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8 UNITED STATES DISTRICT COURT  
9 NORTHERN DISTRICT OF CALIFORNIA

10  
11 IN RE SIPEX CORPORATION  
SECURITIES LITIGATION  
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14 This Document Relates To:  
15 ALL ACTIONS  
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Master File No. 05-CV-00392 (WHA)

CLASS ACTION

**DEFENDANT WALID MAGHRIBI'S  
REPLY MEMORANDUM OF POINTS  
AND AUTHORITIES IN SUPPORT OF  
MOTION TO DISMISS CONSOLIDATED  
AMENDED CLASS ACTION COMPLAINT**

Revised date: November 17, 2005  
(per Court order)

Time: 8:00 a.m.  
Courtroom: 9

The Honorable William H. Alsup



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1 Defendant Walid Maghribi respectfully submits this reply memorandum in further support  
2 of his motion to dismiss Plaintiffs' Consolidated Amended Class Action Complaint for Violation  
3 of the Securities Exchange Act of 1934 (the "Complaint" or "Compl.").

4 **I. INTRODUCTION**

5 Plaintiffs operate under a mistaken view of litigants' burdens in motions to dismiss  
6 brought under the Private Securities Litigation Reform Act of 1995. *See* Plaintiffs' Omnibus  
7 Memorandum of Law In Opposition to Defendants' Motion to Dismiss ("Opp.") at 8:13-22. It is  
8 Plaintiffs' burden to submit a complaint that "state[s] with particularity facts giving rise to a  
9 strong inference that the defendant acted with the required state of mind." 15 U.S.C.  
10 § 78u-4(b)(2). It is Plaintiffs' burden to plead all facts underlying all allegations made on  
11 information and belief. *Id.* § 78u-4(b)(1). Where those allegations come from anonymous  
12 sources, it is Plaintiffs' burden to plead "adequate corroborating details." *In re Daou Systems,*  
13 *Inc. Sec. Litig.*, 397 F.3d 704, 712 (9th Cir. 2005). Moreover, it is Plaintiffs' burden to meet these  
14 pleading standards before and without the aid of formal discovery. *Medhekar v. District Court,*  
15 *99 F.3d 325, 328 (9th Cir. 1996)* (per curiam); *see also In re Calpine Corp. Sec. Litig.*, 288 F.  
16 *Supp. 2d 1054, 1090-91 (N.D. Cal. 2003)*; *cf.* Opp. at 15:26-16:1, 25 n.18 (objecting to discovery  
17 stay). The consequence of Plaintiffs' failure to meet any of these obligations is clear: dismissal  
18 of the Complaint. 15 U.S.C. § 78u-4(b)(3)(A).

19 Mr. Maghribi's opening brief demonstrated that Plaintiffs do not meet these burdens, for  
20 the Complaint does not plead specific facts giving rise to a strong inference of Mr. Maghribi's  
21 scienter. Plaintiffs refute none of Mr. Maghribi's contentions. Instead, their brief often  
22 mischaracterizes both those contentions and the Complaint itself. No matter how often the brief  
23 repeats the inadequate allegations of the Complaint, it does not plead a basis to taint Mr.  
24 Maghribi's name with the serious matter of a securities fraud claim.

25 **II. THE COMPLAINT DOES NOT PLEAD A STRONG INFERENCE OF SCIENTER**

26 Mr. Maghribi's opening brief ("Opening") demonstrates that the allegations of the  
27 Complaint referring to him do not plead a strong inference of his intent to defraud. Mr.  
28 Maghribi's contentions remain unrefuted.

1           **A.     SP207 Transaction**

2           Plaintiffs principally rely on an alleged transaction involving a part called the SP207.<sup>1</sup> As  
3 a threshold matter, Mr. Maghribi noted that this is the only allegedly improper transaction  
4 challenged in the Complaint. Opening at 3:26-27. Plaintiffs vehemently deny this. They  
5 undoubtedly do so because they recognize that if all the Complaint challenges is a single  
6 transaction of relatively small size – and one in which Mr. Maghribi’s involvement in any fraud is  
7 inadequately pleaded to boot, *see* pp.3-5, *infra* – this does not amount to the purported systematic  
8 and massive fraud that Plaintiffs repeatedly tout in their brief, and that is required in order to  
9 plead a strong inference of scienter. *See In re Portal Software, Inc. Sec. Litig.*, No. C-03-5138  
10 VRW, 2005 WL 1910923, \*10 (N.D. Cal. Aug. 10, 2005) (even assuming complaint alleged one  
11 improper \$700,000 transaction, it would not plead strong inference of scienter); Sipex Mem. at  
12 7:13-19 & n.2 (alleged SP207 transaction relatively small in amount). Plaintiffs thus assert that  
13 the transaction is but “an example” (Opp. at 5:9) that is “illustrative” of the purported fraud (*id.* at  
14 13 n.7), and they repeat the mantra “sham transactions” as if the Complaint actually alleges other  
15 instances of the type of transaction that Plaintiffs claim is represented by the SP207 deal. *Id.* at  
16 2:12, 26:17, 28:1, 32:8, 32:14-15.

17           The Complaint belies Plaintiffs’ assertions. It does not allege any particulars of any  
18 challenged transaction other than the purported SP207 deal. It pleads no customers, amounts,  
19 products, dates, or improper circumstances of any other transaction – let alone the personal  
20 involvement of Mr. Maghribi in any of these matters. In the absence of such allegations,  
21 Plaintiffs take the fall-back position that CW1 alleges that he was asked by Mr. Maghribi to enter  
22 into unspecified improper transactions that did not take place. Opp. at 5:15-17, 14:2-3, 15:22-27,  
23 27:16-17. The Complaint pleads nothing about these purported non-transactions. As such, these  
24 allegations fail to meet Reform Act standards for pleading accounting fraud. *Daou Sys.*, 397 F.3d  
25 at 713. Indeed, these uncorroborated allegations fail to give Mr. Maghribi notice of the

26           <sup>1</sup> Plaintiffs assert that Mr. Maghribi instructed that the SP207 part be used in the transaction.  
27 Opp. at 14:7-8, *citing* Compl. ¶¶ 50, 173. The cited references to the Complaint, however, do not  
28 allege this. Plaintiffs also find it significant that “Defendants do *not* dispute the \$350,000  
transaction.” Opp. at 27 n.19 (emphasis in original). It is Plaintiffs, however, who repeatedly  
assert that factual disputes are inappropriate on a motion to dismiss.

1 circumstances of his alleged wrongdoing, and hence also fail to satisfy Fed. R. Civ. P. 9(b).  
2 *Neubronner v. Milken*, 6 F.3d 666, 673 (9th Cir. 1993).

3 The Complaint also belies Plaintiffs' related assertion that "numerous witnesses stated that  
4 Maghribi routinely authorized improper revenue recognition through, e.g., sham transactions and  
5 premature shipments." Opp. at 32:7-9; *see also id.* at 13:4-5 (asserting that numerous sources  
6 allege "Maghribi's involvement" in improprieties). The supposed "numerous witnesses" are a  
7 fiction of Plaintiffs' brief. No one other than CW1 even attempts to allege that Mr. Maghribi  
8 ordered or approved any "sham transaction." The source for the allegations regarding purported  
9 "premature shipments," CW3, claims that the preshipments were ordered by Sipex managers, not  
10 Mr. Maghribi, in meetings that Mr. Maghribi is not alleged to have attended or directed. *See*  
11 Compl. ¶ 55 (CW3's allegations); Opp. at 6:3-10 (account of alleged meetings); *see also* Sipex  
12 Reply at 7:20-21 (CW3 left Sipex less than one month into twenty-one month class period).

13 In sum, CW1's account of the purported SP207 transaction is the most that the Complaint  
14 can offer as to Mr. Maghribi's scienter. It is not enough. For one thing, CW1's account is not  
15 corroborated as required by *Daou Systems*. Opening at 4:1-10; *see also In re Business Objects*  
16 *S.A. Sec. Litig.*, No. C 04-2401 MJJ, 2005 WL 178860, \*6 (N.D. Cal. July 27, 2005) ("Moreover,  
17 besides the statements of these three confidential witnesses, Plaintiffs have offered the Court no  
18 corroborating evidence, such as internal documents or public filings, to support their assertions of  
19 falsity."). Rather, CW2, the alleged distributor \ customer in the transaction, fails to corroborate  
20 CW1's claim that Mr. Maghribi personally ordered and approved the transaction, and fails to  
21 allege that it was given an explicit right of return. Opening at 4:11-5:4. In addition, the  
22 Complaint contradicts CW1's account by alleging indicia of a legitimate transaction: a *bona fide*  
23 sale that later was requested to be reversed (*id.* at 4:21-26), and an end user customer (Selectron)  
24 with an actual need for the SP207 part (manufacturing for Pace). *Id.* at 5:2-4. Plaintiffs'  
25 additional spin on the transaction (e.g., that it was a mistake to ship the parts to CW2) also is  
26 consistent with a *bona fide* SP207 transaction, as it is described in the Complaint. *Id.* at 5:5-7:1.<sup>2</sup>

27 <sup>2</sup> Plaintiffs' claim that Mr. Maghribi attributes a fraudulent shipment to a mistake rather than  
28 fraud (Opp. at 16:19-20) misconstrues his actual contention: according to the Complaint itself,  
the SP207 parts were destined for Selectron, and hence if a shipment to CW2 was made it

1 In response, Plaintiffs admit that the Reform Act requires that the Complaint corroborate  
2 CW1's account. Opp. at 11:14-20 (also citing *Daou Systems* for standard for pleading allegations  
3 from anonymous sources); *id.* at 11:24-25 (complaint must allege "adequate corroborating  
4 details," quoting *In re Silicon Graphics, Inc. Sec. Litig.*, 183 F.3d 970, 985 (9th Cir. 1999)).<sup>3</sup>  
5 They also admit that there is no documentary corroboration. Opp. at 16:3-11. Plaintiffs instead  
6 claim that the Complaint alleges other forms of corroboration: Sipex's announcements that it was  
7 restating its financials,<sup>4</sup> and the ethical training and other remedial steps announced months after  
8 the class period. *Id.* at 11:25-12:3, 16:6-11, 19 n.13, 34:12-20.

9 These allegations are all Plaintiffs offer, but they cannot suffice. ***None of the***  
10 ***"corroborating" allegations even so much as mentions Mr. Maghribi or the SP207 transaction.***  
11 Moreover, Plaintiffs' assertions that CW2 "corroborated the key facets of CW1's account" (Opp.  
12 at 15:7-14) and provided information showing that Mr. Maghribi was the "*architect*" of  
13 wrongdoing (*id.* at 26:25-27) conspicuously omit the most important facet of all when it comes to  
14 Mr. Maghribi's scienter: his involvement in the transaction or in any wrongdoing. Rather, CW2  
15 states that it was contacted by CW1, not Mr. Maghribi, about the transaction (*id.* at 15:10-12), in  
16 contradiction to CW1's allegation that Mr. Maghribi spoke to CW2 directly. Opening at 4:14-16.  
17 This is not a matter of raising a hearsay objection (Opp. at 16 n.11), but rather a legitimate basis  
18 to reject CW2 as providing the corroboration for CW1's allegations that is required by the  
19 Reform Act. Opening at 4:16-20, citing *In re Northpoint Communications Group, Inc. Sec.*  
20 *Litig.*, 221 F. Supp. 2d 1090, 1097-98 (N.D. Cal. 2002); 15 U.S.C. § 78u-4(b)(1).<sup>5</sup>

21 Plaintiffs also argue that Mr. Maghribi has presented an alternative account of the SP207

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22 actually was a mistake, not an indication of fraud. Opening at 6:3-7.

23 <sup>3</sup> On one occasion, Plaintiffs cite Fed. R. Civ. P. 12(b)(6) as the applicable standard (Opp. at  
24 11:5-13), ignoring the fact that this case is governed by the Reform Act and the heightened  
25 particularity standards of 15 U.S.C. § 78u-4(b)(1). Plaintiffs also claim that they do not have to  
26 plead "evidence" (Opp. at 15:27-16:2), misinterpreting Mr. Maghribi's accurate (and conceded)  
27 contention that the Complaint must plead corroboration.

28 <sup>4</sup> The Complaint attributes these announcements to Sipex only. Opening at 2 n.1. This flash of  
common sense proved to be temporary: Plaintiffs' brief mis-attributes the announcements to all  
defendants, even those who had left Sipex by the time they were issued. Opp. at 11:27-12:1.

<sup>5</sup> See also *Portal Software*, 2005 WL 1910923 at \*9 (where ex-controller relied on information  
supplied by others, "plaintiffs must describe the job title, job description, duties, and dates of  
employment for the controller's sources before this information can be deemed reliable.").

1 transaction that introduces new facts and cannot be accepted at this stage. Opp. at 14:12-14, 17:3-  
2 7, citing *In re Cell Pathways, Inc.*, No. 99-725, 2000 WL 805221 (E.D. Pa. June 20, 2000). To  
3 the contrary, the key elements of Mr. Maghribi's account of the transaction come from the  
4 allegations of the Complaint itself. The Court reasoned in *In re Commtouch Software Ltd. Sec.*  
5 *Litig.*, No. C 01-00719 WHA, 2002 WL 31417998, \*12 (N.D. Cal. July 24, 2002), not discussed  
6 by Plaintiffs in this context, that a transaction is not suspicious where an innocent interpretation  
7 may be derived from a complaint's allegations. Plaintiffs' further argument that the innocent  
8 interpretation of is "patently implausible" (Opp. at 17:3) is a phrase offered without explanation,  
9 itself lacking plausibility. In any event, CW1's allegations are uncorroborated and insufficient  
10 even without the innocent explanation evident from the allegations of the Complaint.

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

12 Mr. Maghribi also demonstrated the insufficiency of the allegations regarding distributor  
13 agreements and product returns. The Complaint alleges that Mr. Maghribi approved distributor  
14 agreements, some of which provided for "price protection, stock rotation *and/or* return rights"  
15 which supposedly precluded revenue recognition. This disjunctive syntax fails to distinguish  
16 between legitimate types of returns which no one could fault Mr. Maghribi for approving, and  
17 unspecified types of improper returns. Opening at 7:3-25, citing *Gavish v. Revlon, Inc.*, No. 00  
18 Civ. 7291 (SHS), 2004 WL 2210269, \*13 (S.D.N.Y. Sept. 30, 2004). The Complaint also fails to  
19 cite any basis in the law or GAAP for its claim that the very existence of price protection and  
20 stock rotation return rights (which Sipex disclosed) precludes revenue recognition. Opening at  
21 8:21-9:1. The same errors also undermine the Complaint's allegation that because Mr. Maghribi  
22 authorized product returns, he must have been aware that they were due to "price protection,  
23 stock rotation and/or return rights" or because products had been preshipped. *Id.* at 7:9-22.  
24 Furthermore, the Complaint fails to allege the amount, nature, customer, or other particulars of  
25 any improper return, or improper returns in the aggregate. *Id.* at 8:16-18; Sipex Mem. at 10-11.

26 Plaintiffs not only do not refute these contentions; they feign ignorance of them. They  
27 assert that Mr. Maghribi's challenge to their disjunctive syntax is addressed solely to a different  
28 phrase in the Complaint, the allegation that returns were authorized by Mr. Maghribi *or* the COO.

1 Opp. at 31:20-24 & 32 n.23. This is an indefensible reading of Mr. Maghribi’s brief. It actually  
2 said that the Complaint’s allegations “rely on a disjunctive syntax that fails to distinguish between  
3 legitimate transactions and unspecified improper returns” because the allegation that Mr.  
4 Maghribi “approved ‘price protection, stock rotation *and/or* return rights’ (emphasis added) does  
5 not segregate the proper and disclosed types of returns from other types of returns that may be  
6 improper.” Opening at 7:12-13, 16-19. Plaintiffs make no response to this contention. Rather,  
7 they continue the same obfuscation and disjunctive syntax that renders the Complaint inadequate.  
8 Their brief again asserts that stock rotation and price protection return rights preclude revenue  
9 recognition.<sup>6</sup> Yet in response to Mr. Maghribi’s contention that there is nothing inherently wrong  
10 with these types of rights of return (*id.* at 7:13-16 & n.6), Plaintiffs do not mention stock rotation  
11 or price protection returns at all, and they do not cite any law or GAAP provision to the effect that  
12 these types of returns preclude revenue recognition. Instead, Plaintiffs switch gears and discuss  
13 an alleged right to return products that were preshipped. Opp. at 33:4-9, *purportedly responding*  
14 *to* Opening at 7. Plaintiffs’ failure to justify their challenge to stock rotation and price protection  
15 returns proves Mr. Maghribi’s point that the disjunctive returns-related allegations of the  
16 Complaint cannot plead his scienter.

17 Plaintiffs’ failure to address the Complaint’s disjunctive syntax also undermines their  
18 response to Mr. Maghribi’s point that no inference of scienter arises from the allegation that the  
19 reasons for product returns were reflected on unspecified RMA forms. Opening at 8:19-21.  
20 Plaintiffs argue that the reasons for the returns stated in the forms must be presumed to be  
21 accurate, and that the reasons included returns due to preshipments. Opp. 6:17-18, *citing* Compl.  
22 ¶ 59; *see also* Opp. at 18 n.12, 28:22-23 (averring to possible summary report on returns).  
23 However, the cited paragraph 59 of the Complaint acknowledges that the reasons for returns  
24 listed on the RMAs included stock rotation, and Plaintiffs’ brief concurs. *Id.* at 28:15-18 (reasons  
25 for returns listed on RMAs included stock rotation and price protection). Accordingly, the

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26  
27 <sup>6</sup> *See, e.g.*, Opp. at 28:11-14 (“Furthermore, distributors often returned products for stock rotation  
28 or price protection. The existence of such return rights also precluded Sipex from recognizing  
revenue upon shipment.”); *id.* at 28:2-5 (there were “stock rotation, price protection and/or return  
rights that precluded recognition.”); *id.* at 29:8-10 (similar assertions); *id.* at 12:9-15 (same).

1 Complaint does not allege that the RMAs informed Mr. Maghribi of any material amount of  
2 returns that were due to preshipments, as distinguished from returns that were due to legitimate  
3 stock rotation and price protection rights and would not cause any executive to suspect fraud. In  
4 addition, because the Complaint does not allege the contents of the RMAs, it does not allege that  
5 the documents informed Mr. Maghribi that any preshipment-related returns were the result of  
6 fraud rather than a mistake as to the shipping date on the part of Sipex or the customer. *Accord*,  
7 Sipex Reply at 4:11-13, *replying to* Opp. at 20:18-20 (implausible that employees would report a  
8 fraudulent reason for a product return).

9 Plaintiffs' fall-back position is that customers had *per se* right of returns for products that  
10 were preshipped. Opp. at 12:8-9, 21:1-2, 28:9-11, 33:7-9 (*citing* Compl. ¶ 177). This allegation,  
11 however, does not appear in the paragraphs of the Complaint that purportedly explain why the  
12 alleged returns at Sipex precluded revenue recognition under Statement of Financial Accounting  
13 Standard No. 48. *See* Opening at 8:21-26, *citing* Compl. ¶¶ 169-170. Plaintiffs cannot draft the  
14 Complaint as a puzzle and expect Mr. Maghribi to piece together its falsity allegations. *Wenger*  
15 *v. Lumisys, Inc.*, 2 F. Supp. 2d 1231, 1244 (N.D. Cal. 1998). Even if they are considered, the  
16 preshipment returns allegations do not plead falsity or scienter. The Complaint does not plead  
17 any basis to support Plaintiffs' opinion that customers had *per se* returns rights because it does  
18 not allege that Sipex made shipments without a contractual right to do so. Opening at 15:26-27.<sup>7</sup>  
19 At most, the Complaint alleges, in generic terms, that shipments were made before they had been  
20 scheduled or authorized. Opp. at 17:25, 28:8-9, 28:15-16. This is different from alleging that  
21 Sipex did not have a legal right to ship when it did.<sup>8</sup> Finally, as noted above, the Complaint does  
22 not allege that Mr. Maghribi ordered or authorized any preshipment; nor the amount, nature,  
23 customer, or other particulars of any preshipment(s).

24  
25 <sup>7</sup> Significantly, Plaintiffs' references to contractual shipment terms (Opp. at 18:25, 29 n.21) refer  
26 only to customers' shipment authorizations, not to what was or was not allowed by contract.

27 <sup>8</sup> Plaintiffs cannot argue that the Court must accept an allegation that there was no legal right to  
28 ship (which is not made in any event) because even under Fed. R. Civ. P. 12(b)(6), the Court need  
not accept the truth of legal conclusions cast in the form of factual allegations. *Western Mining  
Council v. Watt*, 643 F.2d 618, 624 (9th Cir. 1981); *In re Syntex Corp. Sec. Litig.*, 95 F.3d 922,  
926 (9th Cir. 1996) (court need not accept as true conclusions of fact or law pled as "facts").

1 Mr. Maghribi also refuted the Complaint's other returns-related allegation: CW5's belief  
2 that Mr. Maghribi or the Vice President of Sales entered into unspecified agreements with  
3 unspecified distributors at unspecified times allowing them to return products without making  
4 offsetting orders, as was required under their distributor contracts. The Complaint pleads no basis  
5 for CW5's "opinion" that this violated GAAP because CW5 does not allege that customers were  
6 given any improper return rights at the time the sales were made and revenue was recognized.  
7 Opening at 7:25-8:14 & n.7, citing *In re Exodus Communications, Inc. Sec. Litig.*, Nos. C 01-  
8 2661 MMC *etc.*, 2005 WL 186289, \*33 (N.D. Cal. Aug. 5, 2005) (not addressed by Plaintiffs)  
9 (rejecting accounting fraud allegation based on anonymous source's belief); *see also* Sipex Reply  
10 at 5:4-15 (CW5 allegations also inadequate because (s)he was absent during class period).  
11 Plaintiffs' response that the contracts in place at the time of the sales allowed only fixed amounts  
12 of returns (Opp. at 20:11-19) reinforces rather than refutes Mr. Maghribi's point. A post-sale  
13 accommodation to allow additional returns that had not been part of a contract at the time of the  
14 sale does not mean that Sipex had granted a right to return from the outset that might have  
15 precluded revenue recognition under SFAS 48 – it means the opposite.

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

17 Mr. Maghribi also demonstrated that scienter cannot be inferred from his status as CEO or  
18 his purported "hands on approach" to that position. It defies logic, the Reform Act, and *In re*  
19 *Read-Rite Corp. Sec. Litig.*, 335 F.3d 843 (9th Cir. 2003), to assume that CEOs such as Mr.  
20 Maghribi are omniscient about everything that happens in a corporation, even in its "core  
21 operations." Opening at 10:3-13, 11:19-12:1, 12:15-13:4. Hence, there is no basis to presume  
22 that even if the restatement was the result of side letters or other improprieties, Mr. Maghribi  
23 must have been aware of or participated in the improprieties. Rather, as in *In re Metawave*  
24 *Communications Corp. Sec. Litig.*, 298 F. Supp. 2d 1056 (W.D. Wash. 2003), Mr. Maghribi's  
25 involvement in or knowledge of improprieties must be alleged with specific facts. Opening at  
26 10:22-11:18. His involvement or knowledge is not, and cannot be, alleged from the random e-  
27 mail messages proffered by the Complaint, which are dated before the class period and have  
28 nothing to do with any transactions or wrongdoings challenged in the Complaint. *Id.* at 9:5-19.

1 Plaintiffs attempt to avoid this issue. They claim not to rely on any proposition regarding  
2 an executive's presumed knowledge of the core operations of a business. Opp. at 32:4-5. They  
3 do not cite *In re PeopleSoft, Inc. Sec. Litig.*, No. C 99-00472 WHA, 2000 WL 1737936 (N.D.  
4 Cal. May 25, 2000); the discredited case of *Epstein v. Itron, Inc.*, 993 F. Supp. 1314 (E.D. Wash.  
5 1998); or (in this context) the dubious case of *Cosmas v. Hassett*, 886 F.2d 8 (2d Cir. 1989).  
6 They deny that they proffer the pre-class period e-mails for an inference of Mr. Maghribi's  
7 omniscience. Opp. at 4 n.4. Yet despite these denials, Plaintiffs aver to and seek presumptions of  
8 omniscience that the Ninth Circuit and the Reform Act forbid. For example, Plaintiffs assert that  
9 Mr. Maghribi "micromanaged" Sipex, as if that conclusory statement matters in pleading scienter  
10 (which it does not). Opp. at 1:9. Likewise, Plaintiffs transform an innocuous press release issued  
11 seven months before the class period quoting Mr. Maghribi to the effect that he would try to do  
12 his best to help Sipex's shareholders by taking personal leadership in moving the Company  
13 forward, into a signal that whatever fraud that occurred at Sipex was directed by Mr. Maghribi.  
14 Opp. 3:24-25, 27:23-25, 32:19-20 (including this press release in list of purported irregularities  
15 that also includes the SP207 transaction). Apparently, Plaintiffs believe that Mr. Maghribi  
16 decided to announce to the world, in advance, that he intended to engage in securities fraud.  
17 There is no basis in the press release or logic for this flight of fancy on the part of Plaintiffs, and  
18 none of these omniscience-based allegations plead a strong inference of Mr. Maghribi's scienter.

19 Plaintiffs also seek to substitute assumptions of scienter for the specific factual allegations  
20 required by the Reform Act by arguing that the purported improprieties must have been known to  
21 Mr. Maghribi because Sipex was a "small company." Opp. at 30:20-31:7.<sup>9</sup> The Complaint does  
22 allege that Sipex was a "small company," whatever that means. Moreover, logic dictates that one  
23 must look first to the underlying predicate of a fraud – *i.e.*, what it is that supposedly occurred –  
24 before one can draw any inference that executives knew about the fraud. *See* Opening at 10:14-

25 <sup>9</sup> The cases Plaintiffs cite in support rely on presumptions regarding executives' knowledge of a  
26 company's core business, a presumption that Plaintiffs chew and which has been rejected by  
27 *Read-Rite. Commtouch Software*, 2002 WL 31417998 at \*\*9-10 (very large transactions would  
28 not "fly under the radar screen" of executives, *citing PeopleSoft*, 2000 WL 1737936 at \*3);  
*Northpoint Communications*, 221 F. Supp. 2d at 1104. Moreover, these cases included additional  
scienter allegations against the respective executives from multiple sources, allegations that are  
absent from the Complaint in this case. *See* Section II(A), *supra*.

1 18. In this case, the Complaint’s unsupported and unquantified allegations do not allege the  
2 predicate of a fraud at Sipex – assuming that the restatement involved a fraud at all, rather than  
3 complex accounting issues beyond the purview of experts. *See id.* at 11:10-13; Sipex Mem. § I  
4 (challenging basis, specificity and materiality of fraud allegations); *In re Lexar Media, Inc. Sec.*  
5 *Litig.*, No. C-04-2013, 2005 WL 1566534, \*6 (N.D. Cal. July 5, 2005) (where predicate of fraud  
6 not alleged, presumption of knowledge of fraud cannot apply).<sup>10</sup> Even if a fraud existed, it  
7 apparently consisted of side letters or return rights that a CEO need not need be involved in  
8 granting to a customer, which depend on secrecy rather than disclosure to the CEO or anyone  
9 else, and which the Complaint does not connect to any large transaction. Opening at 10:22-11:10.  
10 Hence, there is no warrant to assume that Mr. Maghribi must have known about these matters.

11 In the final analysis, Plaintiffs’ claim is that Mr. Maghribi must have known about  
12 whatever fraud that may have occurred at Sipex because he took a “hands-on approach” as CEO.  
13 *See Opp.* at 4:1-21 (describing section of Complaint devoted to this characterization); *id.* at 19:8-  
14 10 (e-mails show “hands-on management”); *id.* at 27:19-23 (e-mails show close involvement in  
15 day-to-day activities of Sipex); *id.* at 31:3-4. The Court rejected this approach to pleading  
16 scienter in *PeopleSoft*, 2000 WL 1737936 at \*4 (“Rote allegations about ‘hands-on’ managers  
17 and ‘important’ transactions should not, by themselves, be enough to demonstrate a strong  
18 inference of scienter.”). Other courts have done the same. *See In re U.S. Aggregates, Inc. Sec.*  
19 *Litig.*, 235 F. Supp. 2d 1063, 1074 (N.D. Cal. 2002) (“plaintiffs must do more than allege that the  
20 key officers had the requisite knowledge by virtue of their ‘hand on’ positions, because that  
21 would eliminate the necessity for specially pleading scienter...” (citation omitted)).<sup>11</sup> *Read-Rite*  
22 sounds the death knell of such arguments. *See Opening* at 10:4-13.

23 In sum, Walid Maghribi is a talented executive who undertook his best efforts as Sipex’s  
24 CEO. However, he is not and may not be presumed to be Superman, personally engaged in every

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25 <sup>10</sup> Plaintiffs’ own difficulty in articulating a cogent, valid explanation of why and when rights of  
26 return preclude revenue recognition (*see* Section II(B), *supra*) refutes their contention that these  
27 issues are so obvious that they must have been known to Mr. Maghribi. *Opp.* at 32:9-15.

28 <sup>11</sup> *See also In re Apple Computer, Inc., Sec. Litig.*, 243 F. Supp. 2d 1012, 1026 (N.D. Cal. 2002),  
*aff’d*, 127 Fed. Appx. 296 (9th Cir. 2005); *In re Baker Hughes Sec. Litig.*, 136 F. Supp. 2d 630,  
648 (S.D. Tex. 2001), *aff’d*, 292 F.2d 424 (5th Cir. 2002).

1 communication with Sipex's customers and every shipment to those customers; nor Big Brother,  
2 peering into the minds and deeds of every employee of a global corporation. Under the Reform  
3 Act and *Read-Rite*, there are no shortcuts to pleading a strong inference of an executive's scienter.  
4 Specific factual allegations are required, and in this case they are lacking.

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

6 Mr. Maghribi also demonstrated that his resignation as the CEO and a director of Sipex is  
7 not alleged to have occurred under troublesome circumstances, and hence has no negative bearing  
8 on his scienter. Opening at 2:5-6, 13:6-16. In response, Plaintiffs rely on a purported bright line  
9 rule that whenever an executive resigns and a company later restates its financials, there is a  
10 connection between the two events and an inference of the executive's scienter. Opp. at 1:20,  
11 33:22-34:10 & n.24.

12 Plaintiffs' argument has no merit. There are no factual allegations in the Complaint that  
13 Mr. Maghribi's resignation was related to the restatement in any manner. Thus, Plaintiffs'  
14 assertion of a connection between the two events lacks the factual basis required by the Reform  
15 Act. 15 U.S.C. § 78u-4(b)(1).<sup>12</sup> To the contrary, Sipex's reaction to Mr. Maghribi's resignation  
16 negates any inference that his resignation was the result of any wrongdoing on his part. Opening  
17 at 13:7-14:6 (Sipex provided severance package to Mr. Maghribi and attributed resignation to  
18 non-fraudulent reasons); *Gompper v. VISX, Inc.*, 298 F.3d 893, 896-97 (9th Cir. 2002)  
19 (allegations inconsistent with scienter must be drawn against plaintiffs). Plaintiffs fail to address  
20 Mr. Maghribi's contention, and hence concede its validity.

21 Equally as important, there is no case law support for Plaintiffs' supposed bright line rule  
22 of law. None of the cases cited by Plaintiffs concerned an officer's resignation or the inferences  
23 to be drawn about a resigning officer's scienter. Rather, they concerned either the resignation of  
24 outside auditors and other advisers, where the issue was the company's scienter;<sup>13</sup> or the

25 \_\_\_\_\_  
26 <sup>12</sup> *Accord, U.S. Aggregates*, 235 F. Supp. 2d at 1074 (declining inference that termination was  
27 related to restatement where complaint had "no particularized allegation refuting the reasonable  
28 assumption that [executive] was fired simply because the errors that lead to the restatement  
occurred on his watch or because he failed adequately to supervise his department").

<sup>13</sup> *See, e.g., Gelfer v. Pegasystems, Inc.*, 96 F. Supp. 2d 10, 16 (D. Mass. 2000) (inference of  
company's scienter where there were repeated restatements and resignation of outside auditors).

1 termination (not, as in this case, resignation) of officers at the same time as the announcement of  
2 a restatement (not, as in this case, six weeks earlier).<sup>14</sup> Plaintiffs' citation to *Coble v. Broadvision*  
3 *Inc.*, No. C 01-01969 CRB, 2002 WL 31093589 (N.D. Cal. Sept. 11, 2002), is particularly  
4 puzzling in this context. Plaintiffs cite the case for the parenthetical "resignation at time of  
5 restatement would be probative of scienter." Opp. at 33:23-24. In fact, *Coble* refused to infer  
6 scienter from the employment-related allegations in that case. 2002 WL 3109589 at \*7. *Coble*  
7 distinguished *Mercatur Software* because the complaint in that case alleged that a company fired  
8 a Vice President and announced the resignation of its CFO on the same day that it announced a  
9 restatement, and because *Mercatur Software* reflects a lenient, plaintiff-friendly Second Circuit  
10 securities jurisprudence that is not in tune with Ninth Circuit norms. 2002 WL 3109589 at \*7.

11 In reality, the law provides that management changes "are not in and of themselves  
12 evidence of scienter." Opening at 13:10-13, quoting *In re Cornerstone Propane Partners, L.P.*,  
13 355 F. Supp. 2d 1069, 1092 (N.D. Cal. 2005). Plaintiffs do not address this case, nor raise any  
14 inference of scienter from Mr. Maghribi's resignation.

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

16 Mr. Maghribi also explained that the stock sale allegations – more precisely, the opposite  
17 thereof – counsel against any inference of scienter. Mr. Maghribi did not sell Sipex stock while  
18 he was supposedly intent on defrauding investors, but rather purchased shares and held them.  
19 Opening at 14:7-23.<sup>15</sup> This is inconsistent with fraud.

20 Plaintiffs' response relies on a red herring. They assert that Mr. Maghribi contended that  
21 his lack of stock sales, by itself, negates any inference of scienter. See Opp. at 37:15-16. Again,  
22 it is difficult to understand how Plaintiffs could have read Mr. Maghribi's brief in this manner. In

23 \_\_\_\_\_  
24 <sup>14</sup> See, e.g., *In re Mercatur Software, Inc. Sec. Litig.*, 161 F. Supp. 2d 143, 150 (D. Conn. 2001)  
25 (company terminated VP-Finance and accepted resignation of CFO on same day it announced a  
26 restatement); *In re McKesson HBOC, Inc. Sec. Litig.*, 126 F. Supp. 2d 1248, 1275 (N.D. Cal.  
27 2000) (allegation that officer was terminated for cause, with other allegations, pleaded scienter).

28 <sup>15</sup> Plaintiffs argue that Mr. Maghribi was required to offer a reason why he purchased stock in  
order to contest whether the Complaint pleads his scienter. Opp. at 37 n.27. Again, this  
argument is difficult to reconcile with Plaintiffs' contention that motions to dismiss are not the  
occasion to raise extraneous factual issues. Moreover, it is up to Plaintiffs to plead a strong  
inference of scienter (*see p.1, supra*), and hence to plead and explain how Mr. Maghribi's stock  
purchases can be reconciled with a purported intent to defraud.

1 fact, the brief stated, “[t]he absence of stock sales, by itself, does not always negate scienter.”  
2 Opening at 14:12-13. Rather, the absence of stock sales is an anti-scienter factor that must be  
3 considered in determining whether a complaint pleads a strong inference of scienter. *Id.* at 14:13-  
4 19. This is the law of the Ninth Circuit, which requires that the totality of a securities plaintiff’s  
5 allegations and judicially noticeable facts be considered in the scienter inquiry. *Id.*<sup>16</sup> The record  
6 on stock sales in this case weighs against an inference of Mr. Maghribi’s scienter.

7 **F. Other Allegations**

8 Mr. Maghribi also demonstrated that the Complaint’s other references to him do not plead  
9 scienter. First, the fact that Sipex reported improvements to its internal accounting processes in  
10 its SEC filings during the class period does not support an inference of scienter. To the contrary,  
11 the fact that improvements were made on Mr. Maghribi’s watch argues against his scienter.  
12 Opening at 14:26-15:11. Tellingly, neither the Complaint nor Plaintiffs’ brief denies that the  
13 reported improvements were genuine. Instead, Plaintiffs point to Sipex’s later internal control  
14 measures, which they characterize with rhetorical flourish as “drastic” and “far-reaching.” *Opp.*  
15 at 34:13-24. The later improvements have no bearing on Mr. Maghribi’s state of mind at the time  
16 of the previous improvements reported in the SEC filings. Plaintiffs must allege that at the time  
17 of these filings, Mr. Maghribi knew that Sipex had issued false financial statements or lacked  
18 internal controls. This the Complaint does not allege.<sup>17</sup>

19 Second, Plaintiffs’ challenge to Mr. Maghribi’s certifications under Section 302 of the  
20 Sarbanes-Oxley Act depends on the premise that he knew that the financial statements issued by  
21

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22 <sup>16</sup> Plaintiffs misconstrue Mr. Maghribi’s citation to *Livid Holdings Ltd. v. Salomon Smith Barney,*  
23 *Inc.*, 416 F.3d 940 (9th Cir. 2005), in connection with this point. *See Opp.* at 37 n.27. It was not  
24 cited for the effect of the absence of stock sales on scienter. Rather, Mr. Maghribi cited both  
25 *Livid Holdings* and *Gompper*, 298 F.3d at 896-97, for the proposition that “the Ninth Circuit has  
26 advised that a complaint’s scienter and anti-scienter allegations must be assessed in their entirety  
27 in determining whether scienter is pleaded.” Opening at 14:13-15. In *Livid Holdings*, plaintiff’s  
28 allegations, considered together, pleaded scienter. In *Gompper*, the anti-scienter allegations were  
a factor in determining that plaintiffs’ allegations, considered together, did not plead scienter.

<sup>17</sup> Plaintiffs also apparently argue that Mr. Maghribi was motivated to defraud in order to avoid  
“incur[ring] the substantial cost of annual ethics training for all employees.” *See Opp.* at 34:24-  
35:3. Not only is motive inadequate to pleading scienter: the notion that Mr. Maghribi would  
engage in fraud in order to avoid (unquantified) training costs is both untenable and unsupported  
by any allegations of the Complaint.

1 the Company were false when made, as the certifications were qualified by the statement that  
2 they were based on Mr. Maghribi's knowledge. Opening at 15:12-21. Plaintiffs agree that with  
3 respect to the certifications, falsity is equivalent to scienter. *See* Opp. at 30 n.22 ("Plaintiffs plead  
4 detailed facts demonstrating that Maghribi knew full well that Sipex's financial reporting was  
5 misleading due to the pervasive improper revenue recognition."). But the Complaint does not  
6 plead a strong inference of scienter, and hence fails to plead false certifications.

7 Third, Plaintiffs claim that unspecified "Backlog Reports" (none of which are alleged)  
8 show that Mr. Maghribi ordered or knew of preshipments. Opp. at 29 n.21. Mr. Maghribi refuted  
9 this claim for lack of a factual basis in the Complaint. Opening at 15:22-27. Plaintiffs' brief  
10 supports Mr. Maghribi's contentions. It alleges that the significance of the Backlog Reports is  
11 that preshipments were made based on a review of the reports in end-of-quarter meetings – yet  
12 the brief (as well as the Complaint) admits that Mr. Maghribi did not attend these meetings, and  
13 that he did not order the preshipments. *See* Opp. at 6:3-10; *see also* p.3:8-12, *supra*. The brief  
14 also alleges that the Backlog Reports reported on shipments that were eligible to be made in the  
15 future. Opp. at 5:20-6:2. By this definition, the Backlog Reports did not report on shipments that  
16 already had been made, and hence whether any preshipments had occurred.

17 Finally, Mr. Maghribi demonstrated that the Complaint's allegations regarding his  
18 relationship with a former CFO, Frank DiPietro, lack any content probative of scienter. Opening  
19 at 15:28-16:14. In response, Plaintiffs attempt to rewrite the Complaint by asserting that the two  
20 officers "often disagreed about accounting issues." Opp. at 28:24. In fact, the only paragraph of  
21 the Complaint containing the pertinent allegations makes no reference to accounting issues. *See*  
22 Compl. ¶ 63 (allegation from CW5, who was not at Sipex when Mr. DiPietro was there, that the  
23 officers "buted heads"); *id.* (allegation from CW3 that Mr. DiPietro disapproved unspecified  
24 business practices and went "head to head" with Mr. Maghribi). Plaintiffs also leap to an  
25 assumption that if there were disagreements over business practices, then Mr. Maghribi must have  
26 been wrong about the (unidentified) issues in dispute, and intentionally wrong to boot. Opp. at  
27 28:27-28 (alleging that existence of disagreements is probative of scienter). The Complaint  
28 contains no allegations to this effect, either.

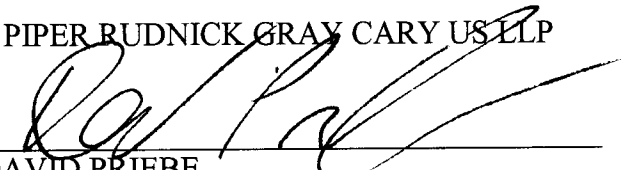
1 **III. CONCLUSION**

2 In enacting the Reform Act, Congress recognized that “[n]aming a party in a civil suit for  
3 fraud is a serious matter. Unwarranted fraud claims can lead to serious injury to reputation for  
4 which our legal system effectively offers no redress.” 141 CONG. R. H13692, H13702 (Nov. 28,  
5 1995) (Report of Conference Committee responsible for Reform Act). For the reasons set forth  
6 above, in Mr. Maghribi’s Opening Brief, and in Sipex’s opening and reply briefs, the allegations  
7 of the Complaint are insufficient to set forth a securities fraud claim against Mr. Maghribi. The  
8 Complaint should be dismissed.

9 Respectfully submitted,

10 September 22, 2005

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