-Oxley Act. Complaint ¶¶ 77, 93, 106, 125, 134, 142, 151. Plaintiffs claim that in
14 these certifications, Mr. Maghribi stated that the financial statement information in each SEC
15 filing “fairly presents, in all material respects, the financial conditions and results of operations of
16 the Company.” *See, e.g., id.* at 46:14-15. In fact, the statements were qualified: Mr. Maghribi
17 stated that based on his knowledge, the financial statements were fairly presented. *See, e.g.,*
18 Exhibit 31.1 to Form 10-Q filed May 13, 2004 (certification for fiscal Second Quarter 2004)
19 (Banie Decl., Ex. C). The Complaint does not plead a strong inference of Mr. Maghribi’s scienter
20 as to any deficiencies in the financial statements; that is, that he knew something to the contrary
21 of his certifications.

22 Third, Plaintiffs allege that Mr. Maghribi and other senior managers had access to
23 “Backlog Reports” that published outstanding orders from customers. Complaint ¶ 54. Plaintiffs
24 do not allege the contents of any of these reports. The Complaint does not allege that Mr.
25 Maghribi ordered or knew of the supposed “early shipments” to customers that Plaintiffs attempt
26 to connect to the Backlog Reports. The Complaint also does not allege that any shipments were
27 made before they could be made under the terms of the agreements with the distributors.

28 Finally, the Complaint makes inchoate allegations regarding Mr. Maghribi’s relationship

1 with a former Chief Financial Officer, Frank DiPietro. Complaint ¶ 63. One source of these
2 allegations, CW5, was not employed at Sipex during Mr. DiPietro's tenure at the company.
3 *Compare id.* at 21:10-13 (CW5 started immediately prior to the class period, which starts on April
4 10, 2003) *with* Form 8-K dated December 2, 2002 (Banie Decl., Ex. D) (disclosing Mr. Pietro's
5 departure from the Company); *accord*, Complaint ¶ 18 (Phillip A. Kagel became Sipex' CFO in
6 February 2003). Consequently, CW5's allegations are phrased in terms of the way things used to
7 be before his or her arrival at Sipex (Complaint at 21:15-19), and are not based on personal
8 knowledge. The other purported source, CW3, merely opines that Mr. DiPietro did not approve
9 of Mr. Maghribi's "leadership or business practices" and went "head to head" with him. *Id.* at
10 21:19-21. No inference of scienter may be inferred from such allegations. *Commtouch Software*,
11 2002 WL 31417998 at *10 (finding wanting allegations that company had "gotten into a 'fight'"
12 with its auditors over accounting issues); *accord*, *In re Best Buy Co., Inc. Sec. Litig.*, No. C 03-
13 6193 ADM AJB, 2005 WL 839099, *8 (D. Minn. Apr. 12, 2005) ("Acknowledging one's
14 frustration with business issues is not the same as making misrepresentations.").

15 **V. CONCLUSION**

16 For the reasons set forth above and in Sipex's brief, the Section 10(b) claim against Mr.
17 Maghribi should be dismissed. Accepting Sipex's contention that a Section 10(b) claim may not
18 be stated against the Company, the Section 20(a) control person claim against Mr. Maghribi also
19 must be dismissed. *Lipton v. Pathogenesis Corp.*, 284 F.3d 1027, 1035 n.15 (9th Cir. 2002)
20 (§20(a) claim requires viable underlying §10(b) claim).

21 Respectfully submitted,

22 Dated: September 1, 2005

DLA PIPER RUDNICK GRAY CARY US LLP

23
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28